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Harmonisation of avoidance rules in European Union insolvencies: the critical elements in formulating a scheme

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Abstract

Only the harmonisation of laws is seen as being able to solve legal uncertainty resulting from legal diversity, but, notwithstanding the advent of the EC Regulation on Insolvency Proceedings, thus far there is no real harmonisation of insolvency laws in the EU. There are indications that the European Commission (EC) has been considering the formulation of a scheme for the harmonisation of the rules that apply in insolvency proceedings to permit the avoidance of transactions entered into prior to the commencement of insolvency proceedings. On this basis this article identifies and analyses those factors that will need to be considered and addressed in the formulation of any harmonised scheme, as well as ascertaining the problems that these factors may cause in the construction of such a scheme. This is a critical issue, for it is all well and good to say that there should be harmonisation, but how that is done, what must be taken into account and what is included in any harmonised scheme is another matter and requires careful thought and consultation.

Keywords: avoidance rules; harmonisation; insolvency proceedings; European Union

1 Introduction

Harmonisation in law refers to efforts to change the laws of two or more countries to be more substantively similar to each other.[1] The UN Committee on International Trade Law (UNCITRAL) has defined harmonisation as: 'the process through which domestic laws may be modified to enhance predictability in cross-border commercial transactions'.[2] In the European Union (EU) context harmonisation has been seen as an instrument that is complementary to the general articles in the Treaty of Rome (the Treaty) when free movement of capital, goods, persons and services has not been achieved.[3]

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1 Draft Common Frame of Reference Outline Edition 2009, Annex (Definitions) 555 and referred to in American Law Institute and the International Insolvency Institute, 'Transnational Insolvency: Global Principles for Co-operation in International Insolvency Cases' (American Law Institute, Philadelphia 2012), fn 209.

2 UNCITRAL, 'FAQ – Origin, Mandate and Composition of UNCITRAL' and quoted in S Block-Lieb and R Halliday, 'Harmonisation and Modernization in UNCITRAL's Legislative Guide on Insolvency Law' (2007) 42 Texas International Law Journal 475, 493.

3 P Slot, 'Harmonisation' (1996) 21 European Law Review 378, 379.

Harmonisation should be employed to realise market integration.[4] Only the harmonisation of laws is seen as being able to solve legal uncertainty resulting from legal diversity.[5] It is provided for in Article 3(h) of the Treaty as one of the mechanisms that is to be used in order to attain the aims of the Treaty,[6] so that it will be employed as a device to the degree that it is necessary for the appropriate functioning of the Common Market. It is deemed necessary because of economic pressures in the EU relating to the Common Market and facilitation of trade.[7] Attempts to harmonise civil law in earnest can be traced back to the late 1980s,[8] when harmonisation was employed in addressing several private law matters in the Single European Act (in 1987).[9]

Thus far harmonisation in insolvency law has only occurred to a very limited extent. Harmonisation commenced with the enactment of the European Regulation on Insolvency Proceedings (the Regulation) which became law across the EU, with the exception of Denmark, on 31 May 2002. It was felt that the Regulation was needed because national legal systems could not achieve the proper functioning of the internal market.[10] The goal of the Regulation was to provide for a universalist insolvency model,[11] founded on one law applying to an insolvency proceeding, and for that law to apply to all matters that related to that proceeding across the breadth of the EU. This was designed to improve the effectiveness and efficiency of insolvency proceedings having cross-border effects.[12] Recital 4 of the Regulation[13] provided that it was necessary to enable the proper functioning of the EU's internal market to prevent people having incentives to transfer assets or judicial proceedings between member states and thereby obtaining a more favourable legal position. The Regulation's objective was to produce a marked reduction in costs incurred in the administration of any insolvency. The Regulation provided clear guidelines that ensured stability and consistency in relation to areas of jurisdiction, applicable law and the recognition and enforcement of judgments.[14] The Regulation has been reviewed and on 26 June 2017 a recast version of the Regulation (EIR) came into force. The EIR very much follows in the tradition of the original Regulation. References to recitals and articles in the EIR in this article are to this later version.

4 Ibid 382.

5 M Haentjens, 'Harmonisation of Securities Law: Custody and Transfer of Securities in European Private Law' unpublished PhD thesis submitted to the University of Amsterdam, 2007, 240.

6 Slot (n 3) 378.

7 L Del Duca, 'Developing Global Transnational Harmonisation Procedures for the Twenty-First Century: The Accelerating Pace of Common and Civil Law Convergence' (2007) 42 Texas International Law Journal 625, 650.

8 H Schulte-Nolke, 'Arbeiten an einem Europaischen Privatrecht – Fakten und populare Irrtumer' (2009) 62 Neue Juristische Wochenschrift 2162, 2162, and referred to in B Zeller, 'Anatomy of EU Contract Harmonisation: Where Do We Stand?' (2015) 21 International Trade Law and Regulation 41, 41.

9 W Van Geren, 'Harmonisation of Private Law: Do We Need it?' (2004) 41 Common Market Law Review 505, 505.

10 Council Regulation on Insolvency Regulations (EC) (1346/2000), 29 May 2000, recital 5.

11 Although Tung referred to the Regulation as providing for a territorialist scheme with universalist pretensions: F Tung, 'Is International Bankruptcy Possible?' (2001) 23 Michigan Journal of International Law 31, 77.

12 Council Regulation on Insolvency Regulations (n 10), recital 8.

13 Recital 5 of the recast version of the EIR.

14 *Seagon v Deko Marty Belgium NV* (Case C-339/07) [2009] BCC 347, [59].

While the EIR goes some way towards harmonising the private international law rules as far as insolvency proceedings are concerned in the member states of the EU,[15] it clearly did not purport to seek to harmonise substantive insolvency law, save in a very limited way. The EIR ensures that decisions on cross-border insolvencies are recognised across the EU and designates both the courts that will have the power to open insolvency proceedings and what law will be applied to the insolvency proceedings.

During the first decade of this century the issue of insolvency law harmonisation was avoided,[16] yet in more recent times the possibility of harmonisation of substantive insolvency law or, at least, elements of it has been seriously considered. In 2010, following a request from the European Parliament, INSOL Europe[17] prepared a report which examined the need for and the feasibility of harmonisation of European insolvency law. The report concluded that several topics were apt for harmonisation and that harmonisation in relation to these topics was desirable and achievable.[18] One of these topics dealt with the avoidance rules applied to insolvencies. Such rules enable transactions or elements of transactions made prior to a debtor entering insolvency proceedings to be avoided (antecedent transactions). These actions are brought, usually, by a person appointed to administer the insolvent estate of a debtor against a third party who has benefited from a transaction entered into with the debtor prior to the opening of insolvency proceedings in relation to the debtor seeking the avoidance of the transaction.[19] This may then lead to the augmentation of the assets comprised in the insolvent estate and, hence, a greater payment to the general creditors of the debtor.

The publication of the INSOL Europe report precipitated one commentator to state that: 'Insolvency Law has finally become a field of law for which harmonisation at a European level is considered both important and feasible.'[20] This can be linked to the fact that the reform of insolvency law is very much near the top of the EU's policy agenda. It is an important element of the EU's Capital Markets Union project, and the *Five Presidents' Report: Completing Europe's Economic and Monetary Union* on 22 June 2015[21] lists the area of insolvency law among the most important bottlenecks preventing the integration of capital markets.[22] Recently the European Central Bank called for the harmonisation of avoidance actions.[23]

15 T Bos, 'The European Insolvency Regulation and the Harmonisation of Private International Law in Europe' (2003) Netherlands International Law Review 31, 33.

16 B Wessels, 'Harmonisation of Insolvency Law in Europe (2011) 8 European Company Law 27, 27.

17 The European Association of Insolvency Practitioners and Scholars.

18 European Parliament, 'Harmonisation of Insolvency Law at EU Level' PE 419.633, Study by INSOL Europe, April 2010, 20: <http://www.europarl.europa.eu/meetdocs/2009_2014/documents/empl/dv/empl_study_insolvencyproceedings_/empl_study_insolvencyproceedings_en.pdf>.

19 As discussed later in the article, others, such as creditors, might be entitled under national legislation of member states to bring avoidance proceedings in some situations.

20 R J de Weijs, 'Harmonisation of European Insolvency Law and the Need to Tackle Two Common Problems: Common Pool and Anticommons' 19 October 2011, 1 <http://ssrn.com/abstract=1950100>.

21 Available at <https://ec.europa.eu/priorities/publications/five-presidents-report-completing-europes-economic-and-monetary-union_en>.

22 EC (DG Justice and Consumer Affairs), 'Study on a New Approach to Business Failure and Insolvency' Tender No JUST/2014/JCOO/PR/CIVI/0075, January 2016, 23 <https://www.cak.cz/assets/pro-advokaty/mezinarodni-vztahy/insolvency_study_2016_final_en.pdf>.

23 Opinion of the European Central Bank, 7 June 2017, para 1.2 <https://www.bankingsupervision.europa.eu/ecb/legal/pdf/con_2017_22_signed_with_twd.pdf>.

Following the abovementioned INSOL Europe report, the European Parliament in a Resolution of 15 November 2011[24] said in recitals that there are certain areas of insolvency law where harmonisation is worthwhile and achievable. The Parliament stated that the lack of harmonisation inhibits predictability of the results of court proceedings.[25] Also a report by the Association for Financial Markets in Europe in February 2016 concluded that convergence of insolvency law and practice provides for significant benefits.[26] The European Parliament said that even if the creation of a body of substantive insolvency law at EU level is not possible, there are certain areas of insolvency law where harmonisation is worthwhile and achievable.[27] One of those areas that INSOL Europe and the Parliament felt was ready for harmonisation was the avoidance rules. But, the INSOL report did not endeavour to provide any possible rules that might be applied as far as harmonisation was concerned.

While not mentioned in the INSOL report, another more recent report, which involved a study into substantive insolvency law in the EU,[28] has found that there are many divergences in the avoidance rules applying across the EU and the provisions of the EIR do not alleviate those or provide a fair resolution of avoidance issues.[29]

There are various shades of harmonisation, but it would seem that what is being envisaged as far as the avoidance rules are concerned is total harmonisation (or exhaustive, hard, maximum or strong harmonisation as it is variously referred to). This is when no lack of adherence to rules is permitted save where safeguard measures are needed.[30] The topic of this paper is considered in the context of total harmonisation.

Where there is total harmonisation, rules will apply across the EU in all insolvencies. There are indications that this approach might be favoured by the EC, but, having said that, it would not appear to be a straightforward answer to the problem when one considers what the provisions of the law will actually be. There are obstacles that would have to be overcome. Any consideration of a harmonisation process in insolvency, where a multitude of jurisdictions is involved, must involve careful thought being given to how the harmonisation will affect and relate to other issues, both involving insolvency and non-insolvency areas of law.[31] Certainly, achieving harmonisation will not be an easy task. There will be some hard decisions that the EC will have to make.

The aim of this paper is to identify and analyse those primary matters that are contained in the legislative regimes of member states and that need to be considered and

24 European Parliament resolution of 15 November 2011 with recommendations to the EC on insolvency proceedings in the context of EU company law (2011/2006(INI)) at recital C and available at <http://www.europarl.europa.eu/sides/getDoc.do?pubRef=-//EP//TEXT+TA+P7-TA-2011-0484+0+DOC+XML+V0//EN>.

25 Ibid, recitals A and B.

26 *Potential Economic Gains from Reforming Insolvency Law in Europe*, 5 <http://www.weil.com/~/media/articles/2016/february/afme-weil-eu-insolvency-reform.pdf?la=en> and now available at: <https://www.accountancyeurope.eu/finance-investment/fee-cmu-policy-update-2/>.

27 European Parliament (n 24), recital C.

28 EC (n 22), chapter 4.

29 Regulation (EU) 2015/848 of the European Parliament and of the Council of 20 May 2015 on insolvency proceedings (recast), Official Journal of the European Union, L141/19, 5 June 2015. For a recent discussion of the recast regulation, see M Weiss, 'Bridge over Troubled Water: The Revised Insolvency Regulation' (2015) 24 International Insolvency Review 192; G McCormack, 'Something Old, Something New: Recasting the European Insolvency Regulation' (2016) 79 Modern Law Review 121.

30 Slot (n 3) 382.

31 D Mindel and S Harris, 'The Pursuit of Harmony Can Easily Lead to Discord – Why Local Insolvency Laws Are Best Developed Locally' (Ernst and Young April 2015) 3.

addressed in the formulation of any harmonised scheme, as well as to ascertain the problems that these matters may cause in the construction of a legislative scheme. There may be other matters that lie outside the regimes of member states at the moment that need to be considered, but due to constraints of space that issue will not be broached here. The subject of the paper is a critical issue, for it is all well and good to say that there should be harmonisation, but how that is done and what is included in any harmonised scheme is another matter. Clearly, it is not going to be an easy task to draft provisions which provide a system that is fair, effective, workable and respected in all parts of the EU, as the avoidance rules that exist in most member states have developed over many years and have done so in order to address particular concerns and issues that have arisen.

Nor is it within the scope of the paper to consider the benefits and drawbacks of harmonisation or to specify how avoidance rules should be formulated.[32] Rather, on the basis that harmonisation were to occur, the paper proceeds to examine what has to be taken into account as far as the technical aspects of avoidance rules are concerned, and with reference to what is the existing position in the various member states.[33] It must be added that this article does not seek to provide a template for harmonised rules, let alone suggest what a scheme might look like and how it would operate. The paper is situated further back than that in the development of a scheme. It aims to analyse the primary issues that need to be considered in the formulation of rules and to make a case for certain approaches. Because of the number of factors that warrant consideration and publishing limits, it is not possible to analyse them individually in as much depth as they deserve. This is something that will have to be done at the point of formulating a harmonised avoidance regime. While giving appropriate examples of avoidance rules applying across the EU, the paper does not seek to discuss the avoidance rules applying in member states in any detail. The recent report for the EC encompassing a study into substantive insolvency law in the EU does that to a degree.[34]

The article is structured as follows. First, it explains the nature of avoidance rules and the policy that appears to underpin them. Second, it discusses the kinds of antecedent transactions that are often subject to avoidance rules. In the third and principal part of the article, there is an analysis of the main factors that seemingly need to be considered either before the drafting of a scheme commences or in the process of drafting such a scheme, with these factors being based on the avoidance rules that presently exist around the EU. Finally, there are some concluding remarks.

For ease of exposition and because more transactional avoidance tends to occur in corporate insolvencies, I will assume that the debtor is a company, but there will be need, of course, for avoidance rules to apply to individual debtors. Whether they are broadly the same or different is something that will have to be considered. The article refers to the person who initiates avoidance actions as the claimant, and the person or entity against whom action is taken is referred to generally as the defendant or the beneficiary of a transaction. The claimant will, most often, be the person who has been appointed to administer the debtor's affairs pursuant to insolvency proceedings. For the purposes of this article this person will be referred to as an insolvency practitioner, which is the term used in the recast version of the EIR.[35]

32 For a discussion, see A Keay, 'The Harmonization of the Avoidance Rules in European Union Insolvencies' (2017) 66 International and Comparative Law Quarterly 79.

33 For a consideration of the issues surrounding harmonisation of avoidance rules, see ibid.

34 EC (n 22) chapter 4.

35 Art 2(5). Previously the person was referred to as the liquidator.

2 Avoidance rules

Historically, avoidance rules go back to Roman times where there were up to four legal processes that could be used to recover property for the estate of a debtor from other parties, with the most well-known action being the *actio pauliana*.[36] The main features of this action have survived to the present day.[37] Over the years European jurisdictions developed their rules on avoidance in different ways and these rules include divergent elements and place emphasis on multifarious approaches, as we see later in the article. This is due to many factors, not least being the sources of law of a country, its history, culture and the kind of legal system that was fostered. Nevertheless, we find today that, while legal systems in the various jurisdictions of the EU differ, the solutions which these systems provide for in relation to antecedent transactions involving the loss of assets of insolvents have many commonalities,[38] which does assist, to some degree, in formulating a harmonised regime.

One of the primary duties of an insolvency practitioner appointed to administer many types of insolvency regimes, and liquidation in particular, is to investigate the affairs of the insolvent that is subject to the relevant insolvency proceedings. An important aspect of this is to determine if there were any transactions entered into by the insolvent before the advent of insolvency proceedings to see if any of them are suspect and can be attacked because they are detrimental to creditors. Avoidance rules obviously are retrospective in effect and permit the setting-aside of transactions that were, at the time they were entered into, generally, valid and not vulnerable to challenge under the general law of the relevant jurisdiction.

No standard theory has really developed in Europe as to the reason for the existence of avoidance provisions, but there are clear policies that underpin them. First, the property of an insolvent is to be distributed fairly and rateably among its creditors,[39] subject to provisions contained in the statutory scheme.[40] Avoidance actions might be seen as promoting collectivism and fairness among creditors, and the underlying purpose of avoidance provisions is usually seen as being to ensure that there is fairness.[41] Nevertheless, fairness does not translate into absolute equality between creditors as legislation in all member states includes provisions embedding the right of priority to certain groups of creditors. A prime example is employees of the insolvent who are usually granted some form of priority in all member states.

Avoidance rules are enacted so as to protect the general body of creditors from the unfair diminution of the insolvent's assets which can be a consequence of a debtor

36 The other actions were: *interdictum fraudatorium*; *in factum*; *in integrum restitutio*: H Roby, *Private Roman Law* (Cambridge University Press 1902) 273.

37 *Seagon v Deko Marty Belgium NV* (Case C-339/07) [2009] BCC 347, [26].

38 Ibid [26].

39 V Finch, 'Directors' Duties: Insolvency and the Unsecured Creditor' in A Clarke (ed), *Current Issues in Insolvency Law* (Stevens 1991), 87; E Warren, 'Bankruptcy Policymaking in an Imperfect World', (1993) 92 Michigan Law Review 336, 353; J McCoid, 'Bankruptcy Preferences and Efficiency: An Expression of Doubt' (1981) 67 Vancouver Law Review 249, 260; A Keay, 'In Pursuit of the Rationale behind the Avoidance of Pre-liquidation Transactions' (1996) 18 Sydney Law Review 56.

40 The most prevalent exception that is found is that the employees of the insolvent are entitled to be paid a part or all of outstanding wages owed to them before other creditors are paid.

41 McCoid (n 39) 271; T Ward and J Shulman, 'In Defence of the Bankruptcy Code: Radical Integration of the Preference Rules Affecting Commercial Financing' (1983) 61 Washington University Law Quarterly 1, 16. Recital 63 of the recast EIR provides that equal treatment of creditors is an important element of the Regulation.

giving an advantage to someone at some point before the opening of insolvency proceedings, and, therefore, there is a distortion in the distribution of the property of the insolvent according to the statutory scheme. Allowing for avoidance is aimed at preventing the unjustified enrichment of one individual to the detriment of all creditors. The provisions seek to address two possible situations. First, insolvents may transfer some of their assets, prior to entry into insolvency proceedings, at below market value, or purchase assets at above market value, in order to benefit some third party, often an associate or connected party; this is action that might be characterised as debtor misbehaviour.[42] Second, a debtor may discriminate in the payment of creditors and satisfy one creditor while ignoring others, which ends up being detrimental to the general body of creditors.[43] These situations often involve the debtor benefiting people who are associated with the debtor. Where a debtor benefits a creditor who is not associated with the debtor, it often is the consequence of pressure brought to bear by the creditor when the creditor becomes aware of the fact that the debtor is in financial distress and might in fact be insolvent.

A second policy, which arguably has only risen to prominence in the past 25 years, is that avoidance provisions exist in order to stop the dismemberment of the insolvent's estate,[44] which is something that can happen when an insolvent enters into transactions prior to insolvency proceedings being opened. The concern is that a reduction of funds and assets might seriously reduce the chances of the insolvent being able to continue to carry on business effectively or at all, and reduces the possibility of the insolvent being able to be restructured.[45] Rules providing for the avoidance of certain antecedent transactions can, arguably, be a factor in protecting the insolvent's estate and, ultimately, the creditors as a general body, as well as exacerbating the debtor's insolvency problems.[46] It would seem that this policy has become of greater importance in recent years as the restructuring of companies has been increasingly regarded as a critical issue in many nations within the EU and is something on which the EC has itself placed emphasis.[47] Nevertheless, the existence of avoidance rules is unlikely to prevent dismemberment for the most part as they only apply *ex post* and creditors, in particular, are likely to put in train processes that will enable them to get paid when a debtor is insolvent or nearing insolvency and then hope that a subsequently appointed insolvency practitioner will decide not to take legal proceedings in order to avoid relevant transactions. On many occasions creditors, for instance, will not know whether a company will be able to be restructured successfully, so they are likely to grab what they can when they can. Unless the continuation of the business of the insolvent is likely to benefit them in some substantial way, such as the fact that the company is a critical customer, creditors may be unconcerned that their receipt of full or partial payment might contribute to the eventual demise of the debtor.

42 A Keay, *Avoidance Provisions in Insolvency* (Law Book Co 1997), 35.

43 'Harmonisation of Insolvency Law at EU Level: Avoidance Actions and Rules on Contracts' (Briefing Note 2011) 11.

44 J Westbrook, 'Two Thoughts about Insider Preferences' (1991) 76 Minnesota Law Review 73, 77; Keay (n 39); R Parry, 'The Rationale of the Transaction Avoidance Provisions of the Insolvency Act 1986' in R Parry, J Ayliffe and S Shivji (eds), *Transaction Avoidance in Insolvencies* (2nd edn, Oxford University Press 2011) 23, disagrees that as far as UK law is concerned that this is a relevant policy.

45 'Harmonisation of Insolvency Law at EU Level' (n 43) 11.

46 L Pineiro, 'Towards the Reform of the European Insolvency Regulation: Codification rather than Modification' (2014) 2 Nederland Internationaal Privaatrecht 207, 212.

47 EC, 'Recommendation of 12.3.2014 on a New Approach to Business Failure and Insolvency' C (2014) 1500 https://publications.europa.eu/en/publication-detail/-/publication/3d2631f9-ab55-11e3-86f9-01aa75ed71a1/language-en>.

A third policy might underlie the avoidance rules. That is, they are designed to deter parties from entering into transactions with insolvents that could be avoided. If such a policy exists, it is highly questionable as to whether it works, given the present state of avoidance rules around the EU and the fact that many parties will take the benefit of such transactions because the company might be saved from entering insolvency proceedings, and, even if it does enter such proceedings, the insolvency practitioner might take the decision not to commence avoidance provisions for any one of a number of reasons, such as lack of funding or evidence. Those benefiting from a transaction with an insolvent might reason that, even if avoidance proceedings are commenced, there might be a deal to be done that will settle the proceedings. Also, even if an avoidance action is pursued and is successful, there will be no penalty imposed on the defendant other than the fact that the benefit of the transaction is lost. Moreover, if a creditor is ordered to return a benefit that is regarded as a preference, the creditor is not prohibited from claiming in the insolvent estate for what is owed. The upshot is that there is little reason why a party would not enter into a transaction if a benefit could be obtained.

The successful end result of a transactional avoidance action will be an enhancement of the corpus of property that is available to the creditors as a whole, and, it is hoped, it will provide a better dividend for creditors.

Important issues in relation to avoidance are predictability and certainty, and these are two factors that might lead to a decision to harmonise avoidance rules. All parties, whether it be a creditor providing credit in the sale of goods, a bank lending money or the insolvency practitioner in insolvency proceedings, need to know the effect of entering into transactions and when there can be interference in the normal processes of commerce.

3 Antecedent transactions

The regimes that member states provide for the avoidance of transactions differ in structure.[48] For example, some regimes consist of only one broad rule, such as transactions that cause detriment to the creditors are to be set aside, whereas other regimes are much longer and provide greater detail. Although some transactions entered into in the time prior to the advent of insolvency proceedings are generally set aside in a vast majority of member states, and notwithstanding that it has been said that national legal systems do not fundamentally differ with regard to the categories of contestable transactions,[49] the laws around the EU do provide for the avoidance of various and different types of transactions. It is not possible in this article to identify and discuss the different transactions that are detrimental to creditors. As legal systems often group different types of transactions into categories,[50] we will focus on the categories. The reason for doing so is that it is highly likely that member states will not accept a harmonised system that does not provide for the avoidance of these categories, and so, for the purposes of this paper, it is conceded that these categories will have to be addressed by a harmonised scheme. The two most prevalent of the categories are, first, transactions that constitute preferences and benefit one or more creditors in relation to the general body of creditors, and, second, transactions which have the effect that the

48 EC (n 22) Chapter 4.

49 European Parliament (n 18) 7.

50 R J de Weijs, 'Towards an Objective European Rule on Transaction Avoidance in Insolvencies' (2011) 20 International Insolvency Review 219, 220.

insolvent loses out and hence so do the insolvent's creditors in subsequent insolvency proceedings because some third party has benefited from, or as a result of, transactions.[51]

The recent report undertaken for the EC on substantive insolvency law in the EU determined that all EU member states include in their avoidance rules some kind of preference provision, with many similarities between the rules in various states.[52] Preferences involve the debtor (who subsequently enters insolvency proceedings) giving some benefit, perhaps payment of a debt owed or the creation of security in favour of one of the debtor's existing creditors, and this is to the detriment of the other creditors who do not get paid or receive any security in relation to the debts owed to them. The creditors suffer detriment in that priority creditors such as employees may not get paid what they are owed, and/or non-priority creditors, who will have to share *pari passu* with one another,[53] will receive nothing or less from what is left in the insolvent's estate because a transaction was entered into. In several member states special rules apply to payments that are made before the date that payment is due or where payment is made in an irregular manner.[54] The beneficiaries of such payments are seen as being less worthy of protection and the payment more reprehensible. In other states no distinction is made between payments that are due and owing and those that are not.[55] Any consideration of a harmonised regime will have to decide whether to make any distinction between those transactions involving payments made when they were due to be paid by the debtor and those transactions that involved payments being made before the debt was due or were made in an irregular manner.

A second category of transaction is the transaction at an undervalue. This involves a debtor providing some benefit to a third party, usually someone associated with the debtor, that enriches the third party to the detriment of the debtor and eventually, if the debtor enters insolvency proceedings, the debtor's creditors. An example would be where a company sells an asset valued at €100,000 to the spouse of one of the company's directors for €50,000. In this example the debtor's estate has lost €50,000. A gift of its property by a debtor is another clear example of a transaction at an undervalue.[56] The abovementioned EC-commissioned study on substantive insolvency found that all member states, except for Cyprus, have some form of transaction at an undervalue avoidance rule.[57]

All but nine member states have some avoidance rule(s) that applies where debtors have sought to put their assets beyond the reach of their creditors.[58] This is sometimes known as a transaction intended to defraud creditors and sometimes as a fraudulent conveyance.[59] With these kinds of rules for avoidance, either or both the debtor and the recipient of the benefit of the transaction must be proved to have intended to defraud creditors of the debtor. These kinds of transactions can be placed in the second category as the relevant transaction involves the debtor not receiving the amount of value that it should from the transaction.

51 See the discussion in Keay (n 39) 59–61.

52 EC (n 22) 147–2.

53 That is equally and rateably.

54 These are known as incongruent payments in Germany (German Insolvency Code (Insolvenzordnung) 1994, s 132) and voluntary payments in the Netherlands: de Weijs (n 50) 231.

55 For instance, see the UK and Ireland.

56 For example, as in Germany: s 134 of the German Insolvency Code 1994.

57 EC (n 22) 154–6.

58 Ibid 163.

59 See Art 3:45 of the Dutch Civil Code.

A significant number of member states, with only five exceptions, include some kind of avoidance rule that invalidates the provision of security in favour of a hitherto unsecured creditor.[60] For example, X, an unsecured creditor of Y Ltd who is owed a substantial amount, agrees to refrain from taking legal proceedings against Y Ltd if the company agrees to give X security for the existing credit. This involves both X's debt being converted from being unsecured to secured, and it leaves the company in no better position financially than it was before granting the security. More importantly, creditors of Y Ltd will, if the company enters insolvency proceedings, be worse off, as the creditor who is now secured will get more from the estate of Y Ltd than the unsecured creditors. Two instances of the invalidation of transactions providing security bear a mention. First, in the UK floating charges may be invalidated when they are granted by companies that are on their last legs[61] and the creation of which will be to the detriment of the unsecured creditors. Second, in Germany[62] any security that is created by a debtor within the three months before an insolvency filing and at a time when the debtor is in a position of illiquidity can be avoided if, at the time of the granting of security, the creditor who became secured as a result of the creation of the security knew of the illiquidity.[63] The voiding of security is really allied to preferences as the general thrust behind the former is to prevent a creditor gaining a preference over other creditors by taking security which will give it, in most states, priority over other creditors. Security and secured interests are treated differently across the EU,[64] and this can lead to problems where an insolvent's property is subject to security that was created in a different member state of the EU to the one in which insolvency proceedings have been opened under the EIR.[65] This is exacerbated by the fact that there is no exhaustive definition of security (rights *in rem*) in the EIR.[66]

How the rules are drafted and whether the avoidance of other types of transactions should be catered for is a matter for a detailed study of the policy behind avoidance, the existing rules in member states and the breadth of such rules. The latter two issues will involve some consideration of important issues that hitherto have been taken into account in the formulation of existing national legislation.

4 Critical factors in a harmonised scheme

If harmonisation is to be implemented, there are a number of factors that have to be examined. In some cases it is inevitable that there will have to be a resolution of issues, precipitated by divergence of approach in relation to how these factors found in the legislation of member states are addressed, if at all. One cannot put a gloss on the fact that in some areas there are almost opposing positions taken by different states. The existence of some of the elements making up an avoidance rule can be a highly

60 EC (n 22), 163.

61 Insolvency Act 1986, s 245 (references to the Insolvency Act are to the British Insolvency Act 1986). For a discussion, see A Keay, *McPherson and Keay's Law of Company Liquidation* (4th edn, Sweet & Maxwell 2017) 728–37.

62 Other member states have similar provisions. For example, see Italy: Clifford Chance, *European Insolvency Procedures* (Clifford Chance LLP 2012) 34.

63 German Insolvency Code 1994, s 132; Clifford Chance (n 62) 49.

64 Miguel Virgos and Etienne Schmit, *Report on the Convention of Insolvency Proceedings* (the Virgos-Schmit Report) (Council of the EU, 3 May 1996) para 100.

65 See, A Keay, 'Security Rights, the European Insolvency Regulation and Concerns about the Non-application of Avoidance Rules' (2016) 41 European Law Review 72.

66 G McCormack, *Secured Credit and the Harmonisation of Law* (Edward Elgar 2011) 54.

controversial matter.[67] One reason that the rules that apply in each state can be so important is that they will affect how the assets of debtors will be distributed and they 'reflect the different policy goals pursued by governments and policy makers'.[68]

Before formulating the rules for avoidance it is necessary for there to be an articulation of the objectives of the inclusion of such rules in insolvency legislation as the objectives will determine what the rules should be. Consensus has to be reached on the fundamental principles that should be implemented in the laying down of avoidance rules. This is important for coherence. The rules must be consistent internally, and they must be consistent with one another.

It has been said that, besides coherence, the following principles must be considered: clarity and precision; thrift;[69] comprehensiveness;[70] and the optimal realisation of legal values.[71] After coherence, it has been suggested that the most important principle to be considered in the construction of a legislative scheme is the optimal realisation of (legal) values, because 'a system of law that leads to the reasonable weighing of values can be considered to be well organised'.[72]

What is clearly to be at the heart of any scheme is that a transaction will only be able to be impugned successfully if it does in fact cause a detriment to the creditors as a whole. This must be the basis behind avoidance, and so, if a transaction occurs on the eve of a company's liquidation because of insolvency but involves the debtor receiving fair value from another for what it has purchased or sold, there is no ground for avoidance as neither the debtor company nor its creditors have suffered a loss.

Now we turn to consider some of the most significant issues that are included in avoidance rules around the EU and which will probably have to be considered in any harmonisation process. The factors identified have been gleaned from the legislation of member states and the recent report prepared for the EC on substantive insolvency law in the EU,[73] with some consideration of the academic and practitioner literature.

4.1 Establishing insolvency

While it might be expressed in different words, the vast majority of EU jurisdictions provide that transactions can only be set aside if the debtor was insolvent at the time of the making of the transactions sought to be avoided.[74] The pervasive use of an insolvency condition for avoidance satisfies the need to consider it here, given the approach articulated at the beginning of this part of the article. Nevertheless, there are good reasons why it should be a condition. For instance, arguably, transactions should not be able to be challenged prior to insolvency as it is only at that point that the company is clearly in financial trouble and it is likely that those dealing with it would only have become aware of these troubles when insolvency can be established.

67 F Mucciarelli, 'Not Just Efficiency: Insolvency Law in the EU and its Political Dimension' (2013) 14 European Business Organization Law Review 175.

68 Ibid.

69 This refers to the requirement that a system should not, without good reason, be complex due to 'redundant and overly complicated constructions': Haentjens (n 5) 15.

70 This requires a system to cover all case law and legislation: ibid.

71 P W Brouwer, 'Systematisering van recht' in P W Brouwer et al eds, *Drie Dimensies Van Recht: Rechtstheorie, Rechtsgeleerdheid, Rechtspraktijk* (Boom Juridische uitgevers 1999) 219–37, 232, and referred to in Haentjens (n 5) 15.

72 Haentjens (n 5).

73 EC (n 22).

74 Ibid 186. For instance, in Germany: see s 132 of the German Insolvency Code 1994.

For a harmonised scheme, it would be necessary to establish a definition of insolvency, for a failure to do so would mean that the kind of certainty that parties crave would not be achieved. Notwithstanding the different terminology used in member states, there is closeness of approach in relation to this factor. For instance, Germany, Austria, Croatia and Bulgaria refer to a debtor being illiquid or over-indebted and in a number of states, including Belgium[75] and Luxembourg,[76] avoidance can only occur where the transaction was entered into when the company ceased paying debts or had suspended payments. Being illiquid in Germany involves a debtor being unable to meet its mature obligations to pay[77] and accords with the concept of cash-flow insolvency which is used in the UK and Ireland. The concept of the cessation of the payment of debts also accords with cash-flow insolvency. The explanation of insolvency in some member states is more precise. In Slovakia, for example, insolvency means that a debtor is unable to pay at least two debt obligations to more than one creditor after they have been due for 30 days.[78] But, then again, in some other member states insolvency is not as precise. For instance, in the Italian legislation it is said that insolvency occurs with the failure to fulfil obligations or by other external factors that demonstrate the debtor's inability to regularly satisfy its obligations.[79]

The UK law provides that avoidance rules only apply where the debtor was unable to pay its debts at the time of the impugned transaction, and this can mean a number of things, but primarily it means that the debtor cannot pay its debts as they fall due (cash-flow insolvency), or the debtor's liabilities are greater than its assets (balance-sheet insolvency).[80] Over-indebtedness in Germany means that the debtor's assets no longer cover existing obligations to pay[81] and is consistent with the concept of balance-sheet insolvency that applies in the UK and Ireland.[82] It is likely that a statement about inability to pay debts in a harmonised regime would not be able to be extensive, and it will rely upon subsequent case law to determine the finer points of the meaning of insolvency. This does leave open the possibility for divergence, but it would be a matter for the Court of Justice of the European Union (CJEU) to ensure that the case law develops consistently as it has in other matters that have been difficult elements of the EIR.[83]

4.2 Subjective v objective

One important matter that is provided for in avoidance provisions, and it often tends to be a highly controversial issue, is whether elements that have to be proved in order for the avoidance of a transaction are subjective or objective. If avoidance can occur when either certain facts and conditions are merely established, then the test provided for is objective, but, if avoidance will only be ordered if it can be proved that the debtor or the person who received a benefit from the debtor had some belief or intention, then that is subjective. Subjective tests are concerned with the state of mind of one or more parties

75 Belgian Bankruptcy Act 1997, Art 9.

76 Law on Commercial Companies 1915, Art 440.

77 German Insolvency Code 1994, s 17(2).

78 EC (n 22), 185.

79 Bankruptcy Law, Art 5.

80 Ss 123(1)(e), 123(2)

81 German Insolvency Code 1994, s 19(2).

82 For further consideration, see EC (n 22) para 5.2.

83 Most prominent has been the CJEU's efforts in relation to determining the meaning of 'the centre of main interests'. See, *Re Eurofood IFSC Ltd* C-341/04; [2006] Ch 508; [2006] BCC 397; *EC Interedil Srl v Fallimento Interedil Srl* C-396/09; [2012] BCC 851; [2011] BPIR 1639.

while objective tests are concerned with objective facts. An example of a test that is objective is providing that a transaction must fall within a certain time period. This matter can be established by events and accounts and there is no need to consider the beliefs or intentions of any parties. An example of a subjective test is found in UK law where it provides that a court order avoiding a preference will only be permitted if the insolvent is proved to have been influenced in deciding to give the preference by a desire to put the beneficiary of the preference in a better position.[84] Many jurisdictions, such as the UK, have a mixture of objective and subjective tests in their array of avoidance rules, but the Netherlands only employs subjective tests.[85]

Clearly, both subjective and objective approaches have their shortcomings. It is not possible to discuss these in depth, but the leading shortcomings for subjective tests are as follows. First, it is frequently demanding on insolvency practitioners in many cases to be required to establish that a subjective test is satisfied. It is often not easy to prove the intention of a person, and even more difficult to establish the intention of a corporate debtor. Second, ascertaining whether a subjective test has been satisfied or not in an avoidance action is time-consuming; it can be a difficult issue for a court to deal with and the outcome of such proceedings is often uncertain,[86] or at least more uncertain than where there is no subjective test involved. The leading shortcomings of objective tests are: an objective test may precipitate uncertainty in that anyone dealing with a company cannot be sure that the transaction will not be avoided at some later point even if he or she did not know of the company's financial problems or the company had no intention of favouring the beneficiary of the transaction; and, if the objective facts can be proved, then the beneficiary of the transaction is liable when he or she might not have been at fault.[87] This seems to be unfair, at least in some circumstances.

Bearing in mind that the general aim of the avoidance rules is to protect the collective scheme of insolvency and that the creditors must have suffered a detriment from a transaction,[88] it makes more sense to provide, on the whole, for objective rules. To offset the harshness of such an approach defences could be provided for to enable a defendant/beneficiary to extricate himself or herself from liability if certain things can be established.

If it is felt that a subjective test has to operate, then what has to be decided is to which party or parties is the test to be applied. Usually, it is applied to either the debtor or the direct beneficiary of the impugned transaction. It could be applied to both and require that the test in relation to both parties had to be satisfied for an avoidance order, but that is likely to make it exceedingly difficult for insolvency practitioners to establish a case and get an order. There are different approaches across the EU as to whether the debtor or beneficiary's state of mind is included in the avoidance rule. For instance, German law provides[89] that, in determining whether or not a preference can be avoided, one has to consider the mind of the creditor/beneficiary of the preferential transfer, whereas in England and Wales it is the insolvent debtor's intention, and not the creditor's, that is one

84 Insolvency Act 1986, s 239(4).

85 R Vriesendorp and F van Koppen, 'Transactional Avoidance in the Netherlands' (2000) 9 International Insolvency Review 47, 51–4.

86 de Weijs (n 50) 222.

87 Ibid 223.

88 M Bridge, 'Collectivity, Management of Estates and Pari Passu in Winding up' in J Armour and H Bennett (eds), *Vulnerable Transactions in Corporate Insolvency* (Hart 2003) 18.

89 German Insolvency Code 1994, s 132.

of the critical issues in being able to establish that a preference was given.[90] It is submitted that, if there is to be a subjective test employed, and it might be more appropriate for some rules, it would seem more sensible to make the subjectivity to be that of the beneficiary/creditor and not that of the debtor.[91] It does not seem fair that, if a beneficiary is blameless, as far as wanting a transaction to be detrimental to creditors of the debtor, he or she suffers a detriment, especially if the transaction is avoided because of the desire or knowledge of the debtor. There is a good argument for saying that it is just and reasonable to require some form of subjective test where the relevant avoidance rule seeks to allow the challenging of transactions that have been entered into in an attempt to defraud creditors. The allegation of fraud is a severe one and arguably requires clear proof of subjective intent. However, if one were to make the test dependent on the beneficiary's state of mind alone then it would be necessary to include a presumption (an issue that is discussed shortly) in relation to beneficiaries associated with the debtor that they would be presumed to have had the requisite state of mind for avoidance, or else, in rules such as transactions at an undervalue, debtors and associated parties might be able to conspire to ensure that the latter did not have the state of mind generally required.

If objective tests are to be implemented then there must be a time constraint placed on the right to avoid, or else it will create a substantial amount of uncertainty.[92] For preference claims, the Americans have a 90-day period prior to the opening of insolvency proceedings in which all transfers by the debtor to a creditor can be set aside, but there is no defence at all to a preference claim provided that all of the conditions of a preference can be satisfied. While in Australia the period in which a preference can be said to have been given is six months, a fairly standard period in EU jurisdictions. In both the US and Australia those creditors who receive preferences within the period mentioned are able to invoke a defence. The next issue is whether a (and if so what) defence is to be made available to a beneficiary of a transaction that is entered into during the period in which a transaction might be set aside. A defence might involve some subjective element and thereby rectify the balance that might be thought to be prejudicial for a beneficiary who would be able to pass a subjective test. For example, a beneficiary's defence might be framed to permit the beneficiary to retain a benefit if he or she did not know that the debtor was insolvent at the time of the transaction.[93] As mentioned already, the Australians do provide a defence to their objective test for preferences. In Australia a court is not to make an order materially prejudicing a right or interest of a person (the beneficiary of the transaction made with the debtor) if all of the following three conditions can be fulfilled: the person became a party to the transaction in good faith and at the time when the person became such a party the person had no reasonable grounds for suspecting that the company was insolvent at that time or would become insolvent; a reasonable person in the person's circumstances would have had no such grounds for so suspecting; the person has provided valuable consideration under the transaction or had

90 Insolvency Act 1986, s 239(5). But not in Scotland. The issue of desire is not relevant in England and Wales where the creditor who received the benefit is a connected person.

91 de Weijs (n 20) 5.

92 de Weijs (n 50) 226.

93 Such an approach would lead us to something close to the German position, although the burden of proof in having a defence as mentioned in the text would place the burden of proof on the beneficiary, whereas in the German position the claimant has the burden of proving that the beneficiary knew that the debtor was illiquid: German Insolvency Code 1994, s 132.

changed position in reliance on the transaction.[94] The US legislation allows for a defence when a payment was made in the ordinary course of business.[95]

The drawback for beneficiaries of transactions wishing to defend an insolvency practitioner's claim is that, usually, they have the burden of proving their subjective state in order to satisfy the defence.

4.3 Presumptions

Legislation in many member states specifies that some presumptions, most of which are rebuttable by the person against whom the avoidance action has been instituted, will be applied in certain circumstances. The existence of presumptions is an implicit acknowledgment by legislators that insolvency practitioners would find it exceedingly difficult to prove some conditions that are contained in avoidance rules if they were not helped by presumptions. It is recognition of the fact that an insolvency practitioner comes to an insolvent's estate with very limited knowledge about the debtor's affairs and he or she can only obtain a restricted amount of information, often because the directors and other officers fail to co-operate. Also it might be an acknowledgment that certain transactions are either potentially or inherently questionable and therefore it is warranted that presumptions are applied. An example is a transfer of property to a party related to the company, such as a director.

A presumption that is included in some legislation is that, where it has to be established that the defendant to the avoidance action knew or ought to have known of the debtor's insolvency when entering into the transaction with the debtor that is impugned, the defendant's knowledge is presumed. The defendant then has to rebut that presumption. In constructing harmonised avoidance rules it will be necessary to consider what matters should be presumed, to whom will the presumption apply and whether or not it can be rebutted, and, if so, how.

4.4 Who can take action?

It is of course a critical matter that there is some provision somewhere that identifies the one who is entitled to take action for the avoidance of a transaction. As INSOL Europe noted in its report on harmonisation of EU law on insolvency, different positions exist in member states as to who is entitled to initiate proceedings.[96] The candidates are the insolvency practitioner (perhaps needing court or creditor approval in some cases), a government official, a court supervisor and possibly a creditor. Certainly, the insolvency practitioner is the most frequent claimant in an avoidance action in and outside of the EU. A creditor might be only able to bring proceedings on some occasions after securing the approval of one of the following: the insolvency practitioner, the court or some other independent body. It would seem to be unwise to permit creditors to bring proceedings without obtaining permission as the institution of avoidance actions would ordinarily be part of the role of the insolvency practitioner, and a creditor should have to establish a

94 Corporations Act 2001, s 588FG(2).

95 Bankruptcy Reform Act, s 547. This defence has caused uncertainty and precipitated a considerable amount of litigation: M J Herbert, 'The Trustee versus the Trade Creditor: A Critique of Section 547(c)(1), (2) and (4) of the Bankruptcy Code' (1983) 17 University of Richmond Law Review 667, 679; E A Orelup, 'Avoidance of Preferential Transfers under the Bankruptcy Reform Act 1978' (1979) Iowa Law Review 209; L L Broome, 'Payments or Long Term Debt or Voidable Preference: The Impact of the 1984 Bankruptcy Amendments' (1987) 78 Duke Law Journal 78.

96 European Parliament (n 18) 20.

good reason why he or she believes that proceedings should be instituted when the insolvency practitioner did not do so.

In a Note, titled 'Harmonisation of Insolvency Law at EU Level: Avoidance Actions and Rules on Contract,' the European Parliament's Policy Section felt that harmonisation in respect of this issue was going too far and trespassing on the national domain,[97] and thus it was viewed to be a matter for nation states as to who might be entitled to bring proceedings. This seems to be understandable and, whoever is entitled to bring proceedings, he or she will be bound by the harmonised scheme.

4.5 Value

It is a critical aspect of provisions that allow for the challenging of transactions at an undervalue and, to an extent, transactions that defraud creditors that it be established that the insolvent debtor did not receive as much consideration in money terms from the transaction as the other party to it. Hence, how one provides for the valuation of the consideration is an important element. Luxembourg,[98] Malta[99] and the UK[100] include in their provisions dealing with transactions at an undervalue that the insolvency practitioner is obliged to prove that what the debtor received was, in money terms, significantly less than what the debtor gave to the other party. No definition or guidance is provided in the legislation and determining whether there was significant undervalue is left squarely within the discretion of the court. Other jurisdictions include reference to value in broad terms. The Hungarian legislation provides that there is avoidance where there is conspicuous undervalue in bilateral transactions.[101] This, like the provisions in Luxembourg et al, suffers from vagueness. Other member states do refer to the unevenness of consideration passing between the parties to a transaction. For instance, the Polish legislation refers to disproportionately low consideration being received by the debtor.[102] The legislation of many member states does not refer to unevenness of value, but merely provides that a transaction is voidable where it is detrimental to the creditors. Unevenness of value would be an indicator of detriment. Possibly, merely stating that a transaction can be avoided if it is detrimental to the creditors is preferable to stating the kind of undervalue that there must be, for it is less vague than the latter approach.

4.6 The suspect period

For the most part avoidance provisions specify a period of time in which a transaction must have been entered into for it to be subject to successful challenge. This is to ensure a degree of certainty and to protect contract finality.[103] Most member states provide a number of time zones for different avoidance rules, although Spain, because it effectively has only one avoidance rule, has one time period applicable to all transactions that might be avoidable. Different periods are specified for the avoidance of different transactions under the law of the various member states. The periods can be quite diverse, and a number of them might be used in any one jurisdiction's avoidance rules. The avoidance of security interests particularly provides an instance of divergence. For instance, Germany's s 130 of its 1994 Insolvency Code provides that security can be contested if

97 European Parliament (n 18) 15–16.

98 Commercial Code, Art 445.

99 Companies Act, Art 303(2)(a).

100 Insolvency Act 1986, s 238.

101 Ibid s 40(1)(b).

102 Insolvency Law, s 127(1).

103 de Weijs (n 50) 226.

it was created within three months of the opening of insolvency proceedings if the debtor was illiquid at the time of the transaction and the creditor knew of the debtor's illiquid state. Yet, in the UK the time period for the invalidation of some floating charges is where the charge was entered into in the 12 months before the commencement of liquidation or administration, but this is extended to two years if the creditor in whose favour the charge is granted is a connected party.[104]

The longest suspect periods tend to be reserved for transactions that involve fraudulent intent on the part of the debtor. For instance, there is no time limit prescribed for transactions to defraud creditors in the UK.[105] The provision of a long time zone does, as with presumptions, help insolvency practitioners who are seeking to avoid an antecedent transaction. Transactions at an undervalue are often next in the length of the suspect period. For instance, in Germany the time period is four years. The shortest suspect period tends to be applied to preferences. Several jurisdictions provide that only transactions entered into during the period of three months before the commencement of insolvency proceedings can be avoided,[106] while a substantial number of other jurisdictions employ a period of six months.[107] One justification for a shorter period for preferences compared with undervalue transactions is probably that the former do not reduce the net estate for distribution while the latter do.

4.7 Calculating the suspect period

Where time periods are established, it is important to know from what point one goes back in time to ascertain whether transactions are able to be avoided. The point is usually the time when insolvency proceedings are opened. What opening means can be different in each member state, and that caused some problems in the application of the EIR before its recast. This is a matter that would need to be considered very carefully as potentially it could be of critical importance.

4.8 Association between the insolvent and the counter-party (connected persons)

Some avoidance laws might only apply where the insolvent and the person or company with whom it makes the transaction are connected in some way. Alternatively, avoidance rules might apply equally to parties connected and unconnected to the insolvent, but the time in which the rule applies might be somewhat different. For example in the UK a preferential transfer can only be challenged when it is entered into within six months before the commencement of insolvency proceedings,[108] whereas that period extends to two years where the recipient of the preference is connected to the insolvent.[109] Furthermore, the existence of a connected party in a transaction might provide an insolvency practitioner with the benefit of a presumption in some respects. An example is where the beneficiary of the transaction has to be proved to have been aware of the debtor's insolvency when the transaction was entered into; this is presumed if the beneficiary is a connected person.

104 Insolvency Act 1986, s 245.

105 Ibid s 423.

106 Croatia, Denmark, Finland, Hungary (90 days) and Sweden.

107 See Belgium, Bulgaria, Cyprus, Ireland, Latvia, Malta, Poland and the UK.

108 Insolvency Act 1986, ss 240(1)(b) and 341(1(b).

109 Ibid ss 240(1)(a) and 341(1)(c).

The reason why a longer suspect period is usually provided for where there is a connected party involved in a transaction is that a connected party might either directly or indirectly cause the business of the debtor to continue for a term before it enters insolvency proceedings so that any transaction entered into falls outside of the suspect period that is provided for in the avoidance rules. Also, a connected person could either influence the directors of the company in the decisions they make, particularly as to whether the company enters insolvency proceedings, or they can even manipulate company decisions.

At present, all member states make provision for connected persons save for France,[110] Malta and Luxembourg.[111]

If special provision were made for transactions that involve connected persons, and one would assume that legislation would do so given the fact that nearly all EU states currently make such provision, it has to be decided who is to be included within the category of connected person. This is not easily resolved. Usually, the following are included: relatives of an individual insolvent; directors and shareholders of an insolvent company; companies in the same corporate group as an insolvent company; and relatives of directors.[112] But the various member states provide different definitions of persons who are connected. The Netherlands is particularly broad and includes foster children of a director of the debtor company.[113] Other states that provide a fairly comprehensive list of connected persons are Poland and Spain,[114] while others provide for a limited provision. An example is Italy where only spouses are seen as associated persons.

4.9 The avoidance of transactions peculiar to one or few jurisdictions

A major issue that has to be considered is what approach is to be taken in relation to the avoidance of transactions that might be provided for in only one or two jurisdictions. The relevant provisions are notable as there is nothing or little to which they can be compared and they owe their existence to considerations that are often special to the particular member state. What is likely is that a matter that is covered by an avoidance rule in one member state might be dealt with in another state by provisions in non-insolvency legislation. An example of a provision that is peculiar to one state is the UK's provision for the avoidance of extortionate loans.[115] Such transactions, or at least similar transactions, might be avoidable under consumer legislation or other civil law provisions in other member states.

It is obviously not possible for a harmonised set of avoidance rules, unless they are going to be overly long and complicated, to be able to encompass all of the rules that are peculiar to one or even a few jurisdictions. If a scheme were to do this it would be too complex. Provisions that presently exist in member states could be considered and evaluated as to whether they might be broadened and included in harmonised rules. If not, then national governments might consider moving the provision into some other piece of national legislation. Another option would be to permit states to add local rules on to a harmonised set of rules, provided that they do not clash or overlap with the

110 But personal links between the parties might be taken into account in determining whether the party dealing with the debtor was aware of the debtor's insolvency.

111 EC (n 22) 142.

112 See, for instance, Insolvency Act 1986, ss 249 and 435.

113 Bankruptcy Act, Art 43.

114 EC (n 22) 163.

115 Insolvency Act 1986, s 244.

former. The drawback with this latter option is that it would not foster certainty. It would also mean that practitioners would not be conversant with, potentially, many different rules across the EU, which is one concern that has been voiced about the present state of affairs.[116]

4.10 Orders

Obviously, on most occasions it is the order of a court with which an insolvency practitioner is most concerned. Even where an avoidance rule renders a transaction void automatically, as some rules do, a court order might be needed to support the voiding of the transaction. For example, an order might be needed to force a party to pay money or return property to the estate of the insolvent. What is actually ordered can be critical. What the EC must consider, if deciding to embark on harmonisation, is whether the rules formulated will include specific directions as to what orders might be made, or whether the nature of the orders are left entirely within the discretion of the court hearing the matter. There are advantages and disadvantages with either approach. The advantage of provisions that specify exactly what a court can order if the claimant makes out his or her case is that the claimant knows what he or she will get if the case is successful. The disadvantage with it is that, while a judge might find creative ways of providing what he or she thinks is just, the judge's hands are tied to a large degree. The advantage with providing courts with wide discretion is that it enables courts to tailor their orders to do justice to the case, which might even include providing some allowances for the defendant, such as where the defendant has improved property which he or she received from the debtor and which has to be returned to the insolvent through the insolvency practitioner appointed because of the voiding of the transaction.

4.11 Time bars

There is provision in the legislation of most, if not all, member states providing that, as far as most avoidance rules are concerned, proceedings in the courts for an order of avoidance or a related order must be commenced within a specified time period or else the right to bring proceedings is lost. The importance of time bars or limitation periods is exemplified by the decision of the CJEU in *Lutz v Bauerle*.[117] In this case an insolvency practitioner of a German company against which insolvency proceedings had been commenced in Germany could not recover certain funds pursuant to a German avoidance rule that had been paid from the insolvent company's Austrian bank to the beneficiary in Austria. The reason was that under Austrian law, although not under German law, the time for bringing proceedings had elapsed. The CJEU said that the Austrian law took precedence because of Article 16 of the EIR.[118]

The limitation period varies in member states. It is two years in Poland,[119] three years in Germany, the Netherlands and Italy, and in the UK it depends on the type of claim that is made and is either six or 12 years.[120] The harmonisation of a period of time, which *may* involve a different period for each kind of avoidance rule, might conceivably not be a major obstacle to harmonisation. But the greater problem is that the point from which time runs differs across the EU. In Croatia, Germany and Italy it begins from the

116 European Commission (n 22) para 4.13.

117 Case C-557/13, [2015] EUECJ C-557/13. The case is discussed in Keay (n 65).

118 Art 13 under the EIR as it applied at the time of the case. It is Art 16 under the recast EIR.

119 Although it is five years for actions that are classified as *actio pauliana* claims.

120 Limitation Act 1980, ss 8 and 9.

point when the insolvency proceedings are opened.[121] In the UK time runs from the date on which the cause of action accrued, which will normally be the date of the appointment of the insolvency practitioner. In other states, such as Poland and Portugal, it is from the date of the declaration of bankruptcy, and elsewhere it will begin from the time when the insolvency practitioner becomes aware of the relevant facts that indicate a transaction can be avoided.[122] This is the case in Greece, for instance, where the insolvency practitioner has one year to bring the proceedings.[123] Even if a common starting point were prescribed, such as the opening of insolvency proceedings, this is different in member states, and it is not always clear what is the opening of proceedings.[124] Perhaps one possible solution is to nominate the appointment of an insolvency practitioner as the commencement of the time period and then provide a particular time running from that point.

Unfortunately, while the issue of time bars might be seen as procedural, it is something that cannot really be left to national states, because it can have, as *Lutz v Bauerle*[125] demonstrates, a major impact on whether avoidance rules are able to be enforced, and if each member state were to retain its own limitation period for avoidance rules it would defeat the need for certainty, one of the prime reasons behind harmonisation. It would make it more difficult for insolvency practitioners to know what time they have to work to, and a full knowledge of the limitations in 27 (excluding Denmark) states is unreasonable. Also, divergence on the actual periods could be seen as producing inequality and unfairness.

In weighing up the inclusion of a limitation period considerable thought would have to go into whether a period on the short side were proposed or whether a long period was appropriate. The danger with short limitation periods is that they places a significant burden on insolvency practitioners to determine whether transactions might be potentially avoidable, to seek legal advice, possibly obtain funding, and to gather the necessary evidence. Yet the advantage is that they serve to focus the mind of insolvency practitioners on such actions early on in their administration. The concern is that, if a period is unreasonably short, insolvency practitioners will either not be able to come to grips with the affairs of the insolvent sufficiently to decide whether avoidable transactions were entered into, and this is especially the case in relation to complex and large insolvencies, or they will simply not bother to address the issue of avoidance. Another danger is that proceedings might be commenced prematurely without the insolvency practitioner having really assessed the evidence. The consequence could be that the estate of the insolvent is vulnerable to the payment of costs to the person against whom proceedings were initiated and where the insolvency practitioner loses the case or withdraws. The benefit of long limitation periods is that it enables insolvency practitioners to be meticulous in their investigations and evidence gathering, but the potential drawback is that they can lead to procrastination or a lax approach in ascertaining whether transactions might be attacked or actually initiating the proceedings.

121 EC (n 22) 165.

122 Ibid.

123 Greek Insolvency Code, s 51.

124 This was made manifest in the celebrated case of *Re Eurofood IFSC Ltd* C-341/04; [2006] Ch 508; [2006] BCC 397.

125 Case C-557/13, [2015] EUECJ C-557/13

4.12 Transactions relating to restructuring

When insolvent, a company might endeavour to engage in a restructuring process in order to try and save it from liquidation. The EU, in line with many of its member states, has gauged that it is important to permit a company to have reasonable chances of saving itself and reducing the losses of stakeholders, such as creditors and employees. This culminated in the EC's publication of a proposal in November 2016 for a Directive on preventive restructuring frameworks.[126] In engaging in the process of restructuring a company is going to run up debts and may seek and obtain new financing with the aim of enabling it to continue to operate and possibly develop. If the company's attempt fails and it is placed in liquidation the avoidance rules will be considered by the insolvency practitioner. Consideration needs to be given to whether a harmonised regime of avoidance would entitle an insolvency practitioner to challenge transactions that were entered into during an attempt to rescue the company from its financial malaise.

In most member states, such as the Czech Republic, Estonia, Germany, Hungary, Lithuania, Luxembourg, Malta, the Netherlands, Slovakia and the UK, there is no special protection presently provided in relation to transactions involving the provision of new finance or the giving of credit on supply contracts, and avoidance rules will apply.[127] So, a repayment of a loan during a restructuring process could be challenged as a preference in many member states provided that the payment fell within the conditions formulated for a preference. However, for the most part, any security that is granted in exchange for new financing, and in order to support restructuring, will usually be safe from attack. In this kind of case, the financier is giving something new to the company and the company is therefore benefiting; there is no ultimate detriment to the creditors. In some states the protection of security granted for new money is restricted somewhat. For instance, in France, new financing cannot be challenged if the lender supplied funds and it was in relation to a settlement that had been approved of by the court.[128] The position in Romania[129] and Slovenia[130] is similar. In somewhat of a like manner, new financing cannot be challenged in Greece, where no new financing arrangements can be attacked subsequently provided that the new financing occurred during the execution of a restructuring plan.[131] The proposed new Directive would protect new financing in that it would not be declared void or voidable as an act detrimental to creditors in the context of subsequent insolvency procedures except where the transactions had been engaged in fraudulently or in bad faith.[132] There are incipient elements of such an approach in the rules that presently exist. For example, in Germany any transaction involving new financing is deemed not to have been entered into with the intention of harming creditors if it has been entered into pursuant to a serious effort to restructure.[133]

126 EC, 'Proposal for a Directive on Preventive Restructuring Frameworks, Second Chance and Measures to Increase the Efficiency of Restructuring', COM (2016) 723 final, 22 November 2016.

127 EC (n 22),167.

128 Commercial Code L 631–8, 3.

129 Insolvency Law, Art 117.

130 Insolvency Act (ZFPPIPP) (Slovenia), Arts 44 and 273.

131 Insolvency Code, Art 45(c).

132 Proposed Art 16.1.

133 EC (n 22) 167.

5 Conclusion

In his report for UNCITRAL in relation to the harmonisation of international trade law in 1966, Clive Schmitthof said that harmonisation would reduce conflicts and divergences,[134] and arguably a harmonised avoidance law would also do this for European insolvencies, as well as overcoming many of the concerns that exist with the present state of the law. But the devil is not only in the detail; it is also in constructing a schema for harmonisation which involves identifying the leading issues that have to be considered. The point was made at the outset that this paper's purpose was not to endeavour to formulate harmonised rules. That will need to be done and will probably involve a fair degree of pragmatism, as obtaining a perfect scheme is impossible. What the paper has sought to do is to identify those factors that are important parts of avoidance rules across the EU and which will need to be considered by the EC in any attempt to harmonise. There will be some hard decisions to be made and not all of them might be seen as producing fairness. The problem is that we can try as hard as we are able, but not all aspects of insolvency law and practice will lead to fairness. The fact is that the advent of insolvency is such that some, if not all, will be disadvantaged to some extent. That is the nature of the insolvency event.

A recent study has found that all member states have avoidance rules in their insolvency legislation.[135] The study has also found that all states, or at least a vast majority, have some form of avoidance rule in respect of four kinds of transactions: preferences, transactions at an undervalue, transactions defrauding creditors, and transactions granting security in certain circumstances. It is likely that any harmonised rules will cover these kinds of transactions. However, deciding on the kinds of transactions that will be legislated for is only part of the task. The way that the rules address the issues canvassed in this paper is a critical matter. The EC will have to decide which factors are dealt with in a harmonised scheme and what are left to individual states. The more that is left to individual nations to address, the more likely it is that there will be residual divergence that could attenuate some of the benefits of having a harmonised system of rules.

134 The Secretary-General, 'Report of the Secretary-General' delivered to the General Assembly, UN doc A/6396 & Add 1 and Add 2 (23 September 1966), para 8, and referred to in Block-Lieb and Halliday (n 2) 493.

135 EC (n 22), Chapter 4.

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Post-Brexit Britain and the pay culture: challenges and opportunities

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Abstract

This paper examines the impact of Brexit on financial services regulation in relation to three areas linked to executive remuneration. They are: the bonus cap; the clawback of pay; and the level of disclosure required by shareholders with regard to details of directors' remuneration. It will be argued that legally Brexit will have little impact on any of the three areas. UK legislation has already incorporated a great deal of EU legislation. The status quo of retaining such legal restrictions seems sensible in light of public sentiment towards unfairness in executive compensation and uncertainty towards the Brexit negotiations. Nevertheless, London faces stiff competition from other major international financial centres in a post-Brexit era. The loss of single passporting rights is also encouraging major banks to invest in other European financial centres. Brexit creates opportunities too. With the integration of digital technology, it is possible to create convenient platforms where investors can access reports on executive remuneration.

Keywords: Brexit; bonus cap; clawback provision; corporate governance; disclosure requirements; executive remuneration; shareholder engagement.

1 Introduction

'Brexit means Brexit' was possibly the most common catchphrase of 2016. That was the year Britain voted to leave the European Union (EU). Against the Brexit backdrop, there is great uncertainty about the precise future of a number of factors within the UK financial sector. One of them is executive remuneration. The controversy over executive pay has been around for some time: for years we have been told that banks and other financial institutions over-reward their staff. We have also been told that ill-thought-out remuneration designs can lead to unfair transfers of value from companies, their shareholders and other stakeholders to executives, and they can also affect companies' long-term sustainability.[1] For this reason, in order to transform the bonus and excessive pay culture of European Banks, the European Commission has adopted a number of critical measures over the past few years.[2] These have proven popular on a continent struggling to

1 L Bebchuk and J Fried, 'Pay without Performance: The Unfulfilled Promise of Executive Compensation' (Harvard University Press 2004); S Thompson, 'Executive Pay and Corporate Governance Reform in the UK: What Has Been Achieved?' in R S Thomas and J G Hill (eds), *Research Handbook on Executive Pay* (Edward Elgar 2010).

2 Commission Recommendations 2004/913/EC, 2005/162/EC, 2009/385/EC (2013/36/EU) (CRD). <http://eurlex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2009:120:0028:0031:EN:PDF>.

emerge from the ruins of the recent and most catastrophic financial crisis. However, there is now great concern over the fate of the UK remuneration and bonus policies, particularly within the City of London; a city where the pay and bonus culture is a breeding ground for controversy and where the predominant remuneration 'ethos' is often viewed as a contributing factor for reckless and excessive risk-taking.[3] The reason for the concern is this: Europe has heavily influenced the UK's domestic rules, such as the malus provisions, bonus clawback and bonus caps. In fact, the UK Remuneration Codes derive much of their current form from the European regulations.[4] Topical and crucial questions therefore are: what will the UK's exit from the EU mean for the country's remuneration policies? Does the EU continue to influence the way UK-based firms remunerate their high-level employees and, if so, what would change following the public's decision to leave the EU?

It could be said that there are two sides to the same coin here.

On the one hand, in the UK's current political climate there is probably little appetite for introducing changes to the remuneration rules. There is a plethora of reasons for this. To start with, despite a succession of rules aimed at curtailing excessive rewards (particularly since the emergence of the 2008 financial crisis), there has not been a noteworthy decrease in senior executives' pay. On the contrary, pay has continued to increase despite the so-called shareholder spring of 2012.[5] Furthermore, businesses have dedicated significant time and effort adjusting to new rules and legislation. There is also the need to consider the impact that drastic changes can have on the investor community: irrespective of Brexit, investors need to feel confident that they operate within a favourable investment climate; any existing rules that help enhance investor confidence will not be abandoned so hastily. Britain is not experiencing the kind of political climate that would justify deserting policies that target poor remuneration policies and designs. Progressive measures have entered EU and UK law as part of a wider overhaul of capital rules in order to help strengthen investor protection, bring more stability into the banking system and reduce risky speculation. Why would the UK government want to deviate from the existing rules and willingly agree to undergo an extensive revision of its remuneration laws and regulations?

But there is also the other side of the coin. The side that suggests that Brexit can provide the perfect opportunity for the City to shine. Industry participants would argue that Britain can benefit from freeing itself of certain EU regulations, particularly those that the City did not want in the first place. Some of the more unwelcome areas of EU regulation, such as the controversial bankers' bonus cap under the Capital Requirements Directive (CRD) IV (2013/36/EU), could be altered or scrapped altogether and Brexit could finally grant Britain the chance to expand its global footprint without the need to obey a tsunami of EU directives.

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3 A Lui, 'Greed, Recklessness and/or Dishonesty? An Investigation into the Culture of five UK Banks between 2004 and 2009' (2015) 16(2) Journal of Banking Regulation 106.

4 These are implemented in the UK through the FCA Remuneration Code, which makes recommendations on the structure of remuneration for risk-taking staff and requires aggregate disclosure of amounts paid to these staff: FCA Remuneration Code, FSA's Senior Management Arrangements, Systems and Controls (SYSC) sourcebook <https://www.handbook.fca.org.uk/handbook/SYSC/3/>.

5 According to the latest data from the High Pay Centre, Britain's top executives have continued to receive pay rises despite greater scrutiny of executive rewards. The average pay for a FTSE 100 CEO rose to £5.480 million in 2015, an increase from £4.964 million in 2014 and significantly higher than the £4.129 million in 2010. The calculation was based on the 'single figure' pay disclosure of 62 top-flight firms that have published their remuneration reports for the 2015 financial year. This 'single figure' consists of the executive salary, bonuses, long-term incentives and pensions: 'The State of Pay: High Pay Centre Briefing on Executive Pay' (2016) <http://highpaycentre.org/files/The_State_of_Pay_2015.pdf>.

This article will focus on the possible impacts of Brexit on financial services regulation in relation to three areas linked to executive remuneration: the capping of banker's bonuses, a policy pushed forward by the Europeans as part of their most comprehensive banking reforms to date; the clawback of pay, by which money already paid is returned under certain conditions; and finally the level of disclosure required by shareholders regarding details of directors' remuneration and the extent to which shareholder approval is needed. The key question is whether these European initiatives can survive the Brexit currents or whether their 'demolition' will eventually prove unavoidable.

2 Britain: be aware of Brexit?

There is a firm framework in Europe regulating executive remuneration that mitigates the impact of excessive risk-taking. The EU regulators made a direct attempt to eradicate 'rewards for failure' in the financial sector through a variety of measures. Central to these is the CRD IV which is directly applicable to firms across the EU and implemented through national law and the Capital Requirements Regulation (CRR).[6] The purpose of the CRD IV package is to provide a 'single rulebook' across the EU covering regulatory capital requirements, corporate governance and penalties. CRD IV brings the EU into line with the Basel III rules on banking standards, which introduce greater requirements for the quality and quantity of capital, new rules for counterparty risk, new liquidity and leverage requirements, and new macroprudential standards including a countercyclical capital buffer and capital buffers for institutions that systematically demonstrate their significance. They also contain changes to rules on corporate governance, including remuneration, and introduce a standardised EU regulatory reporting.[7] According to the CRD IV, banks and investment firms must implement remuneration policies that are consistent with effective risk management. Remuneration policies must not promote risk-taking that surpasses the level of accepted risk of a particular institution. In addition, a clear distinction must be drawn between the criteria for setting fixed and variable pay: fixed remuneration must be permanent, predetermined, non-discretionary and non-revocable, whilst variable pay must depend on performance. Institutions must be in a position to explain and justify to their stakeholders the use of any variable remuneration component. These rules are binding on all EU member states and apply to all EU banks, the EU operations of foreign banks and institutions, and third-country subsidiaries of EU banks (but largely not hedge funds, which are governed by separate legislation). They give the right to national banks and financial supervisory authorities to take action against any financial institution that fails to comply and allow national supervisors to impose penalties either to restrain discovered breaches of the new rules or to remedy their causes.

Significantly, central to the directive's measures are 'malus' (the adjustment of an award of variable remuneration before it has vested), 'clawback' (the return of money already paid to employees under certain conditions), 'bonus caps' (capping the bonus payments of senior staff in financial institutions) and, last but not least, 'remuneration disclosure' (the level of disclosure required by shareholders regarding details of directors' remuneration and the extent to which shareholder approval is needed). In looking at these

6 (575/2013).

7 Basel III is an overhaul of banking rules and the biggest shake-up of the banking system since the global financial crisis. Before its implementation, the lack of solid financial cushions meant that many banks were at risk, requiring taxpayer-funded bailouts to avoid collapse. Basel III focuses on a ratio of high-quality capital – called tier 1, which is needed to protect it against any future shocks. The high-quality capital will increase to 9 per cent after the rules come into effect: Commission Recommendations (n 2).

measures in more detail, unless otherwise specified, up to 100 per cent of variable pay must be subject to malus or clawback arrangements, a particularly useful tool in circumstances where the employee took part or was responsible for conduct resulting in significant losses to his/her institution or failed to adhere to the appropriate standards of fitness and propriety. In addition, bankers' bonuses are to be capped; the maximum pay-out is set at a year's salary, and this can increase to two years' salary with shareholder approval.[8] In other words, provided two-thirds of shareholders approve, bonuses for regulated staff are capped at 200 per cent of salary; in the absence of such an agreement bonuses are capped at 100 per cent of salary. The other area of executive remuneration addressed by the EU is disclosure of directors' remuneration: a European Shareholder Rights Directive (2007/36/EC) and new EU rules extend shareholders' right to vote under the 'say-on-pay' provisions.[9]

Britain derives its rules on executive pay from domestic as well as EU legislation.[10] Matters related to executive remuneration were first given attention in 1995 following a period of public dissatisfaction on the levels of directors' pay. The result was the Greenbury Code Directors' Remuneration, Report of a Study Group,[11] which recommended establishing remuneration committees of non-executive directors to decide on levels of remuneration and on particular pay packages. The aim was to introduce an element of independence in deciding the level of the executive's pay. The report's recommendations were later incorporated into the UK Listing Rules and the UK Corporate Governance Code 2012.[12] Crucially, the last few years have seen an explosion of reforms to the regulation of the UK's financial industries, including changes to remuneration and bonuses rewarded to executives of large financial institutions. These reforms were heavily influenced by the EU; it is EU initiatives that have affected the domestic requirements (such as the clawback and malus provisions) of the UK Corporate Governance Code and the Investment Association's principles of remuneration. The current UK Remuneration Codes[13] derive much of their present form from European legislative packages and regulations, particularly CRD IV, and the practical details of CRD IV are set out in the revised SYSC Remuneration Code.[14] Importantly, all UK banks and building societies (and some investment firms) are also subject to the requirements of CRD IV.

8 The agreement is on a mandatory 1:1 ratio on salary relative to variable pay, which can rise to 2:1 with explicit shareholder approval.

9 The new EU rules extending shareholders' right to vote under the say-on-pay provisions are to be found in Directive (EU) 2017/828 of the European Parliament and of the Council of 17 May 2017, amending Directive 2007/36/EC as regards the encouragement of long-term shareholder engagement.

10 There are currently over 100,000 items of UK legislation in the UK which have their origins in EU treaties. It is not clear whether these pieces of legislation will remain as they are, be repealed, or come to an end as a result of Brexit. What happens next is a question the UK Parliament will inevitably face in the years to come.

11 Chaired by Sir Richard Greenbury (1995).

12 UK Corporate Governance Code (2012), s D.

13 There are five Remuneration Codes in the UK tailored to different types of firm: SYSC 19A – IFPRU Remuneration Code; SYSC 19B – AIFM Remuneration Code; SYSC 19C – BIPRU Remuneration Code; SYSC 19D – Dual-regulated Firms Remuneration Code; SYSC 19E – UCITS Remuneration Code. The Codes apply to more than 3000 firms, including banks, building societies, large full-scope UK alternative investment fund managers, CRD investment firms such as broker-dealers, investment managers, corporate finance, private equity and venture capital firms, and operators of multilateral trading facilities and management companies of undertakings in collective investments in transferrable securities.

14 In recent years, we have seen the implementation of CRD III and IV, AIFMD, UCITSv and Solvency II, all of which encompass regulation linked to remuneration. These rules that have already been implemented in UK regulation.

And yet, the future of many of the aforementioned areas remains uncertain following Brexit. Uncertainty is not a welcome prospect; the health of the UK economy largely depends on the design of its financial services industry, an industry that accounts for approximately 8 per cent of UK gross domestic product (GDP). In this regard, in the short-to-medium term nothing will change. Still, what happens next matters greatly. Following the country's notice of its exit, a transitional period will follow, during which the UK's future relationship with the EU will be negotiated. Where EU law has been incorporated into primary UK legislation no change will happen. But under the terms of the European Communities Act 1972, EU law can take the form of secondary legislation; such secondary legislation can fall away unless deliberately retained. According to a detailed briefing published by the House of Commons Library concerning the process for the UK leaving the EU, there are provisions of the CRD IV that do not derive from Basel III proposals, but rather from the EU's own policy; amongst these are those relating to corporate governance and remuneration. Upon Brexit, the UK will be free to rid itself of any unwanted provisions without deviating from the Basel III requirements. This means that the aforesaid European-inspired steps, solid as they are, might not survive the Brexit currents; some parts of EU regulation could be altered or scrapped altogether.

The following section will examine three key areas of the UK corporate governance framework that are derived directly from EU initiatives – namely, clawback, caps on bonuses and remuneration disclosure – and will consider whether their post-Brexit 'evaporation' is at all likely.[15]

2.1 Brexit and its impact on 'clawback'

A clawback provision is a special contractual clause by which money already paid to employees must be paid back under certain conditions. Put simply, clawback makes someone give something back. In the employment context, it is triggered when an employer claims repayment of remuneration which has already been paid to an employee upon the happening of specified circumstances. In practice, this normally relates to the repayment of cash, stock or other assets already awarded to an employee. An invaluable tool, it permits firms to instruct executives to return their bonuses under the presence of certain conditions. Bonuses are normally given annually in cash, and frequently in the City of London big parts of bonuses are paid under a different type of arrangement, commonly referred to as the 'deferred incentive plan'. It is these deferred incentive plans that, in practice, are being clawed back. What this means is that performance is measured over a period of time with the bonus being delayed accordingly, thereby granting the employee an incentive to perform well within a specific role. Where a bonus is paid on the basis of performance which subsequently turns out to have been miscalculated, it can be clawed back. This happened recently when directors of Lloyds Bank were asked to return large parts of their bonuses as a result of the bank's decision to pay compensation

15 For an excellent discussion on the remuneration policies in the EU, see Ellis Ferran, 'Crisis-driven Regulatory Reform: Where in the World is the EU Going?' in E Ferran, N Moloney, J G Hill and J C Coffee Jr (eds), *The Regulatory Aftermath of the Global Financial Crisis* (Cambridge University Press 2012); Guido Ferrarini and Niamh Moloney, 'Executive Remuneration in the EU: The Context for Reform' (2005) 21 Oxford Review of Economic Policy 304; For an in-depth evaluation, see T Boeri, C Lucifora and K J Murphy (eds), *Executive Remuneration and Employee Performance-Related Pay: A Transatlantic Perspective* (Oxford University Press 2013) 92. For a more general discussion, see Jaap Winter, 'Corporate Governance Going Astray: Executive Remuneration Built to Fail' in Thomas and Hill (n 1); D Arsalidou, *Rethinking Corporate Governance in Financial Institutions* (Routledge 2015). For a thorough discussion of executive remuneration in the UK and its theoretical underpinnings, see M Petrin, 'Executive Compensation in the United Kingdom – Past, Present, and Future' (2015) 36(7) The Company Lawyer 196; D Arsalidou, 'The Regulation of Executive Pay and Economic Theory (2011) 5 Journal of Business Law 431.

in excess of £3.2 billion to customers who were wrongly sold payment protection insurance.[16]

In the revised UK Corporate Governance Code of 2014, a significant amendment was introduced by the Financial Reporting Council (FRC): firms are now required to include provisions enabling performance adjustment or post-vesting clawback for the variable pay of executive directors (including bonuses and long-term incentives). Firms must also include details of the exact circumstances that entitle remuneration committees to act, should they deem necessary. This differs greatly from the wording used in the previous Corporate Governance Code that granted remuneration committees the power to act 'in exceptional circumstances of misstatement or misconduct'. Now, it is up to individual companies to determine the circumstances that would justify interference by their remuneration committees. As a consequence, many companies will need to strengthen their policies. Even though the majority of companies already have measures in place concerning the clawback of pay under specified conditions, not many include provisions regarding the clawing back of payments already granted. With the toughening-up of the clawback rules, firms are required to define their policies in relation to issues such as the precise circumstances that would provoke clawback, the time limit of the clawback risk and the design of variable deferred pay (that should ensure that sums are withheld or recovered). Crucially also, the Prudential Regulatory Authority (PRA) has recently issued a final policy statement on bonus clawback, together with an instrument making various changes to the Remuneration Code. With effect from 1 January 2015, PRA-authorised firms are required to amend their employment contracts to ensure that bonuses which have already been paid to their employees can be clawed back where necessary.[17] In particular, they are required to clawback bonuses where there is evidence of employee misbehaviour, where the firm or relevant business unit suffers a material downturn in its financial performance, or where the firm or relevant business unit suffers a material failure of risk management. In addition, firms must set the specific criteria for the application of malus and clawback and must also ensure that the criteria for the application of malus and clawback include instances where the employee took part in or was responsible for conduct which resulted in significant losses to the firm, or behaved in a way which failed to meet the appropriate standards of fitness and propriety.[18]

There remain a number of pending questions, particularly in relation to the scope and enforceability of clawback provisions. In addition, there are outstanding technical matters, such as how non-cash bonus awards are valued or whether clawback applies to the gross or net value of bonus awards. There are a number of sensitive issues too, such as which firms should be entitled to retrieve bonuses, as well as some controversial questions, such as the exact circumstances that should entitle firms to retrieve vested and paid bonuses, especially in relation to those granted seven to ten years earlier.

16 Attracta Mooney, 'UK Fund Executives' Pay Slashed: Brexit, Fund Outflows and Declining Profitability Put Pressure on Remuneration in 2016' *Financial Times* (London, 9 April 2017) 8.

17 The PRA, created as a part of the Bank of England by the Financial Services Act (2012), is responsible for the prudential regulation and supervision of around 1700 banks, building societies, credit unions, insurers and major investment firms. The objectives of the PRA are set out in the Financial Services and Markets Act 2000. It has three statutory objectives:

1. a general objective to promote the safety and soundness of the firms it regulates;
2. an objective specific to insurance firms, to contribute to the securing of an appropriate degree of protection for those who are or may become insurance policyholders; and
3. a secondary objective to facilitate effective competition.

18 PRA, r 15.21.

Unsurprisingly, there has been some opposition to use of clawback as an effective governance tool; for instance, the British Bankers' Association challenged this practice primarily on the grounds that it is unfair and potentially unenforceable. It suggested that introducing changes to employment contracts retrospectively, violates employment law in countries where UK banks function and operate. It also claimed that such a policy can destroy results-based pay, causing an increase in the overall pay awarded to executive directors.[19]

Still, there has not been much opposition to clawback, especially compared to numerous other corporate governance measures and initiatives. In fact, despite the controversies and outstanding technical questions, clawback provisions are now well embedded within the UK corporate governance ethos; the UK Corporate Governance Code firmly incorporates the requirement for malus and clawback in relation to executive variable pay (particularly bonuses and share plans) for all UK listed companies. Crucially, there is a high compliance level with the principles of the Code, and within this high level clawback clearly stands out. According to a 2017 survey examining the compliance of UK-based banks with the corporate governance principles, the majority of FTSE 350 firms have implemented a rule that companies must adopt the necessary arrangements to permit them to recover or withhold variable pay. The figures paint a positive picture here: 91 per cent have already adopted a clawback provision that is linked to the annual bonuses awarded to executives, and 78 per cent have adopted a clawback provision linked to their long-term plans.[20]

All in all, amongst the many measures adopted by the FRC to transform the bonus and excessive pay culture of the UK, clawback plays a crucial part.[21] In fact, there is clear enthusiasm to improve and move forward with this provision, as shown by the fact that the Financial Conduct Authority (FCA), in a bid to combat misconduct, is considering mirroring the PRA's clawback scheme with respect to FCA-regulated firms and also extending clawback to bankers' basic salaries (as opposed to solely bonuses).[22] Designed properly, this practice can act as an imperative device for corporate accountability. The appetite here is for strengthening rather than weeding out the clawback provision.[23]

19 'BBA response to Prudential Regulation Authority Consultation on Clawback CP6/14' <www.BritishBankers'Association+clawback>.

20 Corporate Governance Review <www.grantthornton.co.uk/globalassets/1.-member-firms/united-kingdom/pdf/publication/corporate-governance-review-2017.pdf>. The review includes a comprehensive analysis of annual reports of the companies in the FTSE 350 and covers 305 out of 350 FTSE companies. Amongst other matters, it assesses compliance with the disclosure requirements of the UK Corporate Governance Code 2016 (and 2014 where applicable), considers the quality and detail of explanations, and draws attention to best practice and emerging trends in narrative reporting.

21 Others would include boardroom diversity and the disclosure of long-term viability statements.

22 As Wheatley explains, this is primarily because there is a tendency for employers to pay their employees higher basic salaries – a direct consequence of the CRD IV bonus cap. PRA-authorised firms must now ensure that bonuses are subject to clawback for a period of up to seven years after vesting. However, this change does not have retrospective effect: it applies only to bonuses awarded on or after 1 January 2015. Moreover, firms will not have to clawback bonuses where there is a material downturn in financial performance, but they will where either (i) there is reasonable evidence of employee misbehaviour or material error, or (ii) the firm or relevant business unit suffers a material failure of risk management: Martin Wheatley, 'FCA Issue Rules and Guidance on Bankers Remuneration and Clawback Obligations' <www.kingsleynapley.co.uk/comment/blogs/employment-law-blog/fca-issue-rules-and-guidance-on-bankers-remuneration-and-clawback-obligations> (*Kingsley Napley*, 10 July 2017).

23 Another indicator that there is appetite for strengthening the provisions lies in a new proposal by the FCA and PRA that firms should be entitled to extend the clawback period for senior managers for up to 10 years in the event of an internal or regulatory investigation.

2.2. Brexit and its impact on 'caps on bonuses'

Perhaps the most high profile of Europe's laws and regulations is the cap on bonuses.[24] Adopted in 2014, the cap limits bonuses to 100 per cent of salary, or 200 per cent with shareholder approval. This marks a momentous change; previously there was no legal pay limit on bank executives, who could earn performance bonuses many times their base salaries. The cap on bonuses is a direct result of the strong public frustration that had grown across Europe over excessive pay rewards: excessive bonuses, many endlessly argue, encourage executives to care very little about the long-term future of their institutions.[25] Indeed, for many in Europe, bankers, and especially Anglo-Saxon bankers, are inherently gluttonous, careless and self-seeking. There is a general perception that there exists a system of rewards that encourages excessive risk-taking and short-sighted behaviour with little regard to the damaging effects of short-term actions. The idea therefore is that the cap can help suppress these undesirable behavioural traits; it can discourage excessive risk-taking whilst motivating executives to think carefully and prudently about the long-term prospects and profitability of their institutions.

Nevertheless, the UK banking industry has not been too supportive of the idea of imposing caps on bonuses; for instance, the head of trading at ETX Capital in London argued that, as a result of the cap, banks risk losing their top talent.[26] Most crucially, the UK government made a formidable attempt to oppose its implementation; it argued that it would be relatively easy to find ways around the restrictions and that, in limiting bonuses, banks would either raise salaries or come up with alternative ways to pay their executives.[27] Caps on bonuses can easily backfire, driving up fixed salaries to compensate. Firms that are not obligated to stay within the EU will be incentivised to leave and, when banks invest in future divisions, the investments will be based outside the EU. It is therefore important that any new regulation is flexible enough to permit banks to compete and prosper whilst based in the UK.

Eventually, Britain had to conform to the established position once statute passed. Notwithstanding the various challenges from London, the UK failed to garner enough support to prevent legislation on the issue. In fact, the bonus cap has been in effect since January 2014. Still, there continues to be plenty of scepticism towards this policy within the UK. This is hardly surprising; the UK hosts Europe's biggest financial services

24 For a detailed evaluation of the 'problematic' nature of the bonus cap, see K Asai, 'Is Capping Executive Bonuses Useful?' (Working Paper, Monetary and Capital Markets 2 WP/16/196 International Monetary Fund 2016); A Kleymenova and I Tuna, 'Regulation of Compensation' (WP 16/07 University of Chicago Booth School of Business 2017) 1. Also see 'Cap and Flayed – Europe Looks Set to Limit Bank Bonuses' *The Economist* (London, 23 February 2013) 13; Jane DeAnne, 'The Future of Executive Pay' *Financial Times* (London, 3 August 2012) 5.

25 For instance, according to a research study examining the effects of bonuses in 67 European banks, excessive financial sector bonuses caused banks to earn more in the short term but also led to unsustainable risks that eventually materialised in the financial crisis: Matthias Efing, Harald Hau, Patrick Kampkotter and Johannes Steinbrecher, 'Incentive Pay and Bank Risk-taking: Evidence from Austrian, German, and Swiss Banks' <www.eeassoc.org/doc/upload/BANK_BONUSES_ENCOURAGED_EXCESSIVE_RISK-TAKING-_New_evidence_from_the_Austrian,_German_and_Swiss_financial_sectors20150822215351.pdf>.

26 As stated by Joe Rundle, the head of trading at ETX Capital in London: see 'EU Banker Bonus Cap "self defeating"' (*BBC News*, 28 February 2013) <www.bbc.co.uk/news/business-21621045>.

27 George Osborne, the then Chancellor of the Exchequer, lodged a complaint in the European Court of Justice in 2013, arguing that the EU banker bonus cap is misconceived but conceded defeat a year later when he abandoned the legal challenge to overturn the cap: Court of Justice of the European Union No 154/14, 20 November 2014 <https://curia.europa.eu/jcms/upload/docs/application/pdf/2014-11/cp140154en.pdf>.

centre.[28] Nevertheless, London's position is threatened by the imminent move of Morgan Stanley to Frankfurt after Brexit. Other banks, such as Goldman Sachs, Standard Chartered, Daiwa, Sumitomo Mitsui, Nomura of Japan, VTB of Russia and Woori Bank of South Korea, will be expanding their Frankfurt offices. Brussels, Dublin and Paris are also vying for a share of London's banking sector.[29] The bonus restrictions could, in the long run at least, cost jobs in the City, pushing financial institutions to establish themselves in more favourable countries. A self-defeating policy such as this would see the City of London's overseas rivals exploiting this opportunity for their benefit, undermining EU support in Britain.[30] Certainly, from the perspective of the cap's opponents (such as the UK banking industry and the FSA), this is a good time for Britain; the UK's exit from the EU could mean that UK-based banks can be freed from the EU's heavy and unnecessary restrictions on bonuses. Through Brexit, Britain could reinforce its position within the global financial markets, expanding its global footprint without the need to conform to unnecessary and restrictive EU rules.

The UK might decide to abandon the cap, as the case may be; this could be viewed as Britain's golden opportunity to rid itself of a measure that it has always strongly opposed. Those in financial occupations in London and elsewhere will be pleased with this prospect; many consider Brussels to be incorrigibly antagonistic to free markets, oblivious as to how accomplishment is actually attained within them. By abandoning the cap Britain will highlight the fact that there is a fine line between pleasing the crowds and chasing business out of town.[31] Freedom from the cap could make Britain more competitive, particularly as against other large financial markets, such as the USA, which have not followed suit. This is evidently crucial; according to a study conducted by the Bank of England in 2015, since 2013 bonuses have climbed relatively higher in the USA than those in London.[32] The study also underlines the fact that numerous large international banks, such as HSBC and Barclays, are displeased with the cap because of its application to employees more widely (provided a bank has its base in the EU). This makes it more difficult for them to employ and hold on to high-level employees in competitive cities like New York.[33] There is yet another and perhaps more compelling reason here: the cap does not appear to function as originally intended. According to the aforementioned Bank of England study (interestingly conducted a year after the cap was implemented), because of the bonus cap there has been a growth in fixed remuneration as a proportion of total remuneration. In other words, the cap has resulted in bankers' salaries rising as a result of firms refusing to cut pay – at present fixed pay makes up more than 50 per cent of high-level bankers' overall pay, up from less than 10 per cent in 2010.[34] These are the unintended and most detrimental effects of the bonus cap.

28 The UK is home to approximately 78 per cent of the European capital markets and investment banking revenue. Out of this 78 per cent, 55 per cent originates from the 27 countries of the EU. The UK also holds 37 per cent of Europe's assets under management, followed by France (20%) and Germany (10%): see Association for Financial Markets in Europe, 'Implementing Brexit: Practical Challenges for Wholesale Banking in Adapting to the New Environment' (AFME April 2017) <www.afme.eu/globalassets/downloads/publications/afme-implementing-brexit-2017.pdf >.

29 J Rankin, 'Banks and Companies Plan Expansion in Frankfurt after Brexit' *The Guardian* (London, 21 July 2017) <www.theguardian.com/business/2017/jul/21/banks-and-companies-plan-expansion-in-frankfurt-after-brexit>.

30 Arsalidou, *Rethinking Corporate Governance* (n 15).

31 Noted by a senior investment bank executive in an interview with *The Economist* (n 24).

32 Bank of England Research (2015) Q4 55 4 <www.bankofengland.co.uk/publications/Documents/quarterlybulletin/2015/q4.pdf>.

33 Ibid.

34 Ibid.

Yet still, given the present political climate, the government might prefer to retain this EU measure. Even if one accepts the economic argument for scrapping the cap, the current political ambience undermines the impetus for doing so. The continued uncertainty surrounding Brexit is likely to reduce the urgency to add more ambiguity into the mix. Popular sentiment, political pressure and general appearances will matter greatly in this debate. Britain is currently susceptible to systemic uncertainty emerging from Brexit; this is not the time to appear to *soften* the existing regime. Rather, the government might prefer to retain its present system, a system that appears to adopt a consistent approach to pay within the European continent and that, in turn, plays its part in securing a level of confidence within the domestic and international contexts.[35] In fact, the increasing public disarray over Brexit[36] might even result in remuneration levels decreasing – not because of the legal consequences of Britain leaving, but due to pressure upon industry and government to take prudent decisions within prominent and controversial fields, executive remuneration being a key one here.[37] Otherwise we may see London salaries as well as bonuses rising if elements of CRD IV, the EU's banking remuneration regulations, are repealed, an alternative that the UK government would undoubtedly wish to avoid.

2.3 Brexit and disclosure of directors' remuneration

Disclosure of information is said to address corporate governance weaknesses such as information asymmetry and promoting shareholders' voices.[38] It should be made clear at this point that one of the perceived weaknesses in current corporate governance practice (i.e. the causal link between high pay disparities and company performance) is not yet proven. The hypothesis that high pay disparities harm company performance has been debated on both sides by respected academics, scholars and organisations such as the Trade Union Congress and the High Pay Centre. The first step is to analyse whether executive pay is too high. The second step is to prove the causal link between high pay disparities and company performance. The evidence for both is inconclusive to date. A range of factors can influence company performance and executive remuneration is only one of them.

In banking, profitability is even more complex with some banks operating in different jurisdictions and markets. Return on equity, the level of interest rates, bank concentration and government ownership are some of the factors that may influence banks'

35 For an interesting discussion on this issue, see: Niamh Moloney, 'The EU and Executive Pay: Managing Harmonization Risks' in Thomas and Hill (n 1) 466.

36 An increasing number of people think that voting to leave the EU was not a good idea, according to a new poll. The YouGov poll, conducted for *The Times* newspaper in 2017, shows the highest proportion of people regretting the result since the referendum in June 2016, with 47 per cent of respondents suggesting that the UK should not have voted to leave compared with 42 per cent who think it was the right decision: YouGov Poll <https://d25d2506sfb94s.cloudfront.net/cumulus_uploads/document/cbirgnop2j/YG%20Trackers%20-%20EU%20Tracker%20Questions_W.pdf>.

37 As noted in the *Financial Times*, the chief executives of Britain's largest listed fund houses saw a substantial reduction of their pay after the Brexit vote in 2016. This is possibly a result of declining profitability and investor outflows that placed significant pressure on executive pay packages. For example, in 2016 the total amount paid to the chief executives of Jupiter, Ashmore, Aberdeen, Henderson and Intermediate Capital Group decreased by between 10 and 65 per cent, as a result of significant cuts in bonuses. A strong factor contributing to this is the significant market chaos that followed the Brexit vote as well as the election of Donald Trump as US president in November 2016. This resulted in low profitability levels that were actually lower than those in 2015. Consequently, there has been a lot of pressure on pay and executive bonuses in the past year or so, pressure that is likely to go on for longer: Mooney (n 16).

38 Department for Business, Energy and Industrial Strategy Committee, *Corporate Governance*, Third Report of Session (HC 2016–17) ch 2.

profitability.[39] Research into the profitability of banks in the EU has only been undertaken recently. This is unusual given that the EU accounts for approximately 25 per cent of global GDP. It also has a sophisticated wholesale financial services sector, which generates over 30 per cent of the world's wholesale financial services activity.[40] Earlier studies by Berg et al,[41] Pastor et al,[42] Lang and Welzel,[43] Lozano-Vivas,[44] and Dietsch and Lozano-Vivas[45] focus mainly on a small range of banks in Norway, Sweden, Finland, France, Germany and Spain. Later research by Altunbas et al,[46] Bikker,[47] Maudos et al,[48] and Schure et al[49] covers a broader spectrum of EU banks.

Three recent scholarly papers[50] have been cited regularly to support the argument that general executive pay is too high and unrelated to company performance.[51] A critical analysis of these papers will reveal that there are limitations with these studies. The common weakness is that all three papers do not take equity incentives into account. The paper by Cooper et al[52] is not about equity incentives but total pay (which includes salary and bonus). The papers by Philip[53] and Florackis and Balafas[54] only researched into newly granted shares and options. Yet, directors are usually incentivised by shares which have already been granted. Further, the three studies do not take into account of company size or establish the causal link.[55]

In the UK, academics are inconclusive on whether executive remuneration led to distortion of incentives or whether there was too much emphasis on short-termism.

39 P Molyneux and J Thorton, 'Determinants of European Bank Profitability' (1992) 16(6) Journal of Banking and Finance 173.

40 AFME (n 28)

41 S Berg, F Forsund, L Hjalmarsson and M Suominen, 'Bank Efficiency in the Nordic Countries' (1993) 17 Journal of Banking and Finance 371.

42 J Pastor, F Perez and J Quesada, 'Efficiency Analysis in Banking Firms: An International Comparison' (Working Paper EC95–18 Instituto Valenciano de Investigaciones Economicas 1995).

43 G Lang and P Welzel, 'Efficiency and Technical Progress in Banking: Empirical Results for a Panel of German Banks' (1996) 20 Journal of Banking and Finance 1003.

44 A Lozano-Vivas 'Profit Efficiency for Spanish Savings Banks' (1997) 98 European Journal of Operational Research 381.

45 M Dietsch and A Lozano-Vivas, 'How the Environment Determines Banking Efficiency: A Comparison between French and Spanish Industries' (2000) 24 Journal of Banking and Finance 985.

46 Y Altunbas, E P M Gardener, P Molyneux and B Moore, 'Efficiency in European Banking' (2001) 45 European Economic Review 1931.

47 J Bikker, 'Efficiency and Cost Differences across Countries in a Unified European Banking Market' (DNB Staff Reports No 87 De Nederlandsche Bank 2002).

48 J Maudos, J M Pastor, F Perez and J Quesada, 'Cost and Profit Efficiency in European Banks' (2002) 12 Journal of International Financial Markets, Institutions and Money 33.

49 P Schure, R Wagenvoort and D O'Brien, 'The Efficiency and the Conduct of European Banks: Developments after 1992' (2004) 13 Review of Financial Economics 371.

50 C Philip, 'Restoring Responsible Ownership – Ending the Ownerless Corporation and Controlling Executive Pay' (High Pay Centre September 2016); M J Cooper, G Huseyin and R P Raghavendra, 'Performance for Pay? The Relation between CEO Incentive Compensation and Future Stock Price Performance' (Unpublished Working Paper 2016); C Florackis and N Balafas, 'CEO Compensation and the Future Shareholder Returns: Evidence from the London Stock Exchange' (2014) 27 Journal of Empirical Finance 97.

51 A Edmans in Department for Business, Energy and Industrial Strategy Committee, Corporate Governance (n 38).

52 Cooper et al (n50)

53 Philip (n 50).

54 C Florackis and N Balafas, 'CEO Compensation and the Future Shareholder Returns: Evidence from the London Stock Exchange' (2014) 27 Journal of Empirical Finance 97.

55 Edmans (n 51).

Gregg et al[56] analysed pay in the UK financial industry. They concluded that, whilst pay is high in financial organisations, the cash-plus-bonus pay-performance sensitivity of financial firms is not significantly higher compared to other industries. Their results showed that RBS had the highest total compensation in 2000 amongst the big four UK banks. By 2006, however, Barclays had the highest total compensation. Gregg et al are not convinced that the incentive structure in bankers' pay led to excessive risk-taking. One must note, however, that their results did not include equity incentive payments. In the UK, Sir David Walker[57] criticised the role of non-equity incentive payments for not relating to long-term profitability. Perhaps this explains the focus on cash bonus in Gregg et al's study.

One then wonders why both the EU and the UK regulations (Shareholder Rights Directive (2007/36/EC); CRD IV; the Large and Medium-sized Companies and Groups (Accounts and Reports) (Amendment) Regulations 2013 and the Companies Act 2006) ask for disclosure of directors' remuneration if the above causal link is inconclusive to date. The authors submit three reasons why disclosure of directors' remuneration is important to good corporate governance. First, public trust in companies, especially banks, was eroded after the financial crisis of 2007–2009. Although the bashing of bankers and public outcry against bankers' remuneration have died down, the UK has one of the lowest trust levels in businesses in the Global 28 countries. Public trust in businesses in the UK was 45 per cent in 2017.[58] As a comparison, the USA has a 58 per cent trust rate; France has a 50 per cent trust rate; Spain just pipped the UK with a 46 per cent trust rate; and Germany has a 43 per cent trust rate.[59] The UK's trust rate has slipped 1 per cent compared to 2016. The general weak score can be explained by the public's dissatisfaction towards unfairness in executive remuneration and the tax arrangements of certain global companies.[60] Additionally, recent corporate scandals at BHS, Sports Direct, Tesco, Rolls Royce and BAE Systems further weakened the public's trust in companies. The perception of corporate entities and the unfairness felt by the public are important, especially with the uncertainty of Brexit looming over workers.[61] The truth is that the current political climate calls for social, responsible, stakeholder-led corporate governance in our society. Executive pay represents a very small proportion of expenditure for large companies (an estimated 0.6 per cent in the FTSE 100 companies).[62] Corporate boards have the difficult task of balancing the value added by directors against public sentiment and the overall values of the company.

The second reason why disclosure of directors' remuneration matters is because London's appeal as an international financial hub faces stiff competition from other European financial centres, which enjoy the single passporting scheme. In total, there are nine passporting rights covering a range of financial services. Each passporting right derives from an EU directive or regulation. For example, a UK-based bank might use a CRD IV passport to provide corporate advisory services, lending or deposit services to a business in another EU state. Banks established in the EU or European Economic Area

56 P Gregg, S Jewell and I Tonks, 'Executive Pay and Performance: Did Bankers' Bonuses Cause the Crisis?' (2012) 12(1) International Review of Finance 89.

57 D Walker, *A Review of Corporate Governance in UK Banks and Other Financial Industry Entities* (Her Majesty's Stationery Office 2009).

58 Department for Business, Energy and Industrial Strategy Committee (n 38).

59 Ibid.

60 Edelman Trust Barometer 2017; CIPD Pulse Survey, December 2015.

61 Department for Business, Energy and Industrial Strategy Committee (n 38).

62 Edmans (n 51).

(EEA) can establish branches in other EEA countries or provide financial services across the EEA without the need for further authorisation. Brexit transforms British banks into third-country banks. Brexit creates significant hurdles for banks in the EU and EEA when providing financial services in the EU since they lose the single passport advantages.

The alternative of obtaining a licence in each EU country is time-consuming and full of uncertainties. Not all EU countries provide licences. The scope of financial services operating under licences is limited and generally does not carry rights to onward cross-border trade from the country of licensing.[63] The licence regime is subject to the caveat that Britain's regulatory regime is accepted by the EU as 'equivalent' to the EU standards. It can be argued that as long as Britain sustains its current standards under the current range of EU directives and regulations the 'equivalence' regime should apply. The reality is that there are three problems. First, a declaration of 'equivalence' can be revoked within 30 days. A declaration can be full or partial, as well as subject to a time limit. Besides, there is no defined period as to when the European Commission must provide a decision when assessing 'equivalence'.[64] It took the European Commission four years to decide whether central clearing counterparties in the USA are equivalent.[65] This uncertainty does not assist banks in planning for the long-term. Secondly, the 'equivalence' regime is not available in certain core banking activities, such as lending, deposit-taking, credit cards and payments. Finally, and most importantly, there is no agreed definition of 'equivalence' as yet. This is still subject to an agreement between the EU and Britain. Much depends on how much control the EU wishes to retain over Britain's regulatory developments and Britain's ability to break free of particularly onerous provisions.[66]

Finally, disclosure of directors' remuneration is important because shareholders' ability to express dissatisfaction or veto executive remuneration is weak in the UK. Shareholders of public companies in the UK have the right to vote on *advisory* resolutions about executive compensation. The say-on-pay vote was introduced by the UK government to increase 'accountability, transparency, and performance linkage' of executive pay.[67] The advisory nature of such votes means that they are mainly symbolic. Indeed, Ferri and Maber[68] demonstrated that the advisory resolutions on executive compensation had no effect on the level and growth of chief executive officer (CEO) pay. They examined the effect of the say-on-pay legislation in a large sample of UK firms by comparing the determinants of CEO pay before (2000–2002) and after (2003–2005) its introduction. Nevertheless, their research revealed that there was heightened sensitivity towards poor performance, particularly in companies which had very high remuneration. The Enterprise and Regulatory Reform Act 2013 introduced a binding vote on say-on-pay to shareholders of quoted companies, but this is only available every three years in the UK. Using a large sample of binding and advisory votes in UK companies, Gregory-

63 British Bankers' Association 'What is "Passporting" and Why Does It Matter?' (BBA Brexit Brief #3 2016) <www.bba.org.uk/wp-content/uploads/2016/12/webversion-BQB-3-1.pdf>.

64 Directorate-General for Internal Policies, 'Third-Country Equivalence in EU Banking Legislation' (Economic Governance Support Unit 2016) <www.europarl.europa.eu/RegData/etudes/BRIE/2016/587369/IPOL_BRI(2016)587369_EN.pdf>.

65 Ibid.

66 J Ford, 'Financial Future after Brexit: Passporting v Equivalence' *Financial Times* (London, 12 January 2017) <www.ft.com/content/61221dd4-d8c4–11e6–944b-e7eb37a6aa8e>.

67 J Baird and P Stowasser, 'Executive Compensation Disclosure Requirements: The German, UK and US Approaches' (*PracticalLaw.com*, PLC Document 4–101–7960, 23 September 2002).

68 F Ferri and D Maber, 'Say on Pay Vote and CEO Compensation: Evidence from the UK' (2013) Review of Finance 527.

Smith and Mai[69] demonstrate that, even with a binding vote, it is unlikely that shareholder dissent will lead to a reduction in executive pay. The binding votes relate to the election of directors, both executive and non-executive, and the approval of long-term equity-based incentive schemes. The advisory vote relates to the annual advisory vote on the Directors' Remuneration Report. Gregory-Smith and Mai's results show that shareholders tend not to use binding votes to express disapproval of executive pay levels beyond the amounts merited by firm performance. Recent research by Correa et al[70] refutes this. Their research on both binding and advisory say-on-pay laws in 12 countries shows that they are associated with lower executive pay levels – only advisory say-on-pay laws tighten the sensitivity of executive pay to firm performance. Gerner-Beuerle and Kirchmaier[71] examine the impact of the UK's 2013 enhanced executive compensation disclosure rules on shareholders' say-on-pay votes. Using pay information disclosed by FTSE 100 firms, they found that shareholders focused on top-line salaries and seem to disregard the remaining information.

The binding say-on-pay vote to date is disappointing, although more time and research are required to provide more data, especially in the UK. The mixed results of say-on-pay on executive remuneration should not give rise to complete despondency for three reasons. First, the research by Ferri and Maber[72] and Correa et al[73] is encouraging because the advisory say-on-pay resolution has a positive impact on heightened sensitivity towards poor firm performance. Arguably, the evidence to date shows that most shareholders, apart from a few cases reported in the media, are not too unhappy with the level of executive pay. Rather, they are unhappy with the fact that directors should be paid high wages when the company is performing badly as a result of excessive risk-taking. Shareholders are understandably concerned that poor firm performance may lead to poor share returns. As such, high executive pay is not the main issue. The issues are more about the sensitivity of remuneration to company performance and a long-term pay structure.[74]

Secondly, it appears that say-on-pay has increased dialogues between companies and institutional investors.[75] Large institutional investors will have more time and resources than small individual shareholders to monitor directors' remuneration. Finally, the new UK Public Register of publicising listed companies which have faced significant shareholder rebellions or have withdrawn resolutions in 2017 is intended to have a deterrent effect. Although 'significant' is not defined in the new directors' remuneration reporting regime, it is understood from the Directors' Reporting Remuneration Guidance 2016 that it means at least 20 per cent of votes cast against a resolution.[76] Executive

69 I Gregory-Smith and B Main, 'Binding Votes on Executive Remuneration' (Working Paper 2014, Royal Economic Society Annual Conference).

70 R Correa and U Lel, 'Say on Pay Laws, Executive Compensation, Pay Slice, and Firm Valuation around the World' (International Finance Discussion Papers, Number 1084 Board of Governors of the Federal Reserve System, July 2013).

71 C Gerner-Beuerle and T Kirchmaier, 'Say on Pay: Do Shareholders Care?' (Discussion Paper no DP751, Financial Markets Group, London School of Economics and Political Science 2016).

72 Ferri and Maber (n 68).

73 Correa and Lel (n 70).

74 Edmans (n 51).

75 S Mason, A Medinets and D Palmon, 'Say-on-Pay: Is Anybody Listening?' (Annual Meeting Paper AAA 2012).

76 GC100 and Investor Group, *Directors' Reporting Remuneration Guidance* (2016) <https://uk.practicallaw.thomsonreuters.com/Link/Document/Blob/Ib127ccfd606f11e698dc8b09b4f043e0.pdf?targetType=PLC-multimedia&originationContext=document&transitionType=DocumentImage&uniqueId=e9b9418d-73bd-4ec4-bd8d aceebae904d6&contextData=(sc.Default)&firstPage=true&bhcp=1>.

remuneration continues to be of interest for some shareholders. In 2017 38 per cent of resolutions related to annual remuneration reports or policies received significant votes against or were withdrawn. Apart from having a deterrent effect, this Public Register has the benefit of publicising how a company will respond to shareholders' concerns, thus increasing dialogues between the parties. Therefore, disclosure of information such as directors' remuneration should allow more transparency and better communication between companies and individual shareholders.

The evidence from 2017 shows that some shareholders do utilise the disclosed information for voting purposes. Nevertheless, one needs to monitor the future percentages of resolutions cast against annual remuneration to achieve a more accurate correlation between disclosure of executive remuneration and shareholder activism. The literature to date on shareholder activism casts doubt upon the efficacy of shareholder activism due to dispersed ownership in the UK. In 2014, overseas shareholders owned around 53.8 per cent of shares in the UK market.[77] Dispersed ownership in the UK makes it difficult for individual investors to monitor companies. With Northern Rock, 144,000 of the 180,000 shareholders were found to be individual investors with small shareholdings.[78] They lacked information or influence to monitor the board's performance. Coupled with short-termism of shareholders where the average period of share ownership is six months,[79] shareholders face significant hurdles in taking an active part in monitoring directors.[80] The implementation of the Stewardship Code in 2011 has increased shareholder participation by 68 per cent.[81] Good voting turnout at annual general meetings (AGMs) does not necessarily lead to better engagement, since shareholders can purely make noise rather than constructive suggestions. Nonetheless, shareholder engagement in some UK companies, such as Aviva, AstraZeneca and WPP during the shareholder spring in 2012 shows that shareholders can play a positive role in corporate governance by challenging executive pay packages.

2.3.1 Opportunities for improvements

Disclosure of directors' remuneration is thus justified for good corporate governance in light of the above three factors. It is also necessary for Britain's economy in light of Brexit. The European Shareholder Rights Directive was adopted in April 2017 and Britain has until March 2019 to implement it. Such implementation is, of course, not compulsory due to Brexit. However, UK law already contains similar provisions. Say-on-pay legislation is incorporated in the Enterprise and Regulatory Reform Act 2013, the Large and Medium-sized Companies and Groups (Accounts and Reports) (Amendment) Regulations 2013 and the Companies Act 2006 (Strategic Report and Directors' Report) Regulations 2013. Essentially, quoted banks in the UK must have a binding say-on-pay resolution every three years and prescribe the requirements of the annual remuneration report and the minimum requirements of the directors' remuneration policy. The requirement of a company strategic report would provide shareholders with a holistic

77 Office for National Statistics, 'Ownership of UK Quoted Shares 2014' (Statistical bulletin 2015) <www.ons.gov.uk/economy/investmentspensionsandtrusts/bulletins/ownershipofukquotedshares/2015-09-02>.

78 S Wen and J Zhao, 'Corporate Governance and the Financial Crisis: Did the Theories Stand the Test?' (2010) 25 Journal of International Banking and Financial Law 612–17.

79 Ibid.

80 A Lui, 'Cross-border Share Voting and Improving Voting Chain Deficiencies in the 21st Century' (2015) 6(1) International Journal of Corporate Governance 70–85.

81 R Sullivan, 'Investors Falling Short as Active Owners' *Financial Times* (London, 11 September).

picture of the entire company's business model, strategy, development, performance and future prospects. Clause D.2.4 of the UK Corporate Governance Code invites shareholders to approve all long-term incentive schemes. Therefore, the direct impact of Brexit on disclosure of directors' pay is likely to be relatively minor.

There remains the important balance of attracting talent against a backdrop of calls for equality in society. The competitiveness and stability of Britain's financial industry are potentially affected by Brexit. As mentioned earlier, several American and Japanese banks are already moving or expanding their offices in Frankfurt in light of the loss of passporting rights. The increased competition might revive the argument that bankers need to be paid handsomely to retain talent in London. After all, how can banks in London attract talent when other European cities or international cities such as Hong Kong or Singapore are more appealing? Globalisation has without doubt[82] increased the remuneration levels in the financial industry. Research by Gabaix and Augustin[83] shows that between 1998–2003 American firms have grown in size due to globalisation. As a result of this growth, executive pay has also increased. High executive pay is argued to be justified because talent is more important in a globalised world[84] and that the 'scalability' of CEOs is different to that of average employees. Kaplan's data-driven study supports the notion that the market for talent determines CEO salary.[85] Their high salaries are justified because they increase the value of the companies they work for and they can be dismissed for poor performance. The average term for a CEO of a Standard and Poor's 500 company was six years in 2013 in comparison to eight years in 1998.[86] Kaplan's view contrasts to the established view in corporate governance that executive pay is linked to company performance.[87] In his opinion, the media tends to focus on the very high CEO pay and corporate scandals when the reality is not as sensational. Over the past 15 years, the median CEO pay has remained almost the same, but the *mean* CEO pay has decreased a great deal. CEO pay is therefore a reflection of supply and demand in the job market. Kaplan's results are supported by a UK study in 2016. A study into the executive pay of the CEOs of the FTSE 350 companies showed that the median pay was £1.9 million in 2014. This was a rise of 82 per cent since 2011. At the same time, however, increase of invested capital was less than 1 per cent.[88] Talent therefore drives executive pay.

One can argue that CEOs are only part of the bigger employee workforce in a company. Why treat CEOs in a special way? The answer is that there is evidence to show that CEOs matter in life and death. Two research papers of 2017[89] support the argument that CEOs bring positive impact to companies in the long-term. Flammer and Pratima's

82 Edmans (n 51).

83 X Gabaix and L Augustin, 'Why has CEO Pay Increased So Much?' (2008) 123 Quarterly Journal of Economics 49.

84 Ibid.

85 V Sumo, 'Are CEOs Overpaid? The Case Against' (*Chicago Booth Review*, 26 September 2013) <http://review.chicagobooth.edu/magazine/fall-2013/are-ceos-overpaid>.

86 Ibid.

87 B Holmström, 'Moral Hazard and Observability' (1979) 10 Bell Journal of Economics 74–91; M Jensen and K Murphy, 'Performance Pay and Top-Management Incentives' (1990) 98 Journal of Political Economy 225–64.

88 R Davies, '"Negligible" Link between Executive Pay and Firm's Performance, Says Study' *The Guardian* (London, 27 December 2016) <www.theguardian.com/business/2016/dec/27/negligible-link-between-executive-pay-and-firms-performance-says-study>.

89 C Flammer and B Pratima, 'Does Long-Term Orientation Create Value? Evidence from a Regression Discontinuity' (2017) 38(9) Strategic Management Journal 1827; A Edmans, V Fang and A Lewellen, 'Equity Vesting and Investment' (2017) 30(7) Review of Financial Studies 2229.

study shows that there is a causal connection between giving long-term incentives for executives and improved company performance. In particular, their results reveal that shareholders' proposals of long-term incentives to executives improve both firm value and operating performance. Company strategies and stakeholder relationships are also improved as a result of long-term incentives. The second paper by Edmans et al reinforces the long-term structure of executive remuneration. Their use of 'vesting equity' (the amount of stock and options scheduled to vest in a given quarter) leads to CEOs cutting investment on long-term research and design projects and increasing short-term earnings. Thus, they call for giving CEOs long-term incentives so that CEOs can implement long-term investments in research and design. CEOs contracts therefore affect real boardroom decisions.

Equally, a research paper of 2015[90] shows that the departure and death of CEOs can have negative impacts on company value and performance. Besides, a CEO's decision to introduce the use of new technology will have a bigger effect in a large company than in a smaller one.[91] The scalability of average employees is not entirely dependent on the company size. If the maximum number of cars an employee can fix is ten a day, it does not matter whether the company has 500 or 5000 cars. Rewards are thus higher for strategic and managerial talents than pure labour.

Nonetheless, the argument ignores the fact that poor strategies and management can have negative impacts on companies. The financial crisis of 2007–2009 has revealed several examples of poor strategies and management amongst certain UK banks.[92] Therefore, sensitivity of executive pay and company performance matters. The advisory say-on-pay proves to be effective in heightening this sensitivity. Once there is such sensitivity, shareholders will hopefully scrutinise the CEO's actions in more detail. Transparency and disclosure are thus necessary to give shareholders access to information to make informed decisions. Disclosure of directors' remuneration can work both ways. From a company's perspective, more information available to shareholders potentially gives them more ammunition to rely upon at AGMs. Companies should see this not as an inconvenience, but as an opportunity to open dialogues and discuss and resolve matters with shareholders. Nevertheless, more disclosure provides transparency which in turn should increase public trust and investor confidence.

It is important to note, however, that the disclosure should contain accessible information which an average person can understand. Disclosing copious amounts of information is neither sensible nor useful. UK law requires a great deal of disclosure by listed companies, as seen above. In the modern era where digital technology is increasingly popular, it is proposed that such disclosure should be made on digital platforms or mobile applications for shareholders to access. In late 2015, Jimmy Choo worked with Equiniti to produce the first digital platform allowing shareholders to vote online at AGMs. The AGM mobile application was created as a native app (Android and iOS). The app works by directly integrating with the AGM software, which contains information of a physical AGM, such as attendance, voting and presentations. Through the app, shareholders can ask questions and vote on resolutions. Shareholders' identities and credentials are verified. They also need to enter a 'meeting ID' code before they can

90 A Falato, L Dan and T Milbourn, 'Which Skills Matter in the Market for CEOs? Evidence from Pay for CEO Credentials' (2015) 61 Management Science 2845.

91 Edmans (n 51).

92 Lui (n 3).

vote online. Evidence from this Jimmy Choo online AGM reveals that shareholder engagement in 2016 was much better than for the physical AGM in 2015.[93]

Technology can thus improve shareholder engagement and there is interest from other companies in the development of online voting.[94] Publishing dense strategic and directors' reports in a traditional format does not appeal to busy, time-poor investors, especially individual investors. However, useful information from such reports can also be fed into mobile applications and be presented in accessible format. Many mobile applications utilise artificial intelligence such as machine learning and predictive analysis to monitor and predict users' preferences according to their search histories. The authors submit that it would be useful to have a mobile application that can send personalised, tailored disclosure of company information, such as directors' remuneration, strategy and company performance, to shareholders. Keywords, summaries and links to remuneration, strategy and performance should be accessible through the mobile app. Paper copies of reports should still be available for shareholders, but digital technology should allow shareholders to access such information at their convenience and be able to enjoy a more tailored format. By remembering and storing a shareholder's preferences and search histories, algorithms can personalise the reports.

Ultimately, directors' remuneration should be decided by company remuneration committees. It is not for governments to decide the level of executive pay. Regulation is often reactive, driven by political will rather than shareholders' wishes. The American experience in regulating executive pay for 80 years has taught us that a web of remuneration schemes was developed as a result of regulatory arbitrage. In brief, their attempt to regulate pay was unsuccessful and produced counterproductive payment schemes. It is right, however, for a government to increase stakeholders' influence on executive pay. The Conservative government has not adopted the call for an annual, binding say-on-pay vote. However, it will introduce secondary legislation to incorporate more disclosure requirements which will require listed companies to publish their annual pay ratios between CEOs and employees.[95] It also requires companies to explain in their strategic reports how directors comply with s 172 Companies Act 2006 and have regard to employees' interests. The government has asked the FRC to revise the UK Corporate Governance Code to be more specific about the steps that listed companies should take when they encounter significant shareholder opposition (likely to be 20 per cent or more) to remuneration and other resolutions. The tone of the government's response suggests that it will rely mainly on the 'comply or explain' style of the UK Corporate Governance Code. It is prepared, however, to be more prescriptive and legislate if the 'comply or explain' style fails to deliver. It is hoped that listed companies will comply with the new disclosure requirements as legislation can create its own problems. Much depends on the government's ability not to bow down to city lobbyists.[96] Finally, even if the disclosure requirements lead to a reduction of executive pay through a say-on-pay vote, they only cure one weakness of the bigger corporate governance framework in the UK and it might

93 S Ellen, 'AGM Innovation' (ICSA The Governance Institute 2016) <www.icsa.org.uk/knowledge/governance-and-compliance/analysis/september-2016-agm-innovation>.

94 Ibid.

95 Department for Business, Energy and Industrial Strategy, 'Corporate Governance Reform: The Government Response to the Green Paper Consultation' (2017) <www.gov.uk/government/uploads/system/uploads/attachment_data/file/640631/corporate-governance-reform-government-response.pdf>.

96 J Stone and J Watts, 'Brexit: Big Business and Banks are Dominating Formation of Brexit Warns Report' *The Independent* (London, 26 August 2017) <www.independent.co.uk/news/uk/politics/brexit-talks-negotiations-david-davis-corporate-banks-eu-lobbying-brussels-a7913131.html>.

not have a lasting effect. The success of the say-on-pay vote depends largely on shareholder activism. The fact is that overseas investors own 53.8 per cent of shares in UK listed companies.[97] Shareholder activism on a yearly basis, voting on executive remuneration in a dispersed ownership jurisdiction, is thus difficult.[98]

3 Conclusion

Legally, Brexit will have a limited impact on UK law on executive remuneration. This article looked at three specific areas of executive remuneration, namely: the bonus cap; the clawback of pay; and the level of disclosure required by shareholders regarding details of directors' remuneration and the extent to which shareholder approval is needed. A great deal of the law set out in EU directives and regulations is already implemented in UK legislation. Besides, public sentiment for equality in society and the general anxiety over the Brexit negotiations will probably maintain the status quo: certainly, in the foreseeable future until the outcomes of future trade deals are clearer. However, people's memories fade with time. Britain needs to compete with other important financial centres globally in a post-Brexit era. Competition is fierce and talent has become more important. Incentives are required to attract talent to London's financial sector. High executive pay is justified as CEOs' scalability is different to that of the average employee. Most shareholders accept the level of executive pay, contrasted with the public's anger towards unfairness in compensation and distrust of big companies. Sensitivity of executive compensation and company performance is heightened with advisory say-on-pay votes. Continuation of this should be pursued as it should encourage shareholders to engage more with companies, scrutinising CEOs' actions and decisions, leading to better corporate governance. Disclosure of directors' remuneration is required to provide more voice to shareholders. An opportunity arises with digital technology such as mobile applications. They may create better access to such information and personalised services. European legislation in corporate governance has addressed the issue of executive remuneration. Britain now has the choice to retain the status quo, or repeal part or all of the law on executive remuneration. In practice, much depends on political will and market forces. Brexit brings both challenges and opportunities to Britain. It is now up to the government and companies working together for a new Britain after Brexit.

97 Office for National Statistics (n 77).

98 For a discussion on how to improve shareholder engagement, see A Lui, 'Cross-border Voting Chains and the Case for Improving the Quality of Shareholder Engagement' (2015) 6 International Journal of Corporate Governance 70.

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Creeping compulsion to mediate, the Constitution and the Convention

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Abstract

The court backlog in some European countries has inspired the introduction of compulsory mediation schemes to deal with various commercial claims. The article reviews the developing jurisprudence from various courts throughout Europe, to assess the seemingly relentless public policy move towards compulsory mediation and the implications that this has for commercial parties in dispute, lawyers involved in the process and the administration of justice in Europe. The potential that such an approach could amount to a violation of the rights guaranteed by Article 6(1) of the European Convention on Human Rights, as enshrined within the European Convention on Human Rights Act 2003, and Article 40.3 of the Irish Constitution is analysed. The article ultimately discusses the optimal approach for the courts and the legislature to follow to strike the appropriate balance between strong encouragement and coercive compulsion that would avoid offending constitutional and Convention rights and foster a mediation culture.

Keywords: compulsory; commercial; mediation; Article 6(1); Human Rights Convention; Article 40.3; Irish Constitution.

1 Introduction

Mediation is neither a new nor a novel concept in Ireland. Provision for mediation has been made in various pieces of Irish legislation over the past three decades. In the area of family law, solicitors are required to discuss with their clients the possibility of engaging in mediation as an alternative to litigation.[1] Legislative provision for voluntary mediation has also been made to assist with a range of disputes between employers and employees,[2] landlord and tenant disputes,[3] personal injury disputes[4] and in the area of social inclusion.[5] Commercial Court judges possess the power to direct parties to consider

1 S 6, Judicial Separation and Family Law Reform Act 1989; s 6, Family Law (Divorce) Act 1996; s 20, Children Act 1997.

2 S 78, Employment Equality Act 1998; and s 24(1), Equal Status Act 2000. See also <www.workplacerelations.ie/en/Workplace_Relations_Services/Mediation_Services>.

3 S 164, Residential Tenancies Act 2004.

4 S 15, Civil Liability and Courts Act 2004.

5 See, for example, s 19, Disability Act 2005; and s 55, Social Care Professionals Act 2005.

mediation,[6] and commercial contracts frequently provide that the parties must first attempt to mediate their disputes, prior to issuing court or arbitral proceedings.[7]

The most recent and most significant legislative initiative is the Mediation Act 2017, which provides a legal framework for the use of mediation in civil and commercial disputes.[8] The Act covers a range of issues, including the requirement that a mediator and the parties sign an agreement to mediate, prior to the commencement of the mediation, dealing with practicalities, such as the manner in which the process will be conducted and the mediator's fee,[9] and this agreement delays proceedings under the Statute of Limitations until 30 days after the successful conclusion or unsuccessful termination of the mediation.[10] One of the most significant provisions in the Act is that a court may, on application by a party to proceedings or of its own motion where it considers it appropriate to do so, invite the disputing parties to consider mediation to resolve their dispute. In circumstances where the parties decide to engage in mediation, to facilitate the use of the process the court may adjourn the proceedings, make an order extending the time for compliance by a party with rules of court or with any other court order.[11]

While disputes are mediated in the 'shadow of the law', mediation is based on interests rather than rights and the consequent settlement agreement reached may be unrelated to the legal merits of the claim.[12] The mediation process itself is not subject to fair trial requirements, and parties, particularly those that are not legally represented, will not necessarily be protected by the law or by the accountability afforded by a public judgment and an independent judiciary. Courts ensure public accountability for those whose wrongful acts may otherwise go unnoticed and provide protection for weaker parties who seek justice against those who exercise power over them.[13] It is against this backdrop that Article 6(1) of the European Convention on Human Rights (ECHR) has a significant role in maintaining and upholding the important function of civil justice.

2 European Convention on Human Rights Act

Despite the absence of any requirement in the ECHR that it be incorporated into a domestic legal system, it does not itself have direct effect in Irish law in light of Ireland's

6 S 6(XIII), Rules of the Superior Courts (Commercial Proceedings) 2004.

7 While mediation is employed to resolve conflict in various fields, the focus of this article is on commercial mediation; the process that assists in the resolution of disputes between business parties. See E Carroll and K Mackie, *International Mediation: The Art of Business Diplomacy* (2nd edn, Kluwer Law 2006) 3–17. Mediation in this context may be defined as 'a flexible process conducted confidentially in which a neutral person actively assists parties in working towards a negotiated agreement of a dispute or difference, with the parties in ultimate control of the decision to settle and the terms of resolution', available at <www.cedr.com/news/?item=CEDR-revises-definition-of-mediation>.

8 The Mediation Act 2017 was signed into law on 2 October 2017 and commended on 1 January 2018. The Act reflects many of the Irish Law Reform Commission's recommendations in the report it published in 2010 on alternative dispute resolution, discussed further below.

9 S 7, Mediation Act 2017.

10 Ibid s 18.

11 Ibid s 16. This is consistent with Order 56A of the Irish Superior Court Rules, discussed below. The relevant provisions of the Act are discussed under the appropriate parts below.

12 See Deborah R Hensler, 'Suppose It's not True: Challenging Mediation Ideology' (2002) 1 Journal of Dispute Resolution 81–99, 96.

13 See M Cappelletti, 'Alternative Dispute Resolution Processes within the Framework of the World Wide Access to Justice Movement' (1995) 56 Modern Law Review 287, 288. See also R A B Bush, 'Efficiency and Protection, or Empowerment and Recognition? The Mediator's Role and Ethical Standards in Mediation' (1989) 41 University of Florida Law Review 253, at 281–2.

dualist approach to international law.[14] Individuals cannot rely upon it as binding authority in an Irish court and Irish courts do not have the power to grant a declaration under it.[15] The rights contained in the ECHR were enshrined in Irish law by the enactment of the European Convention on Human Rights Act 2003 (ECHR Act).[16]

As Ireland had a body of existing constitutionally protected rights, the ECHR rights comprised within the ECHR Act were to complement not supplement this, essentially involving the domestication[17] rather than the incorporation of the ECHR into Irish law. The ECHR Act requires the courts to interpret legislation in line with the ECHR insofar as it is possible to do so,[18] and requires certain public bodies to perform their functions in a manner compatible with the ECHR, unless precluded by law.[19]

In *Doran v Ireland*[20] the ECtHR pointed out that Article 13 of the ECHR[21] guarantees the availability of a remedy at national level to enforce the substance of Article 6 rights and freedoms in whatever form they may happen to be secured in the domestic legal order. The remedy, according to the court, must be effective in both law and practice. The ECHR Act provides that courts may make a declaration of incompatibility regarding a breach of a Convention right. Unlike a declaration that a law is repugnant to the Constitution,[22] a declaration of incompatibility has no effect on the continued validity and enforcement of that law, unless and until it is amended by the Irish legislature.[23]

In circumstances where counsel have argued that their client's rights under Article 6 ECHR have been violated, Irish judges have been vigilant in reminding them that the rights reflected in Article 6 ECHR are part of Irish law by virtue of the ECHR Act, and

14 See Suzanne Kingston, 'Impact of EU Human Rights Law and ECHR Law in Irish Courts' in Suzanne Egan, Liam Thornton and Judy Walsh, *Ireland and the European Convention on Human Rights: 60 Years and Beyond* (Bloomsbury Professional Dublin 2014) 111–12.

15 Article 15.2.1 of the Irish Constitution provides: 'The sole and exclusive power of making laws for the State is hereby vested in the Oireachtas [Irish legislature]: no other legislative authority has power to make laws for the State'; while Article 29.6 provides: 'No international agreement shall be part of the domestic law of the State save as may be determined by the Oireachtas.' For a discussion on the need for incorporating legislation, see Fiona de Londras and Cliona Kelly, *European Convention on Human Rights Act, Operation, Impact and Analysis* (Thomson Round Hall 2010) 5–9.

16 While the ECHR had persuasive effect in Irish law prior to the commencement of ECHR Act, the obligations in the Act do not apply where the actions complained of took place prior to the Act coming into effect. See *Dublin City Counsel v Fennell* [2005] 1 IR 604. For a discussion on the temporal scope of the ECHR Act, see de Londras and Kelly (n 15) 45–7.

17 Fiona de Londras, 'Neither Herald nor Fanfare: The Limited Impact of the ECHR Act 2003 on Rights Infrastructure in Ireland' in Egan et al (n 14) 40.

18 S 2, ECHR Act 2003.

19 Ibid s 3.

20 App no 50389/99.

21 Article 13 of the ECHR provides: 'Everyone whose rights and freedoms as set forth in this Convention are violated shall have an effective remedy before a national authority notwithstanding that the violation has been committed by persons acting in an official capacity.'

22 See Donncha O'Connell, 'The ECHR Act 2003: A Critical Perspective' in Ursula Kilkelly, *ECHR and Irish Law* (Jordans 2004) 3. See also Gerard Hogan, 'Incorporation of the ECHR: Some Issues of Methodology and Process' in ibid 21–8, for a discussion on the differences between the declarations of unconstitutionality and incompatibility.

23 S 5, ECHR Act 2003. For a discussion on the delay in enacting legislation where declarations of incompatibility have been granted, see Suzanne Kingston, 'Two-speed Rights Protection? Comparing the Impact of EU Human Rights Law and ECHR Law in Irish Courts' in Egan et al (n 14) 113. For an interesting discussion on the relationship of conflict and confluence between the Irish Constitution and the ECHR from the perspective of a High Court judge (now a judge of the Court of Appeal) writing extra-judicially, see Gerard Hogan, 'The Constitution and the Convention: Happily Married or a Loveless Co-existence?' in Egan et al (n 14) 73–86.

that the latter is the source of such rights. For example, in *Foy v An tArd-Chlaraitheoir*,[24] McKechnie J described the position of the Convention within Irish law as follows:

> It is a misleading metaphor to say that the Convention was incorporated into domestic law. It was not. The rights contained in the Convention are now part of Irish law. They are so by reason of the Act of 2003. That is their source. Not the Convention. So it is only correct to say, as understood in this way, that the Convention forms part of our law.

Similarly, Denham CJ in *MD (a minor) v Ireland*[25] stated:

> The claim, as pleaded, is simply that s. 3 is 'in breach of' the Convention. That formulation is not acceptable. It treats the Convention as if it had direct effect and presumes that the Court has the power to grant a declaration that a section is in breach of the Convention. It is clear from the judgments of this Court in *McD v L* [2010] 2 IR 199 that the European Convention on Human Rights Act 2003 did not give direct effect in Irish law to the European Convention on Human Rights. As Murray C.J. stated at page 248, 'The Convention does not of itself provide a remedy at national level for victims whose rights have been breached by reference to the provisions of the Convention'.

As Denham CJ illustrated, it is well established by the Irish Supreme Court that the ECHR may only be pleaded by reference to its limited incorporation through the ECHR Act. One must identify the precise statutory provision or rule of law that is being challenged, and the contentions regarding its compliance or otherwise with the ECHR must be based strictly on the interpretative obligation upon the courts, the duty on any organ of the state to act in a ECHR compliant manner, and/or the duty on the courts to grant a declaration of incompatibility regarding a precise statutory provision or rule of law.[26] Jurisprudential evidence reveals that the Irish courts have largely engaged with the ECHR within the limits of the Irish constitutional framework.[27] The remedies available where a breach of the ECHR Act occurs have been limited, and this is largely due to the failure of the Irish legislature to bring Irish law into compliance with the ECHR and this, it has been suggested, has inhibited the courts' approach.[28]

3 Costs sanctions and the compulsion to mediate

In circumstances where there is a significant risk of onerous costs orders being imposed on recalcitrant parties, it is likely that there will be a significant rise in the number of disputes being mediated.[29] If the Irish courts are to follow the same path as other jurisdictions, it is likely that commercial mediation will only become a prominent form of dispute resolution when heavy costs penalties are deployed by the courts. A judge of the

24 [2007] IEHC 470, para 93.

25 [2012] IESC 10, para 59.

26 Suzanne Kingston and Liam Thornton, *A Report on the Application of the European Convention on Human Rights Act 2003 and the European Charter of Fundamental Rights: Evaluation and Review* (Law Society of Ireland and Dublin Solicitors Bar Association 2015) 35. For a detailed discussion on the limitations of the ECHR Act in terms of the court's interpretive obligations, the obligations of state organs under the Act and the obligation of the courts to award a declaration of incompatibility where there is no alternative remedy to a breach of ECHR rights, see de Londras and Kelly (n 15) chs 4, 5 and 7 respectively.

27 Kingston and Thornton (n 26) 151.

28 Ibid 154.

29 For a discussion on the experience in England after the changes to the Civil Procedure Rules in light of the Woolf reforms discussed further below, see Antony Dutton and Daniel Perera, 'Mediation as a Cost-containment Device in the English Courts: Litigation Becomes the "Last Resort" in Dispute Resolution', *(Mediation Committee Newsletter*, IBA Legal Practice Division September 2006) 32.

Irish Commercial Court suggested over a decade ago that there may be costs implications for parties in certain circumstances where those parties refuse to even consider mediation, despite the absence of legislation at that time facilitating this.[30] Costs sanctions are now provided for in the Mediation Act 2017, under which a court may, where it considers it just to do so, take into account any unreasonable refusal or failure by a party to consider using mediation, or to attend mediation, when awarding costs in the proceedings.[31]

The provision for a costs sanction in the Mediation Act 2017 for an unreasonable refusal to mediate is consistent with the pre-existing position under the Rules of the Superior Courts (RSC) following amendments to them in 2010. In an effort to encourage the use of mediation and other alternative dispute resolution (ADR) processes other than arbitration as part of the courts process, statutory instrument 502 of 2010 (SI 502) introduced a new order 56A to the RSC. Under this rule, the court may, either on application of any of the parties to proceedings or of its own motion, order that proceedings or any issue therein be adjourned and invite the parties to use mediation or, where the parties consent, refer the proceedings or issue to mediation. A new rule 1B was added to order 99 RSC that provides for the court, where an order has been made, to have regard to the refusal or failure without good reason of any party to participate in mediation when awarding costs.[32] These rules also give further effect to the European Communities (Mediation) Regulations 2011[33] that support the framework for mediation of disputes within the European Union (EU) that have a cross-border element.

In *Irish School of Yoga Ltd v Henkel Murphy*,[34] a dispute relating to the termination of a franchise agreement, the High Court granted an order inviting the parties to use ADR to attempt to resolve their dispute under order 56A. Justice Laffoy remarked that:

> . . . prudence dictates that the parties should process the remainder of their differences through an ADR process. What is at stake in these proceedings is totally disproportionate to the costs which will be incurred in pursuing a High Court action . . . Accordingly, there will be an order under Order 56A inviting the parties to use an ADR process.[35]

30 The Irish Commercial Court is a division of the High Court. See Mr Justice Peter Kelly in Michael Tyrrell and Patrick Walshe, 'New Mediation Provisions Enacted' (*Mediation Committee Newsletter*, IBA Legal Practice Division April 2005) 21. Mr Justice Kelly subsequently remarked that he had never had to make a mediation-related costs order nor had a case where someone behaved unreasonably in relation to a request to mediate. See Mr Justice Peter Kelly, 'Speech delivered at the Mediation Works Symposium' (27 May 2008).

31 S 21, Mediation Act 2017.

32 The rule came into force on 16 November 2010 and is similar to the procedure in the Commercial Court mentioned above. As discussed below, England has a developed jurisprudence with regard to costs sanctions for an unreasonable refusal to mediate. In addition to SI 502/2010 introducing a new order 56A to the Rules of the Superior Courts, the likelihood of Irish courts following English decisions on costs sanctions is also supported by the broad provisions of order 99, Rules of the Superior Courts, and the advent of s 21 of the Mediation Act 2017. See also J Fox, 'Order 56A and the Cost Implications of Refusal to Engage in ADR' (*Bar Review* April 2007) 22–5.

33 This transposed Directive 2008/52/EC of the European Parliament and the Council of 21 May 2008 on certain aspects of mediation in civil and commercial matters (the Mediation Directive) into Irish law, available at <http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:32008L0052>. See Seán Barton and Heather Mahon, 'Ireland' in Michael Madden (ed), *Litigation and Dispute Resolution* (2nd edn, Global Legal Group) 138 <http://docplayer.net/37739689-Litigation-dispute-resolution.html>.

34 [2012] IEHC 218.

35 [2012] IEHC 218. The provision for a costs sanction for unreasonably refusing to mediate a dispute to support this rule has not to date been employed by the courts.

The case illustrates the willingness of the courts to use the rule to encourage the use of mediation in appropriate circumstances.

A recurring theme in jurisdictions where commercial mediation is well established, and an issue that Irish practitioners and the judiciary must remain mindful of, is the concern expressed that the more vigilant the judiciary becomes in encouraging mediation through the use of costs sanctions, the more it appears that mediation is becoming compulsory. In determining costs, courts in jurisdictions where costs penalties have been applied have had to decide when reviewing the parties' behaviour, whether they are willing to look inside the process and consequently infringe upon mediation confidentiality.[36] The concern is that the further that sanctions are likely to extend, the greater the likelihood that mediation confidentiality will be eroded. In light of the approach adopted in the Mediation Act 2017,[37] which provides for comprehensive mediation confidentiality subject to limited exceptions, the Irish legislature[38] has followed the English position of protecting mediation communications, and it is to be hoped that the confidentiality provisions in the Act will be applied strictly by the courts.[39]

Compulsory forms of mediation, if employed in Ireland are likely to run into allegations that they violate the rights guaranteed by Article 6 of the ECHR, as reflected in the ECHR Act and Article 40.3[40] of the Irish Constitution. Experience of mediation when recommended in the Commercial Court would seem to indicate, similar to the experience of the judiciary in the UK, that voluntary mediation is preferable to compulsory mediation as it is more likely to lead to a successful outcome.[41] The Irish courts have the benefit of, and can glean guidance from, English, European Court of

36 See *Carleton (Earl of Malmesbury) v Strutt & Parker* [2008] EWHC 424 (QB); [2008] 5 Costs LR 736, where both parties unusually waived confidentiality and the successful claimant's costs award was reduced due to his unreasonable conduct in the mediation process. See also In *Kay-El (Hong Kong) Ltd v Musgrave Ltd* [2005] IEHC 418. See Fox (n 32) 25. Article 7 of the Mediation Directive requires member states to ensure that mediators and others involved in a mediation process, in the absence of agreement, are not compelled to give evidence in civil, commercial or arbitration proceedings regarding information arising out of the mediation process except where necessary for overriding reasons of public policy or where necessary to enforce a mediated settlement agreement.

37 S 10, Mediation Act 2017.

38 While accepting that objectively verifiable actions such as complete refusal to consider mediation could attract a costs sanction, the Irish Law Reform Commission advised against imposing a good faith requirement on mediating parties as this would risk undermining key principles including the impartiality of the mediator and the confidentiality of the process, and this approach is now reflected in s 10 of the Mediation Act 2017. The commission approved of the approach in *Halsey*, discussed below, that the court determines whether to impose costs sanctions without having to explore the subjective intentions of the parties during mediation. See Law Reform Commission, *Alternative Dispute Resolution Report: Mediation and Conciliation* (LRC 98–2010) 90–2 <www.lawreform.ie/_fileupload/Reports/r98ADR.pdf>.

39 In *Farm Assist Ltd (in Liquidation) v Secretary of State for the Environment, Food and Rural Affairs* [2009] BLR 399, Ramsay J clarified that, in England, a communication remains privileged even where the client shares it with the mediator on a confidential basis. Consequently, the client will be able to restrain the mediator from making any unauthorised use of the information. For a discussion of the case see, A K C Koo, 'Confidentiality of Mediation Communications' (2011) Civil Justice Quarterly 192, 200. See also 'Case Comment: Mediation' (July/August 2009) Construction Newsletter 7. For a discussion on the need and the rationale for the introduction of a distinct mediation privilege in England, in part to bring it into line with European jurisprudence, see Koo 'Confidentiality' 192–203.

40 Article 40.3 subparts 1 and 2 of the Irish Constitution provide: '1 The State guarantees in its laws to respect, and, as far as practicable, by its laws to defend and vindicate the personal rights of the citizen. 2 The State shall, in particular, by its laws protect as best it may from unjust attack and, in the case of injustice done, vindicate the life, person, good name, and property rights of every citizen.'

41 Mr Justice P Kelly, 'Alternative Dispute Resolution and the Commercial Court' [2010] Arbitration and ADR Review 92–7, 93.

Justice (ECJ) and European Court of Human Rights (ECtHR) jurisprudence when dealing with these issues.

Dyson LJ, in delivering the *Halsey v Milton Keynes NHS Trust* judgment, remarked that 'to oblige truly unwilling parties to refer their disputes to mediation would be to impose an unacceptable obstruction on their right of access to the courts . . . and, therefore, a violation of article 6'[42]. He subsequently regretted making the remarks on the issue of compulsion. He conceded that 'in and of itself compulsory mediation does not breach article 6', based on the judgment of the ECJ in *Rosalba Alassini v Telecom Italia SpA*.[43] The ECJ in *Alassini*[44] decided that a provision in Italian law which required parties to submit to mediation, failing which they forfeited their right to bring proceedings before the courts, was not in contravention of Article 6.[45]

The court in *Alassini* found that, provided compulsory mediation schemes are in the general interest and proportionate, the principle of effective judicial protection does not preclude them. A critical element in the case was the judicial presumption, supported by observations provided by the German government, that a voluntary mediation scheme would not be as effective. Unfortunately, the background rationale for this position is not included in the judgment. Advocate General Kokott concluded that:

> [the] mandatory dispute resolution procedure without which judicial proceedings may not be brought does not constitute a disproportionate infringement upon the right to effective judicial protection . . . Provisions such as these constitute a minor infringement upon the right to enforcement by the courts that is outweighed by the opportunity to end the dispute quickly and inexpensively.[46]

The scheme in the case was free of charge to the parties. It remains to be seen what the outcome will be if a case in the future comes before the court to be decided where a similar scheme involves a significant cost, as the higher the cost of mediation, the stronger the argument that it constitutes a greater hurdle as regards access to justice. With regard to the criticisms of Dyson LJ's judgment in *Halsey* mentioned above, *Alassini* does not confirm the Court of Appeal's view that a compulsory scheme would interfere with the right to trial, but 'at most it merely imposes a short delay'.[47]

Other leading English jurists, such as Lightman J, Lord Phillips CJ, Lord Clarke MR and Sir Anthony Clarke MR, have also commented that an order for mediation does not interfere with the right to trial, as it does not propose mediation in lieu of a trial, but merely imposes a delay. Lord Phillips, for example, a former head of the judiciary in England and Wales and founding president of the UK's Supreme Court, who referred specifically to Dyson LJ's judgment in *Halsey*[48] and proceeded to say that: 'Parties should

42 *Halsey v Milton Keynes NHS Trust* [2004] EWCA Civ 576; [2004] 1 WLR 3002; [2004] 4 All ER 920, 9.

43 See Lord Dyson, 'A Word on *Halsey v Milton Keynes*' [2011] 77(3) Arbitration 337, 337, 339, keynote speech, Third Annual Mediation Symposium of the Chartered Institute of Arbitrators (London, October 2010). See also Lord Dyson MR, 'Halsey 10 Years On – The Decision Revisited' (keynote speech, Belfast Mediation Conference May 2014) 6, 10.

44 *Rosalba Alassini v Telecom Italia SpA* (C-317–320/08) [2010] 3 CMLR 17.

45 See Gary Meggitt, '*PGF II SA v OMFS Co* and Compulsory Mediation' (2014) 33(3) Civil Justice Quarterly 335–348, 335 and 348.

46 *Rosalba Alassini v Telecom Italia SpA* (C-317–320/08) [2010] 3 CMLR 17, para 57. For a detailed discussion of this case, see Jim Davies and Erika Szyszczak, 'Case Comment, ADR: Effective Protection of Consumer Rights?' (2010) 35(5) European Law Review 695–707.

47 Lightman J, 'Breaking Down the Barriers' (*The Times Online* 31 July 2007) <http://business.timesonline.co.uk/tol/business/law/article2166092>.

48 [2004] EWCA (Civ) 576.

be given strong encouragement to attempt mediation before resorting to litigation. And if they commence litigation, there should be built into the process a stage at which the court can require them to attempt mediation.'[49] Others support this view by pointing to the fact that compulsory mediation occurs in other jurisdictions, such as Germany, Italy and Greece, with no successful Article 6 challenges.[50]

However, Jackson LJ rejected compulsory mediation in his *Review of Civil Litigation Costs Final Report*,[51] although, consistent with the rationale in *Halsey*, he supported sanctions against those who unreasonably refused to mediate.[52] Despite such judicial clarification, some contend that the courts in England do in fact compel mediation surreptitiously, through the use of what is termed implied compulsory mediation. The contention is that while officially mediation is not compulsory, in practice implied compulsory mediation forms part of the civil justice system, through a process where judges, supported by the Civil Procedure Rules (CPR), are making it clear to parties that they expect that they will engage in mediation, and parties, mindful of the potential adverse cost consequences, feel compelled to engage in the process. This issue has been exacerbated, it seems, by austerity over a number of years and the consequent pressure on court resources.[53]

Dyson LJ's support for mediation and the use of costs sanctions to support it is not unqualified. He has remarked that 'the court should not exercise that power if it is satisfied that the parties are truly unwilling to embark upon a mediation'.[54] He argued that compulsory mediation could constitute a denial of access to justice in some circumstances, for example, if coupled with high mediation costs, and that it is not the role of a court of law to force compromise upon disputants who do not want it.[55] However, in light of the seemingly low cost of mediation compared with the high cost of going to trial, the costs issue is unlikely to arise. With regard to the second contention, it risks violating the cardinal principle of equality before the law to treat litigants unequally on the basis of their willingness to mediate and one should not confuse a degree of compulsion to enter into a process from which settlement may result, a process that parties may exit at any time, with the settlement itself that will be arrived at only

49 See speech by Lord Phillips of Worth Matravers, Lord Chief Justice of England and Wales, 'Alternative Dispute Resolution: An English Viewpoint' (India 29 March 2008) <www.civilmediation.org/downloads-get?id=119>.

50 See Lightman J, 'Mediation: An Approximation to Justice' (speech given at S J Berwin, 28 June 2007) <www.judiciary.gov.uk/Resources/JCO/Documents/Speeches/berwins_mediation.pdf>; Matravers (n 49); Sir Anthony Clarke MR, 'The Future of Civil Mediation' (8 May 2008) <www.civilmediation.org/downloads-get?id=128>; Lord Clarke MR, 'Mediation – An Integral Part of our Litigation Culture' (Littleton Chambers Annual Mediation Meeting, Gray's Inn, 8 June 2009). See also Kenneth J Ryan, 'Promoting ADR through the Imposition of Costs Sanctions: Is it the right Approach?' (*International Bar Notes* February 2013) 13–19, 14.

51 See also Irish Law Reform Commission, *Consultation Paper on Alternative Dispute Resolution* (LRC CP 50–2008) 74.

52 See Jackson LJ, 'Review of Civil Litigation Costs Final Report', 14 January 2010, xxiii <https://www.judiciary.gov.uk/wp-content/uploads/JCO/Documents/Reports/jackson-final-report-140110.pdf>.

53 See Masood Ahmed, 'Implied Compulsory Mediation' (2012) 31 Civil Justice Quarterly 151–75, specifically 164–70. See also Sue Prince, 'Mandatory Mediation: the Ontario Experience' [2007] Civil Justice Quarterly 79–95, 93.

54 See Dyson, 'A Word on Halsey' (n 43); and 'Halsey 10 Years On' (n 43).

55 See Dyson, 'A Word on Halsey' (n 43); and 'Halsey 10 Years On' (n 43)

when it is reduced to writing and signed by both parties, and in a commercial context drafted and reviewed by the party's respective legal teams.[56]

In the USA, compulsory mediation schemes have been introduced in a number of states with federal district courts empowered to require parties to mediate disputes under a power granted by the Alternative Dispute Resolution Act 1998.[57] Signatories to the ECHR, such as Belgium and Greece, have adopted compulsory mediation schemes without any successful Article 6 challenges. Similarly, in Germany, federal states can introduce legislation to require litigants to either engage in court-based or court-approved mediation prior to litigation commencing.[58] The European Commission has stated that the EU actively promotes and encourages the use of mediation to assist dispute resolution and avoid the worry, time and cost associated with litigation.[59] This is reflected in Article 3(2) of the Mediation Directive that provides that the encouragement it offers to mediation is made 'without prejudice to national legislation making the use of mediation compulsory . . . provided that such legislation does not interfere with the right of access to justice'. Such experiences appear to indicate that schemes of compulsory mediation do not in and of themselves give rise to a violation of Article 6,[60] provided mediation is presented as a condition precedent to litigation or arbitration and not the only means of resolution.[61]

4 Commercial mediation, the Constitution and the Convention

In *Golder v UK*,[62] the ECtHR remarked that 'one can scarcely conceive of the rule of law without there being a possibility of having access to the courts'.[63] The Irish Supreme Court in *Tuohy v Courtney*[64] acknowledged the distinct rights to litigate and to have access to the courts. While access to the courts is an important constitutional and Convention right, formal complex procedural rules have resulted in costly legal advice.[65] Dissatisfaction with the administration of justice has been a public concern for some time,[66] and in this context mediation has a crucial role to play in providing wider access

56 See A K C Koo 'Ten Years after Halsey' [2015] 34(1) Civil Justice Quarterly 77–95, 79–80.

57 S 652 (28 USC).

58 Katja Alexander et al, 'Mediation in Germany: The Long and Winding Road' in Katja Alexander (ed), *Global Trends in Mediation* (2nd edn, Kluwer Law 2006) 233. The experience in Ontario suggests that an enhanced voluntary mediation scheme is a better solution and less financially burdensome on the state than a compulsory one. See Ministry of Justice, 'Solving Disputes in the County Courts: Creating a Simpler, Quicker and More Proportionate System: A Consultation on Reforming Civil Justice in England and Wales – The Government Response' (CM8274 February 2012) 172.

59 <https://e-justice.europa.eu/content_eu_overview_on_mediation-63-en.do>

60 Courts in the USA have developed a tradition of ordering mediation in the face of resistance from the parties. *In Re Atlantic Pipe Corporation* [2002] 304 F3d 135, the Court of Appeals for the First Circuit said that a Federal Trial Court has the inherent authority to order compulsory mediation where appropriate. It remarked that, in some cases, a court may be warranted in believing that compulsory mediation could yield significant benefits, even if one or more parties objects, believing that while the parties may fail to reach agreement, the benefit of settlement can be worth the risk.

61 See, for example, ibid.

62 (1975) 1 EHRR 524.

63 *Golder v UK* (1975) 1 EHRR 524, para 34.

64 [1994] 3 IR 1, ILRM 503. See also G W Hogan, G F Whyte and J M Kelly: *The Irish Constitution* (4th edn, Tottel 2003) 1446.

65 Rita Drummond, 'Court-annexed Mediation in England: Foundations for an Independent and Enduring Partnership' (November 2007) <http://ssrn.com/abstract=962122>.

66 Roscoe Pound, 'The Causes of Popular Dissatisfaction with the Administration of Justice' (1906) 39 Reports of the American Bar Association, Part 1, 395.

to justice and, as reflected in the Mediation Act 2017, the courts have a fundamental role in integrating mediation into the civil justice system by encouraging parties to consider mediation in appropriate cases.[67]

Article 6 is the most frequently invoked and most robust ECHR article, stemming from the gravity of the right comprised in it.[68] The prominent position given to the right to a fair trial is symbolic of its value in upholding a democratic society.[69] Length of proceedings in civil cases represents the most frequently invoked violation of Article 6.[70] Mediation has emerged as a possible partial solution to what many view as an insoluble problem.[71]

Article 6(1) of the ECHR provides:

> In the determination of his civil rights and obligations or of any criminal charge against him, everyone is entitled to a fair and public hearing within a reasonable time by an independent and impartial tribunal established by law. Judgment shall be pronounced publicly . . .

Consistent with its aim and purpose, Article 6(1) has been interpreted broadly by the ECtHR.[72] This has resulted in the creation of new guarantees that are not specifically mentioned in the article and are considered as natural corollaries of the written guarantees of Article 6, such as the right of access to justice which has developed into one of the fundamental guarantees of Article 6.[73] The ECtHR believed that any interpretation of Article 6 that did not view Article 6(1) as concerning both the conduct of proceedings, and the actual right to institute them in the first place would contradict a universally recognised principle of law and would allow the state to close its courts without infringing the ECHR, resulting in the right of access to justice developing into one of the fundamental guarantees of Article 6.[74] In *Airey v Ireland*,[75] the ECtHR held that the ECHR is intended to guarantee rights that are practical and effective rather than rights that are theoretical or illusory.

Both the structure and content of ECHR Article 6(1) and the guarantees under the Irish Constitution are quite similar. As noted above, Article 6(1) provides for a basic entitlement to fair procedures in civil and criminal matters. The equivalent constitutional provisions are reflected in a number of articles. Article 38[76] elucidates guarantees

67 See also Irish Law Reform Commission (n 51) 331.

68 D J Harris, M O Boyle and C Warbrick, *Law of the European Convention on Human Rights* (1st edn, Butterworths 1995) 164; and *De Cubber v Belgium* [1984] ECHR 14. It is also the article most frequently found to have been violated, see Helen Fenwick and Gavin Phillipson, *Text, Cases and Materials on Public Law and Human Rights* (3rd edn, Routledge 2011) 311.

69 Harris et al (n 68); *De Cubber v Belgium* [1984] ECHR 14.

70 See, for example, Christof Rozakis, 'The Right to a Fair Trial in Civil Cases' [2004] Judicial Studies Institute Journal 97. See also Council of Europe/European Court of Human Rights, *Guide on Article 6 of the European Convention on Human Rights, Right to a Fair Trial (Civil Limb)* (2013) 50–4, available at <www.echr.coe.int/Documents/Guide_Art_6_ENG.pdf>.

71 Warren Winkler CJ (Ontario), 'Access to Justice, Mediation: Panacea of Pariah?' (2007) <www.ontariocourts.on.ca/coa/en/ps/index.htm>.

72 *Delcourt v Belgium* (1970) 1 EHRR 355.

73 See *Golder v UK* (1975) 1 EHRR 524, see para 28 and subsequent paras. See also Christof Rozakis, 'The Right to a Fair Trial in Civil Cases' [2004] 2 Judicial Studies Institute Journal 96–106, 98.

74 Rozakis (n 73) 98.

75 (1979) 2 EHRR 305.

76 Article 38.1 of the Irish Constitution provides: 'No person shall be tried on any criminal charge save in due course of law.'

pertaining to a trial in due course of law on criminal matters. Article 34[77] provides a general principle of fair procedures that apply to the administration of justice in court, and, in the case of other decision-making bodies, this principle is comprised within the unenumerated rights provisions of Article 40.3.[78] There are clear equivalents between the two instruments. For example, Article 6(1) provides a guarantee of a fair trial by an impartial tribunal, while Article 35.2 of the Constitution provides that judges shall be independent in the exercise of their judicial functions and subject only to the Constitution and the law. The guarantee of fair procedures in civil matters is not quite as explicit in the Constitution as in the ECHR, but they are elucidated in constitutional jurisprudence.[79]

While there is a significant degree of similarity between the guarantees comprised in Article 6 of the ECHR, now enshrined in the ECHR Act, and Articles 34, 38 and 40.3 of the Constitution, it appears that there are areas that will remain purely the reserve of the Irish constitutional guarantees and that the level of scrutiny required by the Constitution is likely to be greater than that under the ECHR. Consequently, the constitutional provisions are likely to be the definitive port of call for most challenges to civil procedures albeit that the argument will be influenced by the jurisprudence under the ECHR. As noted above, this approach would seem to be consistent with the approach envisaged by the legislature in the ECHR Act, as it requires the courts to interpret legislation in line with the ECHR insofar as it is possible to do so.[80] However, the ECHR Act may be the only instrument providing the possibility of a remedy resulting in a divergence from constitutional principles of Irish law. An example of such divergence, prior to the introduction of the ECHR Act, where the ECHR provided a remedy for which there was no immediate Irish equivalent is in the area of delay in civil proceedings.[81] It has been suggested that the Irish courts are more likely to declare constitutional rights rather than find breaches of the ECHR Act in situations where, if the ECHR had never been incorporated as part of Irish law, it is questionable as to whether the right would have been identified at all.[82]

However, albeit that they are not strictly bound by it, Irish courts must take account of ECtHR jurisprudence,[83] and experience suggests that Irish courts are extremely reluctant to develop an autonomous meaning of ECHR rights as protected by the ECHR Act that depart from ECtHR jurisprudence.[84] This approach by the Irish courts

77 Article 34.1 of the Irish Constitution provides: 'Justice shall be administered in courts established by law by judges appointed in the manner provided by this Constitution, and, save in such special and limited cases as may be prescribed by law, shall be administered in public.'

78 Article 40.3 subparts 1 and 2 of the Irish Constitution (n 40).

79 *In Re Haughey* [1971] IR 217 (HC); *State (Healy) v Donoghue* [1976] IR 325 (HC & SC); *Kiely v the Minister for Social Welfare* [1977] IR 267 (HC & SC); and *O'Brien v Bord Na Mona* [1983] IR (HC &SC). With regard to the potential issues under Article 6 that have already arisen under the Constitution as applies to the enforcement of the independence of the judicial function, it has been suggested that the Constitution as interpreted requires a more robust approach and more exacting standards than Article 6 of the ECHR. See, for example, *Maher v Attorney General* [1973] IR 140 (SC); *Deaton v Attorney General* [1963] IR 170 (SC); and *Curtis v Attorney General* [1985] IR 458 (HC). For a more detailed discussion of this issue, see Donal O'Donnell, 'A Comparison of Article 6 of European Convention on Human Rights and the Due Process Requirements of the Constitution of Ireland' [2004] Judicial Studies Institute Journal 37–67, 41–2, 44.

80 S 2, ECHR Act 2003.

81 See O'Donnell (n 79) 56–7.

82 See James MacGuill, 'The Impact of Recent ECHR Decisions on the Constitution' [2007] 2 Judicial Studies Institute Journal 50–75, 52. For a discussion of common law, the ECHR law and comparative constitutional law, see generally R Clayton and H Tomlinson, *The Law of Human Rights* (Oxford University Press 2009).

83 S 4, ECHR Act 2003. See also de Londras (n 17) 46.

84 See, for example, *McD v L* [2009] IESC 81. See also de Londras (n 17) 45–8.

makes discussion of ECtHR jurisprudence particularly salient in assessing the likely approach of the Irish courts in dealing with constitutional and ECHR Act rights of access to the courts.

Breaches arising from the pressure to mediate

There are potentially at least three situations where an applicant may seek to claim that their Article 6(1) rights have been infringed in the context of the pressure to undertake mediation.[85] The first is where a party reached a mediated settlement agreement and consequently cannot pursue an action in court. As the agreement that results from a successful mediation is likely to reflect the interests of the parties rather than their legal rights, it is less likely to reflect the legal merits involved in a potential claim, and parties may settle for less than they would achieve through a negotiated settlement and will often discharge their own costs.[86] However, it is not usually possible for the courts to review the settlement agreements as they are binding contracts.[87]

The second possible challenge arises where funds are expended on an unsuccessful mediation that could have been employed as litigation costs. However, in the context of commercial mediation, experience suggests that mediating disputes costs significantly less than litigation, and this challenge would have greater relevance to low-value claims.[88]

The third possible basis for a challenge could occur where a party is successful in their court action, but due to their unreasonable refusal to mediate the dispute the party receives an adverse costs award and consequently contends that this constitutes a denial of their right of access to court, i.e. that their right of access to court is 'theoretical and illusory'. This claim could be defeated if it can be shown that the party waived their right by going to mediation, provided the type of dispute falls within the ECtHR autonomous definition of 'civil rights and obligations' and is consequently covered by Article 6(1).[89] While there is some doubt whether some of the procedural rights encompassed in Article 6(1) are capable of waiver,[90] the right of access to court is not absolute, and the ECtHR has confirmed on numerous occasions that Article 6 does not prevent a party from waiving their right to a fair trial of their own free will, either expressly or tacitly.[91]

85 See Rhona Smith, *Textbook on International Human Rights* (5th edn, Oxford University Press 2012) 106–7. See also Philip Leach, *Taking a Case to the European Court of Human Rights* (3rd edn, Oxford University Press 2012) 26–76. See also Shirley Shipman, 'Waiver: Canute against the Tide?' (2013)32(4) Civil Justice Quarterly 475–7.

86 For example, see Hazel Genn, 'Central London County Court Pilot Mediation Scheme: Evaluation Report' (LCD Research Series 5/98), 70, 71, 88–89, 97. See also Shipman (n 85) 475.

87 Mediated settlements of commercial disputes are binding contracts when reduced to writing and signed by the parties and are consequently enforceable through the courts. Article 6 of the Mediation Directive provides that EU member states must ensure that the content of a written agreement arising from a mediation should be made enforceable at the request of the parties. The court would only look to set aside the mediated settlement agreement if there was, for example, evidence of duress or coercion. See R Feehily, 'The Legal Status and Enforceability of Mediated Settlement Agreements' [2013] 12(1) Hibernian Law Journal 1–26.

88 In light of the confidential nature of the process, it is impossible to glean objective independent empirical evidence on this point. See generally Grania Langdon-Down, 'Commercial Mediation: Resolution Revolution?' (*Law Society Gazette,* England and Wales, 30 September 2013) <www.lawgazette.co.uk/law/commercial-mediation-resolution-revolution/5037884.fullarticle>.

89 See S*tankov v Bulgaria* (2009) 49 EHRR 7. See Shipman (n 85) 476.

90 The ability to waive one's right to an impartial tribunal would be an example. See *Pfeifer v Plankl v Austria* [1992] 14 EHHR 692; *Ozerov v Russia* (64962/01) Judgment May 18, 2010. See also Shipman (n 85) 476.

91 See Richard Stone, *Textbook on Civil Liberties and Human Rights* (10th edn, Oxford University Press 2013) 184; see also *Sejdovic v Italy* (56581/00) Judgment 1 March 2006. See also Shipman (n 85) 476.

The conditions to effectively waive Article 6(1) rights

As discussed below, arbitration clauses provide an example of an effective waiver of the right of access to court that does not conflict with the ECHR.[92] In determining whether a right under Article 6(1) has been effectively waived, the ECtHR has reviewed whether four criteria have been satisfied.[93]

First, the waiver must be unequivocal,[94] but this can be implied. For example, an arbitration agreement can amount to a voluntary waiver of court proceedings and a tacit, unequivocal, waiver of certain Article 6(1) guarantees.[95] This principle could be extended to mediation, where a party that voluntarily acquiesces in a mediation which results in a settlement could be perceived as tacitly but unequivocally waiving their Article 6(1) rights.[96]

Second, the waiver must be made in a context where there are sufficient minimum safeguards appropriate to the significance of the right waived.[97] A waiver of the right of access to court must be accompanied by appropriately high safeguards in light of the importance the ECtHR places on the right of access to court.[98] While it is unclear what safeguards are sufficient, appropriate representation would appear to constitute a sufficient safeguard in appropriate circumstances,[99] such that a person who had legal counsel present could be deemed to have waived their right of access to court when they agreed to a mediated settlement agreement.[100]

The third condition is that the right waived must not run counter to any important public interests.[101] However, provided that parties to a commercial mediation are legally represented and are made aware that the settlement agreement when reduced to writing is final, it is unlikely that a waiver in such circumstances could be considered counter to important public interests.

The final condition is that the waiver must not be tainted by constraint.[102] In *Deweer v Belgium*,[103] a butcher faced the stark choice between a fine or the closure of his business until a hearing would take place to determine whether he was guilty of over-pricing meat. In light of the economic pressures of closure and uncertainty about the timing and length of the trial, he opted to pay the fine, despite having an arguable defence that could have vindicated him. The threat of closure of his business within 48 hours, the loss of income, continuing salary costs and the loss of customers over a period of months constituted constraint according to the ECtHR. The fact that the settlement fine was modest relative

92 *Deweer v Belgium* (1980) 2 EHRR 429.

93 For a detailed discussion of each criterion, see Shipman (n 85) 476–84.

94 *Le Compte, Van Leuven & De Meyere v Belgium* (1983) 5 EHRR 183, para 35. See also Shipman (n 85) 477; Leach (n 85) 172–3.

95 *Suovaniemi v Finland* (31737/96), Decision 23 February 1999.

96 See Shipman (n 85) 478–9.

97 *Poitrimol v France* (1994) 18 EHRR 130, para 31. See also Shipman (n 85) 477.

98 *Golder v UK* (1975) 1 EHRR 524. See also *Tsirlis and Kouloumpas v Greece* (1996) 21 EHRR CD30, para 98; *Giorgiadis v Greece* ((1996) 21522/93) Report (31), 47. See also Shipman (n 85) 479.

99 See *Suovaniemi v Finland* (31737/96), Decision 23 February 1999; and *Zu Leiningen v Germany* (59624/00) Decision 17 November 2005. See also Shipman (n 85) 480.

100 See Fenwick and Phillipson (n 68) 312. See also Shipman (n 85) 480.

101 *Hakansson and Sturesson v Sweden* (1991) 13 EHRR 1, para 66. See also Shipman (n 85) 477; Leach (n 85) 172–3.

102 See *Deweer v Belgium* (1980) 2 EHRR 429.

103 (1980) 2 EHRR 429.

to a potential fine of up to 3000 times higher if found guilty in court contributed to the pressure of the closure.[104]

It has been suggested that the principles established in this case could be applied in a context where a party waives their right of access to court by engaging in mediation that results in a mediated settlement agreement. The court concluded that in circumstances where the possibility of trial caused fear, for example, where refusing a settlement resulted in a trial and the possibility of a more severe sanction, this pressure on its own would not be inconsistent with the right of access to court.[105] However, in determining whether to refuse to mediate a dispute, when proposed by either a judge or another party, a disputant encounters the additional pressures of judicial encouragement and potential adverse costs.[106]

The compulsion to advise

In choosing between mediation and litigation, disputants may face pressure in the form of advice and/or encouragement to mediate from their legal advisors and judges, as both lawyers and judges are in turn often under a degree of pressure to encourage parties to settle.[107]

The changes to the CPR introduced following Lord Woolf's *Access to Justice Report*[108] illustrate the pressure to encourage the use of mediation with the support of various measures, including costs sanctions for parties who win at trial but who unreasonably refused an offer to mediate a dispute that could have settled.[109] The culture change desired by Lord Woolf that was reflected in the changes to the CPR has become embedded in the civil justice system in England. This is reflected by the Court of Appeal when stressing that the legal profession in England must take note of the judicial direction contained in *Halsey*[110] and cannot 'shrug aside'[111] reasonable requests to mediate with impunity. The court also stated that it 'is entitled to take an unreasonable refusal into account, even when it occurs before the start of formal proceedings; see rule 44.3(5)(a) of the Civil Procedure Rules 1998'.[112] In light of such judicial comments it has been suggested that all members of the legal profession who conduct litigation should

104 *Deweer v Belgium* (1980) 2 EHRR 429, para 51(b). For a discussion of this case, see Brenda Tronson, 'Mediation Orders: Do the Arguments against Them Make Sense?' [2006] 25 Civil Justice Quarterly 412–18, 417. See also Matravers (n 49).

105 *Deweer v Belgium* (1980) 2 EHRR 429, para 51(b). See also Shipman (n 85) 482–3.

106 For a detailed discussion of various approaches to encourage legal professionals and their clients to undertake mediation, see Shirley Shipman, 'Court Approaches to ADR in the Civil Justice System' [2006] 25 Civil Justice Quarterly 181, 186–94.

107 See ibid 188–90; and Shipman (n 85) 483–4.

108 For a full text of the Civil Procedure Rules and Practice Directions for civil litigation in England, see <www.justice.gov.uk/civil/procrules_fin/index.htm>.

109 CPR 1.1(1) provides that: 'These Rules are a new procedural code with the overriding objective of enabling the court to deal with cases justly.' This was later amended to include 'justly and at proportionate cost' with the added explanation that includes 'enforcing compliance with rules, practice directions and orders'. See Jackson (n 52) 31. The CPR was amended in light of the Jackson report, for an overview of the main changes to the CPR introduced by the Jackson report, see T Allen, 'The Jackson Report Amendments to the CPR: What Do They Do to Encourage Settlement (if Anything)?' (26 March 2013) <www.cedr.com/articles/?item=The-Jackson-Report-Amendments-to-the-CPR-What-do-they-do-to-encourage-settlement-if-anything>.

110 [2004] EWCA (Civ) 576.

111 [2005] EWCA Civ 358, Ward LJ at para 43.

112 Rix LJ at para 50. Rule 44.3(5) states that the conduct of the parties includes conduct before, as well as during, the proceedings and in particular the extent to which the parties followed any relevant pre-action protocol.

now routinely discuss with their clients whether their disputes are suitable for mediation.[113]

This approach is also reflected in the Mediation Act 2017. Prior to issuing proceedings on behalf of a client, practising solicitors[114] and barristers (where a client is directly represented by a barrister)[115] must advise clients to consider mediation as an alternative to litigation. If the client elects to institute proceedings following the provision of information on mediation services, including details of mediators, information about the advantages and benefits of mediation, and information on confidentiality obligations and the enforceability of mediated settlements, the solicitor must provide a statutory declaration with the application confirming that the obligations to advise on the mediation option to resolve the dispute have been discharged.

In the South-African case, *Brownlee v Brownlee*,[116] a costs sanction was imposed as a direct consequence of a failure to mediate on the parties lawyers in a way that has not yet happened in England or Ireland. The lawyers effectively agreed not to advise mediation in a case which the judge believed would have benefited from it, and he consequently limited what they could charge their own clients as a result and made no order between the parties. The approach adopted by the court in *Brownlee* presents a cautionary tale to the legal profession in countries like Ireland that have adopted a costs sanction as part of the legislative armoury to encourage parties to settle disputes regarding what judges might do if lawyers fail to advise their clients about mediation.[117] This is something that the English Court of Appeal in *Halsey*[118] effectively made a professional duty and the Mediation Act 2017[119] made a legal obligation.

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113 See Lara Clarke, 'Mediation in the Post-*Halsey* Era' (*Mediation Committee Newsletter,* IBA Legal Practice Division August 2005) 19.

114 S 14, Mediation Act 2017.

115 Ibid s 15. This would be quite rare in practice as most clients would in the first instance be represented by a solicitor.

116 Case no 2008/25274.

117 In the USA, under Oregon statute ORS 20.075, 'the diligence of the parties in pursuing settlement of the dispute' is one of the factors that the court should consider in awarding attorney fees. It has been suggested that commercial contracts could provide that the prevailing party may recover its lawyers' fees only if it made reasonable efforts to use the mediation process provided in the contract to resolve the dispute. However, it would be difficult to determine 'reasonable efforts' in practice, not least because of confidentiality and privilege concerns. See Caroline Harris Crown, 'Are Mandatory Mediation Clauses Enforceable?' (2010) 29(2 spring) Litigation Journal 3–5, 5.

118 [2004] EWCA (Civ) 576. In *McManus v Duffy* [2008] GLD 17, a case involving a mediation direction under s 15 of the Civil Liability and Courts Act 2004, Mr Justice Feeney noted that, even though the defendant was unwilling and believed that mediation was unlikely to succeed, this did not mean unwillingness to proceed. He believed the test was whether there were benefits to be gained from mediation as opposed to the likelihood of reaching a settlement. This amounts to a much lower threshold than in *Halsey*, discussed below, and as such could be construed as going much further in support of mediation. It has been suggested that it is difficult to conceive of a case where mediation will not assist, even where it has little reasonable prospect of success. See G Carey, 'Reasonableness and Mediation: A New Direction?' (2010) 28 Irish Law Times 207. See also Fox (n 32) 24.

119 Even before the introduction of the Mediation Act 2007, the Irish Solicitors code of conduct made provisions in this regard. Part 2.2 (final para) of *A Guide to Good Professional Conduct for Solicitors* (3rd edn), provides that 'solicitors should familiarise themselves with . . . mediation and . . . recommend [mediation] . . . to clients where appropriate. Initiating . . . mediation . . . is consistent with effective and zealous representation' <www.lawsociety.ie/globalassets/documents/committees/conduct-guide.pdf>. The Irish Law Reform Commission had also recommended that the duty on solicitors to advise their clients in relation to mediation should become a legal obligation. See Law Reform Commission (n 38) 72–7 <www.lawreform.ie/_fileupload/Reports/r98ADR.pdf>.

In *Halsey*[120] the Court of Appeal dismissed the two appeals against costs awarded in favour of successful claimants who had refused to mediate. Dyson LJ held that the burden was on the unsuccessful party seeking a costs sanction against the successful litigant to show why there should be a departure from the general rule that costs should follow the event, and that such a departure was not justified unless it was shown that the successful party had acted unreasonably in refusing to mediate. The Court of Appeal gave a non-exhaustive checklist of factors that may be relevant to the issue of whether a party unreasonably refused to mediate, as follows:[121]

- the nature of the dispute;
- the merits of the case;
- the extent to which other settlement methods were attempted;
- whether the costs involved in the mediation would have been disproportionately high;
- whether any delay in setting up and attending the mediation would have been prejudicial; and
- whether the mediation had a reasonable prospect of success.

However, the weighting given to each factor by the courts is unclear when determining if a refusal to mediate is unreasonable. CPR 1.4(2)(e) requires the court to encourage disputants to mediate their disputes rather than litigate in appropriate circumstances. As made clear by the Court of Appeal, the stronger the court's encouragement, the greater the likelihood that it will find a party's refusal unreasonable when deciding costs.[122] Unlike the English courts, Irish courts have not had the opportunity to develop costs jurisprudence in a context where a party unreasonably refuses to mediate. However, consistent with the position in England, the Mediation Act 2017 provides that the court should take into account any unreasonable refusal or failure by a party to the proceedings to consider using mediation, and any unreasonable refusal or failure by a party to the proceedings to attend mediation following an invitation to do so when deciding on costs.[123] The threat of a costs sanction in this context will no doubt put pressure on parties to mediate rather than litigate, and it is arguable in the appropriate circumstances that this constitutes constraint, with the effect that a disputant's waiver of their Article 6(1) rights could be considered tainted.[124]

Since the *Deweer* case, the ECtHR has introduced the concept of the margin of appreciation when dealing with Article 6 (1) cases.[125] It has been suggested that in further developing the doctrine of waiver, the ECtHR should recognise that the threat of adverse costs sanctions amounts to pressure with the effect that any waiver of the right of access

120 [2004] EWCA (Civ) 576.

121 See Kent Dreadon, 'Mediation, English Developments in an International Context' (*Mediation Committee Newsletter,* IBA Legal Practice Division April 2005) 16. See also the decision in *P4 Ltd v Unite Integrated Solutions plc* [2006] EWHC TCC 2924, as an example of a subsequent case where the court was careful to apply the *Halsey* framework to the issues in that case. The 'non-exhaustive' aspect of the list of factors has been criticised as potentially being 'infinite', which is seen as unhelpful to the rule of law which demands clarity and consistency as to what constitutes unreasonable refusal to mediate. See also A K C Koo, 'Unreasonable Refusal to Mediate: The Need for a Principled Approach – PGF II' (2014) 33(3) Civil Justice Quarterly 261–5, 264.

122 See *Halsey* [2004] EWCA Civ 576, para 33.

123 S 21, Mediation Act 2017.

124 See Shipman (n 85) 489.

125 See *Osman v UK* (1998) EHRR 10, para 147. See also Leach (n 85) 242–4.

to court is tainted by constraint. This would need to be balanced against contentions by state parties that the constraint may be justifiable in appropriate cases, for example, where the measure restricting access pursues a legitimate aim, doesn't impair the essence of the right, and finds the proportionate balance between the public interest and the fundamental right of the individual.[126] Legitimate aims that the ECtHR has accepted include measures to enable the general or efficient functioning of the civil justice system, such as ensuring the efficient use of court resources, or in a context where the concern is the protection of the interests of others.[127] Financial constraints that prevent disputing parties from taking or defending claims in court have been a particular concern for the ECtHR. While not a direct financial constraint, the threat of adverse costs may, as discussed, be used to encourage recalcitrant parties to engage in mediation.[128] These factors should also be borne in mind by the Irish courts when parties who appear before them claim that their right of access to court has been breached under the ECHR Act.

5 Conclusion

One of the main contentions against compulsory mediation, as discussed above, is that it actually or potentially obstructs constitutional and ECHR principles relating to the right of access to court. In a context where litigation is stayed pending mediation, some have suggested that it hinders a public hearing 'within a reasonable time'.[129] However, a stay in such circumstances would not create the kind of delay that could be characterised as an infringement of the right of access to court, which in practice often takes no more than four weeks from initial referral to outcome, based on the experience in England and Wales.[130]

When considering the implications of compulsory mediation as it affects constitutional and ECHR principles relating to the right of access to court, reference may be made to the position of arbitration as one of the available 'alternatives' to the court process to resolve disputes. However, arbitration is well established, having been statute-based for some time,[131] and can be distinguished from mediation as it is a binding adjudicative process for the 'determination of civil rights and obligations' in a private arbitral forum, where parties have contracted out of their right of access to court. Conversely, mediation is non-adjudicative and could not be regarded as a 'determination'. The neutral third party assists the parties in reaching a resolution and, as noted, they are free to leave the process and pursue their claim in court at any time. Hence, the

126 *Ashingdane v UK Series* (1985) 7 EHRR 528. See also Shipman (n 85) 491.

127 See Shirley Shipman, 'Compulsory Mediation: The Elephant in the Room' (2011) 30 Civil Justice Quarterly 163–91, 181–2.

128 See Shipman (n 85) 491.

129 For an interesting analysis of the arguments for and against the introduction of compulsory mediation in Australia, and the approach of the courts in imposing compulsory mediation in each state and territory, as well as the federal jurisdiction in Australia, see David Spencer and Michael Brogan, *Mediation Law and Practice* (Cambridge University Press 2006) 265–311.

130 Tony Allen, *Mediation Law and Civil Practice* (Bloomsbury Professional 2013) 206–7. According to the Courts Service Annual Report 2016, it can take up to four months depending on the time required for the hearing, from the first return date to the date of full hearing on the Commercial List of the High Court, while Circuit Court waiting times for commercial matters in some parts of Ireland can take up to 18 months. See Courts Service Annual Report 2016 at 75 <www.courts.ie/Courts.ie/library3.nsf/(WebFiles)/300A3D2A10D824E80025816800370ED2/$FILE/Courts%20Service%20Annual%20Report%202016.pd>.

131 The Arbitration Act 2010 governs domestic and international commercial arbitrations in Ireland. Employment and industrial relations disputes are expressly excluded. It repealed and replaced the pre-existing Arbitration Acts 1954–1998.

compulsion is to initially engage in the mediation process, not an obligation to reach a 'determination' or a resolution.[132]

As noted above, it has been established for some time that arbitration agreements do not breach constitutional or human rights relating to the right of access to court as parties can waive their rights by agreeing to arbitrate their disputes.[133] However, the courts will intervene to protect the right of access to court where undue pressure is put on a party to enter into a non-judicial adjudicative process such as arbitration, or where there is no real opportunity for a party to agree to such a term in a contract.[134]

In *Deweer*, constraint to settle by feeling compelled to waive Article 6 rights was not difficult to discern. In a mediation no party should be constrained to settle because continued participation is voluntary. Mediation has been characterised as symbiotic with litigation, in that mediated settlements are often predicated against the risks of failing to achieve the outcome desired in court, and that engagement in the process, even if such engagement is motivated by a degree of compulsion, should consequently not be viewed as conflicting with constitutional or ECHR Act rights of access to court. Much of the concern seems to centre round confusion about the status of mediation, where some judges in other jurisdictions have viewed mediation as an absolute alternative to litigation, rather than a condition precedent to accessing the court process or alternative adjudicative determination.[135] There appears to be confusion also between the compulsory requirement to initially engage in the process and the voluntary nature of continued participation.[136] The Mediation Act 2017 is helpfully very clear on this point, as it provides that the parties participate voluntarily and may withdraw from the process at any time.[137] Hence commercial mediation operates firmly within the shadow of the law, as parties are free to choose not to settle and return to an adjudicatory process to have their dispute determined by a judge or arbitrator. Similarly, the process is confidential, and nothing said during it can be used against a party in later proceedings. Even unreasonable disengagement is not open to criticism in subsequent litigation.[138]

Halsey established the distinction between encouraging mediation, even in the strongest possible terms, and ordering the parties to do so. The thin line between strong encouragement and compulsion is difficult to draw in practice, and with the threat of sanctions there is a risk that encouragement can look more like coercion.[139] However,

132 Allen (n 130) 204.

133 *Scott v Avery* 10 ER 1121 (1856), confirmed in *O'Connor v Norwich Union Life and Fire Insurance Society* [1894] 2 IR 723. Article 5 of the UN Commission on International Trade Law Model Law, adopted in the Arbitration Act 2010, also provides that 'in matters governed by this Law, no court shall intervene except where so provided in this Law'.

134 Allen (n 130) 204. See also *Deweer v Belgium* (1980) 2 EHRR 429, discussed below.

135 Allen (n 130) 206.

136 Ibid 79.

137 S 6, Mediation Act 2017.

138 Allen (n 130) 80. As noted above, s 10 of the Mediation Act 2017 contains comprehensive confidentiality provisions, subject to limited exceptions. The CEDR Model Mediation Agreement, used widely for commercial mediation agreements in Ireland, also provides comprehensive confidentiality provisions. Hence statements made during the process are protected from subsequent use in proceedings in the event that the mediation proves unsuccessful. The CEDR Model Mediation Agreement is available at <www.cedr.com/about_us/modeldocs>.

139 See Matravers (n 49). See, for example, Dorcas Quek, 'Mandatory Mediation: An Oxymoron? Explaining the Feasibility of Implementing a Court-mandated Mediation Program' (2010) 11 Cardozo Journal of Conflict Resolution 479; Jackson LJ, 'The Role of Alternative Dispute Resolution in Furthering the Aims of the Civil Litigation Costs Review' (RICS Expert Witness Conference, 8 March 2012); Lord Neuberger MR, 'Educating Future Mediators' (Fourth Civil Mediation Council National Conference, London 11 May 2010); Clarke (n 50).

as discussed above, it is important not to confuse a degree of compulsion to enter into a process from which settlement may result, a process that parties may exit at any time, with the settlement itself, that will be arrived at only when it is reduced to writing and signed by both parties and, in a commercial context, drafted and reviewed by the party's respective legal teams. In this context the guidelines set out in *Halsey*[140] are appropriate for the Irish courts to follow in deciding whether costs sanctions could or should be applied.[141] This approach also means that the court does not have to explore the subjective intentions of the parties during the process. For a party in a dispute, it is critical that the court in recommending mediation remains mindful of the power to excuse them if they can show that mediation would be unreasonable in the circumstances. This approach is consistent with the legislative framework elucidated in the Mediation Act 2017.[142]

Where a party is reluctant to engage in the process due to fears of unreasonable behaviour by the party on the other side, experience from England suggests that few inherently unreasonable parties restrain their unreasonableness to circumstances where mediation confidentiality restricts judicial access to what transpired at the mediation.[143] Consequently, there may be sufficient evidence of unreasonable conduct available to a court without the need to intrude into the confidentiality of the mediation. This approach would also provide assistance to parties who have a genuine reason to avoid mediation, for example, where a party needs to have a legal point determined, or where unreasonable behaviour by the other side can be shown, but would otherwise assist in developing a mediation culture for resolving commercial disputes in Ireland.

Lord Phillips remarked that, in light of Dyson LJ's declaration that compulsory mediation would be contrary to a party's Article 6 rights, 'he plainly did not consider that the use of a costs sanction was tantamount to compelling a party to [mediate]'.[144] His remarks highlight the distinction between encouraging parties to mediate and compelling them to do so. It follows that the more severe the potential sanctions, the closer the courts move towards compulsory mediation. It would seem erroneous that in order to avoid the risk of having to pay costs, a defendant should always be prepared to pay a settlement sum amounting to more than the claim is worth.[145]

Irish courts have the benefit of developed jurisprudence from England, the ECJ and the ECtHR in dealing with concerns that a compulsion to mediate infringes upon constitutional and ECHR Act rights of access to court, including the context where a party is subject to a costs sanction for an unreasonable refusal to mediate. This includes the benefit of learning from the mistakes made in *Halsey*, where there was a misunderstanding regarding the clear distinction between the compulsion to initially engage in the process, at least in terms of attendance, and the voluntary nature of

140 [2004] EWCA (Civ) 576.

141 This view is also supported by the Law Reform Commission, which considers that in general terms the guidelines set out in *Halsey* are appropriate in deciding whether costs sanctions could or should be applied, specifically because it means, as noted above, that the court does not then have to explore the subjective intentions of the parties during the process. See Law Reform Commission (n 38) 92. See also *McManus v Duffy* [2008] GLD 17, discussed above.

142 S 21, Mediation Act 2017.

143 See Tony Allen 'Peering behind the Veil of Mediation Confidentiality: A New Judicial Move in *Malmesbury v Strutt and Parker*' <www.cedr.com/articles/?item=Peering-behind-the-veil-of-mediation-confidentiality-a-new-judicial-move-in-Malmesbury-v-Strutt-and-Parker>.

144 Matravers (n 49).

145 See, for example, the remarks of Jack J in *Hickman v Blake Lapthorn* [2006] EWHC 12 (QB).

continued participation. A balance must be struck by the Irish courts when imposing costs sanctions. Encouragement must be weighty enough to avoid being dismissed as a 'mere bureaucratic hurdle',[146] but it must not be so strong as to amount to coercion and breach constitutional or ECHR Act rights.

The legislative framework is now in place to foster the growth of commercial mediation in Ireland. It is important when introducing statutory mediation schemes that the legislature is cognisant of ensuring that any compulsory aspect comprises a compulsion to initially engage and that the parties are free to leave the process at any time. In order to ensure that such schemes do not constitute constraint, financial or otherwise, and fall foul of constitutional and ECHR Act rights of access to court, the compulsion to consider commercial mediation should only impose a short delay, providing the space within which informed parties may attempt to settle their dispute with the assistance of a trained mediator. Mediation must be presented as a condition precedent to litigation or arbitration, not as the only means of dispute resolution. Provided such schemes are in the general interest and proportionate, the principal of effective judicial protection will not preclude them.

146 Hazel Genn, Paul Fenn, Marc Mason, Andrew Lane, Nadia Bechai, Lauren Gray and Dev Vencappa, 'Twisting Arms: Court Referred and Court Linked Mediation under Judicial Pressure' (Ministry of Justice of England and Wales Research Series 1/07 2007), iii <www.cnmd.ac.uk/laws/judicial-institute/files/Twisting_arms_mediation_report_Genn_et_al_1.pdf>.

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Do constructive trusts deter disloyalty?

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Abstract

Constructive trusts of disloyal fiduciary gain often are justified by the argument of deterrence. For there to be effective deterrence, two conditions must be satisfied: first, potentially disloyal fiduciaries must be sufficiently informed, directly or indirectly, of the properties of the constructive trust; secondly, fiduciaries must respond by accurately weighing the costs/benefits of disloyalty and other options before choosing the option that maximises their self-interest. Typically, one or both of these conditions will not be satisfied. Drawing upon insights from the behavioural sciences we find that fiduciaries contemplating disloyalty generally cannot be expected to be cognisant of the properties of the constructive trust and therefore cannot be influenced by them. Even when known, such properties will not necessarily influence fiduciary behaviour due to the way well-informed fiduciaries are likely to perceive and process the risk that their disloyalty will be detected. The deterrence gains generated by the recognition of a constructive trust are therefore likely to be negligible.

Keywords: constructive trusts; fiduciary loyalty; deterrence; behavioural economics.

1 Introduction

When a fiduciary's gain is neither subtracted from nor intercepted on its way to the principal, the appropriateness of constructive trust relief generally is debated on the understanding that 'the primary, if not the only, concern of the law . . . is to deter deviation from duty'.[1] Disagreement emerges not over whether the constructive trust generates extra deterrence – so much is assumed – but over whether the extra deterrence generated is

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1 Peter Watts, '*Tyrrell v Bank of London*: An Inside Look at an Inside Job' (2013) 129 Law Quarterly Review 526, 531. See also Anthony Duggan, 'Constructive Trusts from a Law and Economics Perspective' (2005) 55 University of Toronto Law Journal 217, 229–30; A Duggan, 'Gain-based Remedies and the Place of Deterrence in the Law of Fiduciary Obligations' in Andrew Robertson and Hang Wu Tang (eds), *The Goals of Private Law* (Hart 2009) 365, 384; Emily Sherwin, 'Constructive Trusts in Bankruptcy' [1989] University of Illinois Law Review 297, 337–9. In extra-judicial writings the issue tends to be addressed, as one might expect, primarily as an issue of legal principle, although the deterrent function of the constructive trust is nonetheless acknowledged: see Sir Terrence Etherton, 'The Legitimacy of Proprietary Relief' (2014) 2 Birkbeck Law Review 59, 75; Sir Peter Millett, 'Remedies: The Error in *Lister & Co v Stubbs*' in Peter Birks (ed), *Frontiers of Liability*, vol 2 (Oxford University Press 1994) 51, 56. See also Lord Peter Millett, 'Bribes and Secret Commissions Again' [2012] Cambridge Law Journal 583, 590.

sufficient to justify a proprietary response given the potential impact on innocent third parties, particularly the fiduciary's unsecured creditors.[2]

The deterrence thesis compliments the prophylactic theory of fiduciary obligation articulated by Conaglen.[3] The prophylactic rationale posits that the strict obligation of loyalty seeks to make harm to the principal less likely by requiring the fiduciary to avoid situations in which such harm is more likely to occur. The fiduciary's avoidance of situations in which harm is more likely to occur is secured by changing the fiduciary's calculations of the costs and benefits of acting in those situations. Conaglen thus observes the function of a disgorgement remedy for breach of fiduciary obligation 'is to deter fiduciaries from entering into such transactions in the first place, by seeking to remove any attraction that the transaction might hold'.[4]

The influence of deterrence thinking in extending the reach of the constructive trust is apparent in the cases. Decisions to recognise constructive trusts of bribes and secret commissions have been bolstered by reference to 'powerful policy reasons' for securing full disgorgement.[5] And, while a constructive trust was denied in *Sinclair*,[6] Lord Neuberger MR, as he then was, accepted that the recognition of a constructive trust turned on whether it was 'the only way of ensuring that those with fiduciary duties were dissuaded from breaching their duties'.[7] His Lordship expressed the tentative conclusion that a personal claim for an account of profits is sufficiently dissuasive.[8] However, in *FHR European Ventures* a unanimous seven-member panel of the Supreme Court, which included Lord Neuberger PSC, reached the opposite conclusion. Holding that a secret commission received by an agent was held on constructive trust for the principal, the panel emphasised: (1) the social costs of bribery and secret commissions;[9] (2) the

2 Craig Rotherham, 'Policy and Proprietary Remedies: Are We All Formalists Now?' (2012) 65 Current Legal Problems 529, 534. Compare Peter Watts, 'Constructive Trusts and Insolvency' (2009) 3 Journal of Equity 250, 280 (upon bankruptcy the 'deterrent purpose is spent' and there may be a case for subordinating the principal's claim to those of creditors who have suffered loss) and Anthony Duggan, 'Constructive Trusts' (n 1) 229–30, 247–8 (recognition of a constructive trust upon the fiduciary's bankruptcy is efficient from an *ex ante* perspective).

3 Matthew Conaglen, 'The Nature and Function of Fiduciary Loyalty' (2005) 121 Law Quarterly Review 452. On the difficulty of distinguishing prophylaxis and deterrence, see Lionel Smith, 'Deterrence, Prophylaxis and Punishment in Fiduciary Obligation' (2013) 7 Journal of Equity 87.

4 Matthew Conaglen, *Fiduciary Loyalty: Protecting the Due Performance of Non-fiduciary Duties* (Hart 2010) 80.

5 *Daraydan Holdings Ltd v Solland International Ltd* [2004] EWHC 622 (Ch), [2005] Ch 119 [86] (Collins J). See also *Dyson Techology Ltd v Curtis* [2010] EWHC 3289 (Ch), [189] (Grant J).

6 *Sinclair v Versailles Trade Finance (in administration)* [2011] EWCA Civ 347, [2012] Ch 453.

7 *Sinclair* (n 6) [53]. See also *FHR European Ventures v Mankarious* [2013] EWCA Civ 17, [2014] Ch 1 [116], where Sir Terrence Etherton C expressed the opinion that 'deterring fraud and corruption' is one of the 'important issues of policy' requiring consideration.

8 *Sinclair* (n 6) [53], [90].

9 References to the objectionable nature of the activity might hint at a retributive motive for the recognition of a constructive trust. Indeed, appeals both to retributive and deterrent considerations are not uncommon in this context: see *Soulos v Korkontzilas* [1997] 2 SCR 217, 227 (SC, Can); American Law Institute, *Restatement of Restitution* (Third) §3 cmt a, §43 cmts b & h (explaining disgorgement both in terms of retributive and prophylactic rationales). However, a retributive rationale requires a sanction to be proportionate to the gravity of the wrongdoing, as determined by such factors as the harm inflicted or risked and the wrongdoer's motives. A retributive rationale therefore is incapable of justifying a constructive trust in many instances, as where the profiting fiduciary causes their principal no loss and acts in good faith – for instance, the receipt of the commission in *Williams v Barton* [1927] 2 Ch 9 (Ch) – or where the principal acts in what he or she reasonably considers is in their principal's best interests, as in *Boardman v Phipps* [1967] 2 AC 46 (HL). In such instances the disgorgement sanction 'contains a penal element calculated to deter': *Boardman v Phipps* [1965] Ch 992 (CA) 1031 (Pearson LJ).

importance of removing all of the defendant's gains; and (3) the superior disgorgement potential of a proprietary claim over a personal claim.[10] International and domestic measures to combat bribery and corruption,[11] the panel noted, indicate concern over such activities 'has never been greater than it is now' and suggest the civil law's response should 'be particularly stringent in relation to a claim against an agent who has received a bribe or secret commission'.[12]

Elsewhere in the Commonwealth courts have been emphatic about the deterrent role of proprietary claims.[13] In *Lac Minerals*, for example, La Forest J opined the essence of fiduciary duty 'is its utility in the promotion and preservation of desired social behavior and institutions'[14] and that a constructive trust of fiduciary gain 'acts as a deterrent to the breach of duty'.[15] More recently, in *Grimaldi* the Full Court of the Federal Court of Australia reasoned that '[t]o exclude the bribed fiduciary from the deterrent effect of the constructive trust is . . . to make it unavailable in the very situations where deterrence is likely to be the most needed'.[16] In combating 'the crudest form of fiduciary infidelity', it continued, 'the full range of equity's remedies and techniques (including tracing and following illicit gains) are important instruments of deterrence'.[17]

Of course, in Australia and Canada, unlike in England, the constructive trust is 'remedial' rather than 'institutional' in nature.[18] Consequently, it will not be imposed if other remedies are more appropriate.[19] Potentially unfair effects, particularly on innocent third parties, therefore may be avoided or ameliorated. Deterrence nonetheless remains the driver of the constructive trust absent third-party effects. Thus, in *Grimaldi* the court expressed the opinion that, while a constructive trust of the proceeds of a profitably invested bribe will be denied where the fiduciary is insolvent,[20] outside insolvency a

10 *FHR European Ventures LLP v Cedar Capital Partners LLC* [2014] UKSC 45, [2015] AC 250 [1], [42], [44]. Similar points were made in *Attorney General for Hong Kong v Reid* [1994] 1 AC 324 (PC) 330–1, 338.

11 OECD Convention on Combating Bribery of Foreign Public Officials in International Business Transactions 1999, which implemented calls 'for effective measures to deter, prevent and combat the bribery of foreign public officials' (Preamble); UN Convention against Corruption 2003, the main purpose of which is to 'promote and strengthen measures to prevent and combat corruption' (Art 1(a)); and the Bribery Act 2010, passed in response to concerns about the previously uncertain and fragmented legislative responses to bribery and to implement the UK's international obligations to curb bribery and corruption: see Law Commission, *Reforming Bribery* (Law Com No 313, 2008) paras 1.1, 2.01–2.34.

12 *FHR European Ventures* (n 10) [42].

13 In addition to the cases discussed, see also *Lloyds Trust Company (Channel Islands) Ltd v Fragoso* [2013] JRC 211 (Jersey Royal Court), [28]; *Sumitomo Bank Ltd v Thahir Kartik Ratna* [1992] SLR (R) 638 (Sing HC), [216] (Lai Kew Chai J).

14 *Lac Minerals v International Corona Resources Ltd* [1989] 2 SCR 574 (Can SC), 672.

15 Ibid 673. See also *Soulos* (n 9) 235–6 (McLachlin J); *Strother v 3464920 Canada Inc* [2007] SCC 24, [2007] 2 SCR 177, [155]–[156] (McLachlin CJ).

16 *Grimaldi v Chameleon Mining NL* (No 2) [2012] FCAFC 6, [576].

17 Ibid [576].

18 See generally, Andrew Hicks, 'Conceptualising the Constructive Trust' (2005) 56 Northern Ireland Legal Quarterly 521. For rejection of the remedial constructive trust in UK courts, see *Re Polly Peck International plc (in administration)* [1998] 3 All ER 812 (CA), 830–1 (Nourse LJ); *Compagnie Commerciale Andre SA v Artibell Shipping Company Ltd* [2001] SC 653 (CSOH), [50] (Lord Macfadyen); *Sinclair* (n 6) [37]; *Crossco No 4 Unlimited v Jolan Ltd* [2011] EWCA Civ 1619, [2012] 2 All ER 754, [84] (Etherton LJ); *Bailey v Angove's Pty Ltd* [2016] UKSC 47, [27].

19 *Soulos* (n 9); *Farah Construction Pty Ltd v Say-Dee Pty Ltd* (2007) 230 CLR 89, [200]; *John Alexander's Clubs Pty Ltd v White City Tennis Club Ltd* (2010) 241 CLR 1, [126]–[128]; *Grimaldi* (n 16) [582].

20 *Grimaldi* (n 16) [583] (noting a lien 'may well be sufficient to achieve "practical justice" in the circumstances').

constructive trust 'is likely to be awarded as a matter of course'.[21] To deny a constructive trust in such circumstances would 'create an incentive which should not be tolerated'.[22]

The basic premise of the deterrence thesis is that the constructive trust possesses superior disgorgement properties relative to an account of profits. Its recognition therefore reduces the expected benefit of, and incentive for, disloyal behaviour. This assumes two behavioural conditions are satisfied. First, fiduciaries perceive and understand the implications for them of the disgorgement properties of the constructive trust. Secondly, fiduciaries use this information to undertake a cost–benefit analysis of disloyalty and choose disloyalty only if it maximises their interests. That advocates of the deterrence thesis assume these conditions generally are satisfied is, perhaps, not surprising. The deterrence argument is economic in nature and classical economics – the brand of economics to which most people subscribe, even if only implicitly[23] – assumes actors rationally maximise their own self-interest.[24] Moreover, as one leading economist frankly concedes, 'economic analysis of the behavioural effects of a legal rule generally begins with the assumption that the legal rule is clearly known not only to judges and other public officials but also to those subject to the legal rule'.[25]

In recent years, however, mounting evidence from the behavioural sciences has shown that people's behaviour frequently departs, in systematic and predictable ways, from that predicted by classical economics. Applying these insights this article finds that, far from being 'important instruments of deterrence',[26] the constructive trust and associated doctrines such as tracing are likely to generate little additional deterrence. In practice, the assumptions underpinning the deterrence thesis do not hold: fiduciaries contemplating disloyalty are unlikely to be aware of the disgorgement properties of the constructive trust (whether directly or indirectly) and, in the unlikely event that they are, they are likely to underweight or ignore them. This is not to say that a constructive trust never can influence fiduciary behaviour, but the conditions under which it is likely to do so are atypical.

The article is organised as follows. Section 2 identifies the marginal disgorgement benefits of the constructive trust, which are perhaps more modest than generally is assumed, and identifies the role of disgorgement in the standard economic theory of deterrence. Section 3 outlines key developments in the behavioural sciences which undermine the behavioural predictions of classical economics. Sections 4 and 5 develop these insights in greater detail. Section 4 identifies a number of biases which are likely to cause fiduciaries to perceive a low risk that disloyalty will be detected and explores the implications of low risk perception for deterrence. Section 5 examines the extent to which fiduciaries are likely to become informed about the legal consequences of disloyalty. It finds that cognitive limitations, fiduciary information search strategies and the external information environment will limit the fiduciary's knowledge of the legal implications of disloyalty. While we can expect fiduciaries to cognise the basic notion that

21 Ibid.

22 Ibid [576].

23 Cass Sunstein and Richard Thaler, *Nudge: Improving Decisions About Health, Wealth, and Happiness* (Yale University Press 2008) 6 (noting that most people are committed to the idea that each of us 'fits within the textbook picture of human beings offered by economists').

24 Richard Posner, *Economic Analysis of Law* (9th edn, Kluwer 2014) §1.1; Robert Cooter and Thomas Ulen, *Law and Economics* (6th edn, Berkeley Law Books 2016) 12–13.

25 Louis Kornhauser, 'The Economic Analysis of Law' in Edward Zalta (ed), *The Stanford Encyclopedia of Philosophy* (Winter 2016 edn) <https://plato.stanford.edu/archives/win2016/entries/legal-econanalysis/>.

26 Grimaldi (n 16).

disloyal gain must be 'given up', fiduciaries are unlikely to be cognisant of the more complex properties of disgorgement, such as how the gain will be identified or quantified. Section 6 concludes.

2 Constructive trust and the economics of deterrence

2.1 The marginal disgorgement benefits of the constructive trust

The perceived importance of the constructive trust in deterring disloyalty rests on its superior disgorgement properties relative to a personal claim for an account of profits. As Duggan explains, '[f]or effective deterrence the remedy must capture all D's gains from the wrongdoing' and '[t]he only sure-fire way of extracting all D's gains is to impose a constructive trust'.[27] As will be discussed below, this perhaps overstates the point a little. Nevertheless, a constructive trust may enhance disgorgement as a result of three proprietary aspects: (1) the principal's power to invoke the tracing process; (2) the principal's power to call for the trust property to be transferred *in specie*; and (3) the enforcement advantages that follow from the recognition of a proprietary claim.

2.1.1 Tracing

A constructive trust provides a gateway to the tracing process, which allows the principal to recover secondary profits derived from the investment of the initial gain.[28] By contrast, it sometimes is assumed that an account of profits will not reach beyond the value of the gain initially received in breach of fiduciary obligation.[29] For some, any extension of personal rights and remedies to capture secondary profits risks blurring important conceptual boundaries that should remain clearly delineated.[30]

Tracing is not, however, designed to effect disgorgement of wrongful gain.[31] To effect perfect disgorgement a wrongdoer must be stripped of all of the wealth he or she would not have acquired 'but for' the wrong. Tracing tends to involve transactional rather than causal inquiries. Penner makes the point neatly: 'tracing tracks the transactions a person makes with the property rights at his disposal; it does not track increases in wealth that are causally dependent on prior increases in wealth'.[32] Since it is possible to generate wealth by utilising an initial gain without leaving a transactional trail, claims against

27 Duggan, 'Constructive Trusts' (n 1) 229.

28 *FHR* (n 10) [1], [44]; *Reid* (n 10) 331, 336; Millett, 'Bribes and Secret Commissions' (n 1) 590.

29 *Reid* (n 10) 336; Millett, 'Bribes and Secret Commissions' (n 1) 590; Roy Goode, 'Proprietary Liability for Secret Profits – A Reply' (2011) 127 Law Quarterly Review 493, 495. The view derives some support from the comments of Lindley LJ in *Lister & Co v Stubbs* (1890) 45 Ch D 1 (CA) 15 (rejecting the notion that an agent in receipt of a secret commission might be compelled to account 'for all the profits which he might have made by embarking in trade with it' since this would confound ownership with obligation). The view of Lindley LJ has been long supported by Goode: see Roy Goode, 'Property and Unjust Enrichment' in Andrew Burrows (ed), *Essays on the Law of Restitution* (Oxford University Press 1991) 215, 242 (noting *Lister* was correctly decided because it does not 'allow P to recover by way of personal action a sum measured as if his claim did have a proprietary base'). See also Roy Goode, 'Ownership and Obligation in Commercial Transactions' (1987) 103 Law Quarterly Review 433, 441–4. The perceived limitation of a personal claim may explain why a declaration of constructive trust was sought in *Boardman* (n 9): see Andrew Hicks, 'Proprietary Relief in *Boardman v Phipps*' (2014) 65 Northern Ireland Legal Quarterly 1, 10–12.

30 *Lister* (n 29); Goode, 'Property and Unjust Enrichment' (n 29).

31 See Sarah Worthington, 'Fiduciary Duties and Proprietary Remedies: Addressing the Failure of Equitable Formulae' (2013) 72 Cambridge Law Journal 720, 740–2.

32 James Penner, 'The Difficult Doctrinal Basis for the Fiduciary's Proprietary Liability to Account for Bribes' (2012) 18 Trusts and Trustees 1000, 1006.

traceable proceeds 'are not in any way a substitute for gain stripping as a matter of principle, and they are a very poor facsimile in practice'.[33]

It is, moreover, incorrect to assume that a purely personal disgorgement claim that reaches secondary profits cannot be developed. An account of profits functions to identify the profit made by a wrongdoer as a result of the commission of a wrong. The value of wrongfully acquired profit is identified by a 'but for' test of causation subject to an appropriate remoteness principle.[34] Usually, the remoteness principle limits recovery to benefits arising directly from the commission of a wrong, but in the context of a profiting fiduciary the principle must be weaker and permit recovery of profits arising indirectly from the breach, from the application of the initial gain.[35] If the driver of doctrine in this area is deterrence, and if deterrence makes it imperative to strip a fiduciary of all gains attributable to a breach of fiduciary obligation, relaxation of the usual remoteness rules to capture 'but for' wealth is both logical and necessary. Moreover, a causal inquiry coupled with an appropriate remoteness rule would be a more principled method of measuring the fiduciary's gain than transactional link-tracing. It also would have the advantage of being less disruptive to third parties than a proprietary claim.[36]

Indeed, such a flexible personal disgorgement remedy may exist already. In *Sinclair* Lord Neuberger MR expressed the view, albeit tentatively, that a purely personal disgorgement claim is 'sufficiently flexible' to allow recovery of gains causally linked to a breach of fiduciary obligation.[37] The object of an account in this context, as Morritt LJ emphasised in *Deutsche Bank*, 'is to ensure that the defaulting fiduciary does not retain the profit'.[38] More recently, the Court of Appeal emphasised the flexibility of an account when accepting that an accessory will be liable to disgorge profits flowing from dishonestly assisting in a breach of fiduciary obligation so long as there is a 'sufficiently direct causal connection' between the profits and the underlying wrong.[39]

2.1.2 The transfer advantage

Proponents of the deterrence rationale also point to a cluster of disgorgement benefits generated by the constructive trust claimant's power to seek the delivery-up or conveyance of the property subject to the constructive trust. Where the gain or its traceable substitute is non-fungible the transfer of the asset eliminates the risk that the fiduciary will benefit from post-judgment increases in the value of the asset.[40] It also

33 Ibid 1006.

34 Graham Virgo, 'Restitutionary Remedies for Wrongs: Causation and Remoteness' in Charles Rickett (ed), *Justifying Private Law Remedies* (Hart 2008) 301, 307–10.

35 Ibid 321–2. See also James Edelman, *Gain-Based Damages: Contract, Tort, Equity and Intellectual Property* (Hart 2002) 108–9; William Swadling, 'Constructive Trusts and Breach of Fiduciary Duty' (2012) 18 Trust and Trustees 985, 992; Charles Mitchell, David Hayton and Paul Matthews, *Underhill and Hayton: Law of Trusts and Trustees* (19th edn, LexisNexis 2016) para 27.32.

36 *Sinclair* (n 6) [90] (Lord Neuberger MR).

37 Ibid. Whether the *obiter* survives *FHR* (n 10) may be doubted by some. In *Sinclair* Lord Neuberger MR reasoned that, if he was correct on the issue, 'it undermines the main policy reason supporting [a] proprietary claim: it does not matter to the defaulting fiduciary if he is stripped of his profits because they are beneficially owned by the beneficiary, or because he has to account for those profits to the beneficiary.' However, in *FHR* the Supreme Court appeared to accept that deterrence demanded a constructive trust of the fiduciary's gain: see above nn 9–12 and text. In *FHR*, however, the constructive trust was important primarily for reasons of enforcement: see below nn 45–6 and text.

38 *United Pan Europe Communications NV v Deutsche Bank AG* [2000] 2 BCLC 461, [47].

39 *Novoship (UK) Ltd v Mikhayluk* [2014] EWCA Civ 908, [2014] QB 499.

40 Duggan, 'Constrictive Trusts' (n 1) 229.

avoids the risk of inadequate disgorgement resulting from valuation mistakes.[41] Finally, the transfer of the asset to the principal avoids the risk that the fiduciary will retain a consumer surplus because he or she values the asset more than the market-based measure of a personal disgorgement claim (the problem of 'subjective valuation').[42]

Delivery-up or conveyance of the fiduciary's gain does not, however, follow automatically from the recognition of a constructive trust but is contingent on the claimant's election. Whether the claimant elects to have the property transferred will depend on whether its transfer is more advantageous to the claimant than an alternative available remedy, not on whether the property is particularly valuable to the defendant.[43] Moreover, from a general deterrence perspective valuation mistakes are a concern only if there is systematic under-valuation of gains. Absent evidence of systematically skewed valuation we might expect a relatively even distribution of mistakes that are off-setting. It is also worthy of note that the risk a fiduciary may benefit from post-judgment increases in the value of an asset is ameliorated by the claimant's power to elect to postpone the taking of an account of profits until such time as the value of the gain becomes clear.[44]

2.1.3 Enforcement advantages

As a consequence of the recourse it provides to third parties, a constructive trust may be particularly effective at cutting off avenues for processing ill-gotten gains. Corrupt fiduciaries in particular might transfer their ill-gotten gains to compliant third parties, leaving themselves with insufficient assets to meet any judgment entered against them. However, assets subject to a constructive trust can be followed into the hands of recipients and recovered, unless the recipient is a bona fide purchaser of the legal title without notice. The *FHR* case[45] illustrates the point. The €10 million secret commission was received by Cedar LLC in breach of fiduciary obligation and mixed in its bank accounts with other monies. Transfers equivalent to the value of the commission then were made to Cedar Ltd (a wholly owned subsidiary) and to Mr Mankarious, the moving force behind both companies, who used the monies to fund, amongst other things, the purchase of life insurance policies and freehold property. Cedar LLC was left with no assets to satisfy a claim for breach of fiduciary obligation. A proprietary claim allowed the claimants to follow and trace the commission and recover proceeds from Cedar Ltd and Mr Mankarious.[46]

In contrast to proprietary rights, personal rights receive less protection against interference by third parties. A third party who becomes involved in a breach of fiduciary

41 Mistakes may occur because the property is unique and the absence of a suitable comparator makes valuation difficult or because the value of the gain turns on unpredictable future variables, a particular problem with some business opportunities: see *Lac Minerals v International Corona Resources Ltd* (1989) 61 DLR (4th) 14 (Can SC), 48–9 (La Forest J).

42 Duggan, 'Constrictive Trusts' (n 1) 229; Sherwin (n 1) 338.

43 It is true, as the anonymous reviewer of this article noted, that the *availability* of a specific remedy, not its inevitable enforcement, may have deterrent value. Indeed, it may be that cases in which a gain is valued subjectively by the defaulting fiduciary but not claimed *in specie* by the principal will be relatively few. But, from an economic perspective, so long as a fiduciary can expect to retain a consumer surplus in some cases, however few in number, he or she will discount the expected costs of the remedy accordingly. See further the discussion of the neo-classical economic theory of deterrence below, nn 55–6 and text.

44 *Crown Dilmun v Sutton* [2004] EWHC 52 (Ch), [2004] 1 BCLC 468, [205]–[214] (Peter Smith J) (claimant permitted to postpone the taking of the account until the value of the wrongfully exploited opportunity became clear).

45 *FHR* (n 10).

46 See *FHR European Ventures LLP v Mankarious* [2016] EWHC 359 (Ch) (Master Clark).

obligation may face accessory liability for inducing, encouraging or assisting in the breach. The accessory will be jointly and severally liable with the fiduciary to compensate the principal for the loss resulting from the breach of fiduciary duty[47] or, alternatively, liable to account for any profits resulting from the assistance.[48] However, since higher fault and involvement thresholds are required[49] a principal without a proprietary claim may be left with no effective redress against a culpable third party.[50] A significant advantage of the constructive trust is that volunteer recipients of the fiduciary's gain are bound automatically by the trust claim.[51]

Corrupt fiduciaries are also likely candidates to abscond. The recognition of a constructive trust has incidental benefits in this regard since more options tend to be available to prevent defendants from dealing in identified assets if the claimant is able to demonstrate a proprietary interest. This was one important reason for the proprietary claim in *Reid*:[52] recognition of a constructive trust allowed the registration of caveats against the New Zealand properties allegedly purchased with the bribe monies, frustrating Reid's hope that the properties could be 'sold and the proceeds whisked away to some Shangri La which hides bribes and other corrupt moneys in numbered bank accounts'.[53] The absence of a proprietary claim does not, however, necessarily leave a principal without any power to encumber the assets in the hands of a fiduciary.[54]

2.2 Neo-classical economic theory of deterrence

To the extent the constructive trust has superior disgorgement properties relative to an account of profits, neo-classical economic theory provides a short link to the conclusion that a constructive trust of fiduciary gain enhances deterrence.

Neo-classical economic theory views deterrence as nothing more than an application of the general theory of rational choice under uncertainty.[55] Individuals are assumed to be rational utility maximisers who calculate the probable returns of all available options open to them and pursue the option that gives the greatest return. Thus, rational actors will be deterred from wrongdoing if the expected utility of the commission of a wrong is less than the expected utility of an alternative option. The expected utility of wrongdoing can be reduced by increasing the expected cost of the wrongdoing. The expected cost of wrongdoing is a product of two variables: the objective probability that wrongdoing will be detected and sanctioned (p) multiplied by the sanction (s). It follows that, all other things being equal, the expected cost of wrongdoing can be raised by

47 *Ultraframe (UK) Ltd v Fielding* [2005] EWHC 1638 (Ch), [2006] FSR 16, [1600] (Lewison J).

48 *Novoship* (n 39).

49 Watts (n 1) 530.

50 A claim for accessory liability would, however, seem relatively straightforward in cases replicating the *FHR* fact pattern (above nn 45–6 and text).

51 Additionally, a constructive trust of the gain may extend accessory liability to those who assist the fiduciary in dealings with the gain but who did not assist in the wrongdoing that generated the gain: see, for example, the unsuccessful claim in *Fitzalen-Howard v Hibbert* [2009] EWHC 2855 (QB), [2010] PNLR 11.

52 *Reid* (n 10). For a more detailed account of the important procedural advantages secured by a proprietary claim in the case, see Richard Nolan, 'The Wages of Sin: Iniquity in Equity Following *A-G for Hong Kong v Reid*' (1994) Company Lawyer 3, 4–5, but especially fn 15.

53 *Reid* (n 10) 339.

54 Freezing orders are available to prevent the disposal of assets with the intention of defeating judgment and, in some jurisdictions, pre-judgment charging orders and caveats against dealings in land are available without a proprietary interest in the relevant land: Watts (n 2) 283.

55 Gary Becker, 'Crime and Punishment: An Economic Approach' (1968) 76 Journal of Political Economy 167.

increasing either *p* or *s*, and different combinations of *p* and *s* can achieve the same sanction effect: a fall in *p* can be off-set by a compensating uplift in *s* and vice-versa.[56]

According to this model, the mere requirement that a wrongdoer give up their gain whenever caught will have little dissuasive effect unless detection and enforcement rates are perfect.[57] Since they are not, disgorgement per se is a poor deterrent because it leaves wrongdoing profitable on average.[58] However, there likely will be other formal and informal elements of a sanction, in addition to disgorgement, which a rational wrongdoer will factor in to their calculation of the expected cost of wrongdoing. In the fiduciary context, these include: (1) termination or non-renewal of the relationship; (2) firm-level sanctions, such as organisational censure, limited promotion prospects or dismissal;[59] (3) professional embarrassment, negative peer perception or loss of reputation;[60] and (4) criminal sanctions.[61]

If a constructive trust removes more from a fiduciary than an account of profits its recognition will, in combination with other sanction elements, increase the total value of *s* and thereby raise the expected cost of disloyalty. By raising the expected cost of disloyalty, fewer opportunities for wrongdoing will yield an expected net benefit in excess of the expected net benefit of legitimate options, resulting in less wrongdoing.

3 The behavioural challenge to rational choice economics

The deterrence thesis follows neo-classical economics in its assumptions about how fiduciaries identify and perceive risk and how they obtain and process information. However, behavioural scientists have shown that in some contexts the traditional economic account of human behaviour not only fails to describe accurately the psychological processes by which humans make decisions, it also lacks predictive power. These insights generally are collected together under the label 'behavioural economics'.[62] Behavioural economics attempts 'to increase the explanatory and predictive power of economic theory by providing it with more psychologically plausible foundations'.[63] The field has two distinguishing characteristics. First, it focuses on identifying the systematic and predictable ways in which the behaviour of agents deviates from that predicted by rational choice theory. Secondly, it is empirical in nature in that it looks for evidence about how actors really do behave.

56 Thus, if an expected sanction of £50 is required to deter, and detection and sanctioning of wrongdoing falls from one in two to one in four, the desired level of deterrence can be preserved by increasing the sanction from £100 (0.5 x £100=£50) to £200 (0.25 x £200=£50): A Mitchell Polinsky, *An Introduction to Law and Economics* (2nd edn, Little Brown 1989) 77–8.

57 Hence theft cannot be deterred merely by requiring a thief to return stolen property if caught: Cooter and Ulen (n 24) 562.

58 Smith (n 3); Lionel Smith, 'Fiduciary Relationships: Ensuring the Loyal Exercise of Judgment on Behalf of Another' (2014) 130 Law Quarterly Review 608, 627.

59 As to the powerful influence of such sanctions, see Richard Hollinger and John Clark, 'Formal and Informal Social Controls of Employee Deviance' (1982) 23 Sociological Quarterly 333.

60 For professional fiduciaries a reputation for honesty and loyalty may be as important as a brand name is to a manufacturer: Tamar Frankel, 'Fiduciary Law' (1983) 71 California Law Review 795, 835–6; Kenneth Davis, 'Judicial Review of Fiduciary Decisionmaking – Some Theoretical Perspectives' (1985) 80 Northwestern University Law Review 1, 8.

61 For instance, the receipt of a bribe is punishable by a maximum of ten years' imprisonment, an unlimited fine, or both: Bribery Act 2010, s 11(1).

62 For an accessible history, see Richard Thaler, *Misbehaving: The Making of Behavioral Economics* (Allen Lane 2015).

63 Erik Angner and George Loewenstein, 'Behavioral Economics' in Uskali Maki (ed), *Handbook of the Philosophy of Science: Philosophy of Economics* (Elsvier 2012) 641, 642.

3.1 Systematic and predictable deviations from rationality

Sometimes, people do not aspire to make optimal decisions because it is not feasible given the constraints under which they operate. Long ago Herbert Simon provided the influential insight that the capacity of humans to make rational decisions is curtailed by limited information, limited time and limited computational capacity. Simon coined the term 'bounded rationality' to capture this insight and offered a model of decision-making in which utility maximisation is replaced with 'satisficing', the idea that in many contexts individuals in fact *aim* to make decisions which are approximate and satisfactory rather than optimal.[64] For instance, when considering how informed individuals are likely to be in a given situation, satisficing provides a more plausible model than the assumption that actors are perfectly informed or will search for an optimal amount of information.[65]

Building on Simon's insights, psychologists Daniel Kahneman and Amos Tversky discovered non-optimal decisions also may be the *unintended* consequence of the operation of heuristics and associated judgment biases.[66] Heuristics are simplifying shortcuts of intuitive thinking, cognitive 'rules of thumb', which reduce the complexity of a task. Heuristics generally are 'highly economical and usually effective'.[67] But they also come with characteristic biases which arise in certain, predictable situations. For example, estimates of the probability of an event typically are mediated by an assessment of its 'availability' – 'the ease with which instances or occurrences can be brought to mind'.[68] Usually, availability is a good indicator of event probability since common events tend to come to mind with greater ease than rare events. However, since factors other than general frequency affect ease of recall – for instance, the vividness of an event – reliance on availability can produce errors.[69]

A crucial finding of the heuristics and biases research project is that heuristics misfire in predictable ways. In the years following Kahneman and Tversky's pioneering studies, psychologists devised numerous experiments to identify and map the operation of heuristics and their associated biases. This research produced 'a taxonomy of deviations from rationality'[70] – an outline of the predictable ways in which decision-makers deviate from the rationality assumptions of traditional economics.[71] It provides a 'more subtle,

64 Herbert A Simon, 'A Behavioral Model of Rational Choice' (1955) 69 Quarterly Journal of Economics 99; Herbert A Simon, 'Information Processing Models of Cognition' (1979) 30 Annual Review of Psychology 363. See, generally, Peter Earl (ed), *The Legacy of Herbert Simon in Economic Analysis*, vol 1 (Edward Elgar 2001).

65 See Section 5, below.

66 Daniel Kahneman and Amos Tversky, 'Prospect Theory: An Analysis of Decisions Under Risk' (1979) 47 Econometrica 313; Amos Tversky and Daniel Kahneman, 'Judgment under Uncertainty: Heuristics and Biases' in Amos Tversky, Daniel Kahneman and Paul Slovic (eds), *Judgment Under Uncertainty: Heuristics and Biases* (Cambridge University Press 1982) 3; Daniel Kahneman and Amos Tversky, 'On the Reality of Cognitive Illusions' (1996) 103 Psychological Review 582.

67 Tversky and Kahneman, 'Judgment under Uncertainty' (n 66) 20. See. generally, Gerd Gigerenzer, Peter Todd and ABC Research Group, *Simple Heuristics That Make Us Smart* (Oxford University Press 2000).

68 Tversky and Kahneman, 'Judgment under Uncertainty' (n 66) 11. See, generally, Daniel Kahneman, *Thinking, Fast and Slow* (Penguin 2012) 129–45; Scott Plous, *The Psychology of Judgment and Decision Making* (Temple University Press 1993) 121–30.

69 Amos Tversky and Daniel Kahneman, 'Availability: A Heuristic for Judging Frequency and Probability' (1973) 5 Cognitive Psychology 207, 209.

70 Herbert A Simon, 'The Behavioral and Social Sciences' (1980) 209 Science 72, 75.

71 As to which, see Daniel Kahneman, 'Maps of Bounded Rationality: Psychology for Behavioral Economics' (2003) 93 American Economic Review 1449; Robyn LeBoeuf and Elder Shafir, 'Decision Making' in Keith Holyoak and Robert Morrison (eds), *The Oxford Handbook of Thinking and Reasoning* (Oxford University Press 2012) 301.

textured understanding of how actors make decisions in various situations' by providing a 'pragmatic collection of situation-specific insights' that can be applied to 'modify the implausible elements of rational choice theory and supplement the inadequate elements in order to create a tool with more predictive power in specific situations'.[72]

3.2 Empirical foundations of the behavioural claims

The claims of behavioural economics are empirical in the sense they are informed by scientific insights about actual human behaviour. Although field studies increasingly are employed to gather data, behavioural economics insights predominantly are derived from laboratory experiments. There are legitimate concerns that insights from laboratory experiments are not capable of easy or reliable generalisation.[73] One concern is that experimental settings involve small stakes and therefore may lack incentives that cure real-world actors of their biases. However, there is little evidence that increased incentives have the curative effect claimed and some evidence that incentives can in fact exacerbate biases.[74] A more serious concern is that experimental settings typically do not provide opportunities for individuals to learn to adapt to eliminate biases.[75] Learning opportunities do not, however, diminish all biases.[76] Moreover, in some contexts there will be impediments to learning – for instance, because feedback on choices is too infrequent.[77] Biases affecting the judgment of fiduciaries contemplating disloyal acts, for example, are unlikely to be corrected because feedback is most likely when wrongdoing is detected and this is likely to be infrequently. Finally, there is concern that many of the identified biases pull in opposite directions, hence their net effect on behaviour outside of the controlled laboratory environment may be ambiguous.[78] While this is true, not all real-world situations arguably trigger opposing biases. The multiple biases affecting fiduciary perceptions of the risk of detection, for example, are unidirectional, hence cumulative – not conflicting – in effect. Thus, while behavioural economics may be too underdeveloped to be a comprehensive tool of legal analysis, its findings can prove insightful in particular contexts.

4 The fiduciary's perception of detection risk

The actual detection and enforcement probability (p) is central to the neo-classical economic theory of deterrence. The value of p will vary, but generally can be expected to

72 Russell Korobkin and Tom Ulen, 'Law and Behavioral Science: Removing the Rationality Assumption from Law and Economics' (2000) 88 California Law Review 1051, 1074–5. See also Christine Jolls, Cass R Sunstein and Richard Thaler, 'A Behavioral Approach to Law and Economics' (1998) 50 Stanford Law Review 1471, 1487.

73 Richard A Posner, 'Behavioral Law and Economics: A Critique' (2002) 42 Economic Education Bulletin 1, 3; Yulie Foka-Kavalieraki and Aristides Hatzis, 'Rational after All: Toward an Improved Theory of Rationality in Economics' (2011) 12 Revue de Philosophie Economique 3, 20–1.

74 Eldar Shafir and Robyn LeBoeuf, 'Rationality' (2002) 53 Annual Review of Psychology 491, 501–2; Jeffrey Rachlinski, 'The Uncertain Psychological Case for Paternalism' (2002–2003) 97 Northwestern University Law Review 1165, 1167.

75 For instance, it appears that the endowment effect, the tendency to place a higher value on something simply because it is owned, is eroded as individuals gain experience of trading in goods: John List, 'Does Market Experience Eliminate Market Anomalies?' (2003) 118 Quarterly Journal of Economics 41; John List, 'Neoclassical Theory Versus Prospect Theory: Evidence from the Marketplace' (2004) 72 Econometrica 615.

76 Shafir and LeBoeuf (n 74) 502.

77 Rachlinski (n 74) 1220–1224.

78 Roger van den Bergh, 'Behavioral Antitrust: Not Ready for the Main Stage' (2013) 9 Journal of Competition Law and Economics 203, 211, 214–16; Doron Teichman, 'The Optimism Bias of the Behavioral Analysis of Crime Control' [2011] University of Illinois Law Review 1697.

be relatively low. Fiduciary law's 'no further inquiry rule' is designed to raise the value of *p*,[79] but enforcement is premised on detection and in many instances, particularly those involving the receipt of bribes and commissions, the actual probability of detection will be small. The issue for conventional economic analysis is whether *s* is sufficient to compensate for a low *p*. However, from a behavioural perspective it is not the *actual* but the *perceived* probability of detection and enforcement that is important for deterrence. Perceived probability of detection may diverge significantly from the actual value of *p*. Moreover, while conventional economic analysis assumes a linear weighting of risk the behavioural evidence suggests otherwise. In particular, it suggests people have difficulties dealing with small risks and may ignore them altogether. This section identifies the causes of low risk perception, examines how these might affect fiduciaries and considers the implications of low risk perception for deterring disloyalty.

4.1 Causes of low risk perception

A fiduciary will not possess actuarial information about detection rates for disloyal acts. An assessment of the risk of detection therefore will be inferential, drawn from past experience and the fiduciary's observations of the risk. This process opens the door for the operation of biases which may lead to the systematic underestimation of *p*.

4.1.1 Availability bias

In the absence of statistical information, the subjectively perceived likelihood of an event typically is mediated by its 'availability' – the ease and speed with which the event can be remembered or imagined.[80] However, factors unrelated to the frequency or probability of an event may influence availability and generate bias. Much of the research on 'availability' emphasises a positive correlation between salience and availability. For instance, witnessing a house fire will have a greater impact on one's perceived risk of house fires than reading about the same fire in a newspaper due to the vividness of physically proximate events which makes them more memorable.[81] Vivid information is more available than 'pallid, abstract or statistical information'.[82] Equally, recent events usually are more available than earlier ones.[83] 'Imaginability' also influences availability.[84] When scenarios that lead to an event are difficult to imagine, or if no plausible scenario comes to mind, the event tends to be perceived as improbable; if plausible scenarios, or a particularly compelling scenario, can be constructed with ease the event tends to be perceived as probable.[85]

4.1.2 Optimism bias

Availability biases often are compounded by the operation of self-serving biases, a loose collection of biases 'driven by a common human tendency to interpret the world to make

79 Robert Cooter and Bradley Freedman, 'The Fiduciary Relationship: Its Economic Character and Legal Consequences' (1991) 66 New York University Law Review 1045, 1051–6.

80 See the sources cited in nn 68 and 69.

81 Tversky and Kahneman, 'Judgment under Uncertainty' (n 66) 11.

82 Plous (n 68) 126.

83 Sunstein and Thaler (n 23) 36.

84 Tversky and Kahneman, 'Judgment under Uncertainty' (n 66) 12.

85 See Steven Sherman et al, 'Imagining Can Heighten or Lower the Perceived Likelihood of Contracting a Disease: The Mediating Effect of Ease of Imagery' in Thomas Gilovich, Dale Griffin and Daniel Khaneman (eds), *Heuristics and Biases: The Psychology of Intuitive Judgment* (Cambridge University Press 2002) 98.

it square more comfortably with one's own interests and beliefs'.[86] Thus, individuals tend to ascribe too much weight to the contributions they make to particular outcomes (egocentric bias);[87] have excessive confidence in their own forecasts (over-confidence bias);[88] and believe their own risk of experiencing a negative outcome is lower than it actually is (optimism bias).[89] Optimism bias is particularly important given its powerful effects and pervasiveness.[90] As two leading commentators note, the bias 'is an indiscriminate and indefatigable cognitive feature' that causes individuals to 'underestimate the extent to which a threat applies to them even when they can recognize the severity it poses to others'.[91] From a wrongdoer's perspective, detection of wrongdoing is a negative event. Evidence suggests over-optimism operates in this domain: people tend to believe their own wrongdoing is less likely to be detected than the wrongdoing of others.[92] This is particularly likely if a wrongdoer perceives measures to evade detection are within their control. A consistent and robust finding in studies of optimism bias is the existence of a positive correlation between perceptions of control (in the form of steps that can be taken to avoid a negative outcome) and unrealistic optimism about avoiding the outcome.[93]

4.1.3 Biased perceptions of the level of wrongdoing

There is plenty of evidence that people assume others engage in unethical and morally undesirable behaviour more often than they do.[94] A particularly relevant example is

86 Ward Farnsworth, 'The Legal Regulation of Self-Serving Bias' (2003) 37 University of California Davis Law Review 567, 570.

87 Michael Ross and Fiore Sicoly, 'Egocentric Biases in Availability and Attribution' in Tversky, Kahneman and Slovic (n 66) 179.

88 Rachlinski (n 74) 1172.

89 Neil Weinstein, 'Unrealistic Optimism about Future Life Events' (1980) 39 Journal of Personality and Social Psychology 806. For a summary of the vast psychological literature on the bias, see James Sheppherd et al, 'A Primer on Unrealistic Optimism' (2015) 24 Current Directions in Psychological Science 232.

90 See Christine Jolls, 'On Law Enforcement with Boundedly Rational Actors' in Francesco Parisi and Vernon Smith (eds), *The Law and Economics of Irrational Behavior* (Stanford University Press 2005) 268, 270, 273 (finding more than 250 studies documenting this 'highly robust feature of human behaviour'). See also Sheppherd et al (n 89).

91 Jon Hanson and Douglas Kysar, 'Taking Behavioralism Seriously: The Problem of Market Manipulation' (1999) 74 New York University Law Review 630, 657–8. See also Tim Smits and Vera Hoorens, 'How Probable is Probably? It Depends on Whom You're Talking About' (2005) 18 Journal of Behavioral Decision Making 83 (finding information about the probability of future events is often interpreted in a self-serving way).

92 Andrew Guppy, 'Subjective Probability of Accident and Apprehension in Relation to Self-other Bias, Age, and Reported Behavior' (1993) 25 Accident Analysis and Prevention 375, 377–80 (most drivers believe they have a better than average chance of avoiding detection for driving while over the prescribed blood alcohol limit). See also Jolls (n 90) 273–4.

93 Peter Harris, 'Sufficient Grounds for Optimism? The Relationship between Perceived Controllability and Optimistic Bias' (1996) 15 Journal of Social and Clinical Psychology 9; Cynthia Klein and Marie Helweg-Larsen, 'Perceived Control and the Optimistic Bias: A Meta-analytic Review' (2002) 17 Psychology and Health 437.

94 For discussion of relevant studies, see Robert Cooter, Michal Feldman and Yuval Feldman, 'The Misperception of Norms: The Psychology of Bias and the Economics of Equilibrium' (2008) 4 Review of Law and Economics 889, 893–5.

bribery. Although actual incidents of bribery may be relatively low,[95] recent data suggests a majority of people perceive bribery is widespread (64%)[96] and an accepted part of UK business culture (62%).[97] One possible explanation for misperceptions about the level of wrongdoing is that they result from the 'false uniqueness effect' – the tendency of people to underestimate the extent to which others share their positive attributes.[98] The implication of this bias is that 'those who perform a desirable behaviour underestimate the number of others as good as them, whereas those who perform an undesirable behaviour overestimate the number of others as bad as them'.[99] Misperceptions about others' conduct also may be generated by the 'false consensus effect', the tendency of people to overestimate the degree to which others share their beliefs, attributes and behaviours.[100] A consequence of this bias is that a person inclined to undesirable behaviour is likely to overestimate how many others engage in similar behaviour.[101]

Overestimation of the frequency with which others violate norms may have important implications for perceptions about the risk of detection for a norm's violation. If violations are perceived as more prevalent than they are, but incidents of detection are not, the risk of getting caught is likely to be underestimated.

4.2 The fiduciary's perceptions of detection risk

Fiduciaries no doubt are likely to be susceptible to such biases when determining the risk that contemplated disloyalty will be detected. Consider first the general characteristics of fiduciary relationships. Most analyses of fiduciary relationships emphasise the asymmetric distribution of information between the parties, the fiduciary's physical or practical control over the enterprise and the monitoring difficulties faced by the principal.[102] These structural characteristics create numerous opportunities for the fiduciary to render breaches undetectable and no doubt engender feelings of power and control. Given the

95 Survey data collected in one notable study suggests actual instances of bribery in the UK are 'negligible': Transparency International, *Corruption in the UK: Part One* (Transparency International 2010) 4. A more recent survey found 7 per cent of UK respondents admitted to knowing people who have taken or take bribes: European Commission, S*pecial Eurobarometer 397: Corruption* (European Commission 2014) 70. Corruption is more prevalent in some sectors than others – for instance, the construction industry: see Chartered Institute of Building, *Corruption in the UK Construction Industry* (Chartered Institute of Building 2013) 15 (35% of respondents in the construction industry had been offered a bribe at least once in their career).

96 European Commission (n 95) 20.

97 Ibid 54.

98 On the cognitive and motivational causes of this bias, see Cooter et al (n 94) 895–8.

99 Benoit Monin and Michael Norton, 'Perceptions of a Fluid Consensus: Uniqueness Bias, False Consensus, False Polarization, and Pluralistic Ignorance in a Water Conservation Crisis' (2003) 29 Personality and Social Psychology Bulletin 559, 560.

100 Lee Ross, David Greene and Pamela House, 'The "False Consensus Effect": An Egocentric Bias in Social Perception and Attribution Processes' (1977) 13 Journal of Experimental Social Psychology 279; Gary Marks and Norman Miller, 'Ten Years of Research on the False Consensus Effect: An Empirical and Theoretical Review' (1987) 102 Psychological Bulletin 72.

101 Those exhibiting the bias but who are not inclined to engage in an undesirable behaviour are likely to underestimate the frequency with which others engage in the behaviour. The situation is more complex for those not inclined to undesirable behaviour who exhibit both false uniqueness and false consensus biases. It may be that the biases are off-setting, giving rise to relatively accurate perceptions: Cooter et al (n 94) 892, 905–7. Given we are concerned with fiduciaries contemplating breaching their fiduciary obligation it is not necessary to pursue this issue further.

102 See Frankel (n 60); Cooter and Freedman (n 79); Larry Ribstein, 'The Structure of the Fiduciary Relationship' (University of Illinois Law and Economics Research Paper No LE03–003 January 4 2003) (available at SSRN: http://ssrn.com/abstract=397641); Robert Sitkoff, 'The Economic Structure of Fiduciary Law' (2011) 91 Boston University Law Review 1039.

correlation between perceptions of control and over-optimism, we might expect the very nature of the fiduciary relationship to tend to bias fiduciary perceptions about the prospects of avoiding detection of wrongdoing.

More specifically, consider fiduciary appropriations of opportunities. Some appropriations may be difficult to conceal. Where a fiduciary intercepts a maturing business opportunity, for example, the principal or other monitors may be put on notice by the non-arrival of an expected benefit. Similarly, when a fiduciary engages in competition with their principal the principal may be put on notice by the unexplained erosion of trade or by tip-offs from loyal customers.[103] However, in other contexts the existence of steps that might be taken to limit the risk of detection may give the fiduciary cause for optimism. The fiduciary might exploit information asymmetries and limited monitoring to prevent an opportunity from ever appearing on the principal's radar. Equally, fiduciaries might (and frequently do) exploit appropriated opportunities through corporate fronts to conceal their ownership.

A fiduciary contemplating the receipt of a bribe or secret commission is particularly likely to underestimate the risk of detection. If, as we might expect,[104] fiduciaries perceive bribe and commission-taking as more prevalent than they are, they are likely to underestimate the detection risk unless incidents of detection similarly are perceived as more numerous than they are. This will be unlikely. Indeed, the opposite may be true since the event of detection is unlikely to be readily available. The fiduciary's control over relevant information and the ease with which illegitimate payments can be concealed is likely to make plausible scenarios of detection difficult to imagine. On the other hand, where the fiduciary previously has engaged in a similar activity (for instance, the receipt of a small commission) and, as we might expect, escaped detection, salient instances of detection avoidance are easily called to mind. In such circumstances, 'I haven't been caught' easily translates to 'I won't be caught.'[105] Moreover, fiduciaries contemplating bribe and commission-taking are probable candidates for optimism bias because they are likely to perceive the risk of detection as highly controllable. It is in the common interest of both the fiduciary and briber (who also faces sanctions if caught) to cover their tracks, and it is largely within the power of both to do so. Payments of bribes and secret commissions are difficult for monitors to detect since harm to the enterprise with which the fiduciary is entrusted usually is ambiguous or invisible.[106] Often, the bare fact of payment is the only indication of wrongdoing and this is the evidence that the wrongdoers control and have the power to conceal.

4.3 Implications of low risk perception

It follows that we might expect fiduciaries to underestimate the risk of detection, especially in relation to bribe and commission-taking, and to perceive the risk as low. This has three implications for deterring disloyalty.

103 As in *Normalec Ltd v Britton* [1983] FSR 318 (Ch), 321 (Walton J).

104 See nn 95–7 and text.

105 Colin Camerer and Howard Kunreuther, 'Decision Processes for Low Probability Events: Policy Implications' (1989) 8 Journal of Policy Analysis and Management 565, 569.

106 Consider, for example, the €10 million commission in the *FHR* case (n 10). The principals were content with the €211.5 million purchase price they paid for the hotel, presumably because the hotel was difficult to value and the price fell within a broadly acceptable range. This view changed once the commission was discovered, although the extent to which the price was loaded by the commission was unclear. A more modest illustration is *Williams v Barton* [1927] 2 Ch 9 (Ch), where the price paid by the trust for the stockbroker's service was the usual market rate.

First, to maintain the desired level of deterrence, it may be necessary to make adjustments to *s* to compensate for the fiduciary's underestimation of *p*. This suggests that exemplary damages may have a role to play in securing the desired level of deterrence, since they can be adjusted to compensate for low subjective detection and enforcement probabilities.[107] One problem with this strategy, however, is that it assumes the effects of a low *p* can be off-set by increasing *s*. In fact, a low *p* may leave individuals relatively unresponsive to changes in *s*.[108]

Secondly, particular problems arise if the perceived risk of detection falls to zero since, at this point, sanctions become irrelevant. Such an occurrence may be more common than is appreciated because of the way in which individuals process risk: small risks often are treated as 'zero risk' and simply ignored.[109] Thus, it has been observed that individuals may aim to 'get the gist' of a risk, hence 'edit' small risks to zero.[110] Others may use 'probability thresholds',[111] ignoring the consequences of an event if the perceived probability of its occurrence falls below a subjectively determined threshold.[112] In one notable experiment over a quarter of subjects were unwilling to pay anything to insure against a 1 per cent risk of loss while over 10 per cent of subjects were unwilling to pay anything to protect against a 10 per cent risk of loss,[113] implying that such subjects ignored the risk of loss entirely. Such findings have clear implications for the deterrence potential of the remedial regime for fiduciary disloyalty. A fiduciary who is perfectly informed about the remedial consequences of disloyalty will be unresponsive to those consequences if he or she perceives there is no chance they will have to be faced.[114]

Finally, even if a low risk is not translated into zero risk, low risk perception is likely to have implications for a fiduciary's incentive to become informed about the sanctions for disloyalty. The lower a fiduciary's perceived risk that wrongdoing will be detected and the principal's rights enforced, the less incentive there is for the fiduciary to expend the effort or to bear the cost of becoming informed about the legal consequences of disloyalty. Consequently, we might expect more costly or difficult-to-process information about the legal consequences of disloyalty to be ignored. This hypothesis and its

107 See Anthony Duggan, 'Exemplary Damages in Equity: A Law and Economics Perspective' (2006) 26 Oxford Journal of Legal Studies 303.

108 Daniel Nagin and Greg Pogarsky, 'An Experimental Investigation of Deterrence: Cheating, Self-serving Bias, and Impulsivity' (2003) 41 Criminology 167.

109 Camerer and Kunreuther (n 105) 570.

110 Eric Stone, Frank Yates and Andrew Parker, 'Risk Communication: Absolute versus Relative Expressions of Low-Probability Risks' (1994) 60 Organizational Behavior and Human Decision Processes 387. Indeed, in some real-world decision contexts people often do not seek information about the likelihood of an event, but prefer to base decisions on other factors: Oswald Huber, Roman Wider and Odilo Huber, 'Active Information Search and Complete Information Presentation in Naturalistic Risky Decision Tasks' (1997) 95 Acta Psychologica 15.

111 Huber et al (n 110) 27 (finding that where a decision-maker's perceived control of variables is such that the probability of a negative event can be brought below a subjective threshold the risk becomes irrelevant); Paul Slovic et al, 'Preferences for Insurance Against Probable Small Losses: Insurance Implications' (1977) 44 Journal of Risk and Insurance 237 (probability thresholds explain why individuals frequently fail to purchase insurance to protect against low probability, high consequence events).

112 This makes perfect sense: people face many risks in every aspect of their daily lives but can only worry about so many things. Equally, denial of small risks allows people to think about risk in absolute terms, satisfying the psychological desire for certainty: Paul Slovic, Baruch Fischhoff and Sarah Lichtenstein, 'Rating the Risks' in Theodore Glickman and Michael Gough (eds), *Readings in Risk* (Johns Hopkins University Press 1990) 61, 66.

113 Gary McClelland, William Schulze and Don Coursey, 'Insurance for Low-Probability Hazards: A Bimodal Response to Unlikely Events' (1993) 7 Journal of Risk and Uncertainty 95, 103 (fig 2).

114 See n 169–72 and text.

implications, particularly for the deterrence value of proprietary claims, are explored in the following section.

5 What do fiduciaries know?

If the superior disgorgement potential of the constructive trust is to influence fiduciary behaviour then fiduciaries must know and understand the implications for them of proprietary disgorgement. The implicit assumption of the deterrence thesis is that the properties of the constructive trust are perceived and clearly understood by fiduciaries. But the foundation of this assumption is not clear. Economic models, which assume fiduciaries either are perfectly informed or gather optimal information given the resources at their disposal, might be applied. However, these models are unrealistic and generate scarcely credible predictions. A more realistic behavioural account of information-gathering, on the other hand, suggests fiduciaries are unlikely to know much of the constructive trust or its implications, or will ignore them.

5.1 Are fiduciaries perfectly or optimally informed?

Advocates of the deterrence thesis might assume fiduciaries are perfectly informed. On this view there is no difference between the objective properties of the constructive trust and fiduciaries' perceptions of them. But, since perfect knowledge rarely is attainable, this assumption is grossly unrealistic.[115] Humans are not omniscient; information is costly and time-consuming to obtain, absorb and apply.[116] Economic models assuming perfect information thus occupy a 'slum dwelling in the town of economics'.[117]

Alternatively, advocates of the deterrence thesis might apply economic models of information search which accept that actors operate within constraints (of time, computational ability, money etc.), but that within those constraints they optimise.[118] Accordingly, such constrained optimisers will calculate the costs and benefits of searching for each additional unit of information and stop searching at the point the cost of acquiring an additional unit of information exceeds the benefit.[119]

It is not, however, clear whether such models would predict a significant correlation between the objective properties of the constructive trust and fiduciaries' perceptions of the remedy. Better information about sanctions allows more accurate calculation of the expected cost of disloyalty. But this is valuable to the fiduciary only to the extent the additional information leads to a different and improved outcome (e.g. the additional information leads to the selection of a 'no-breach' option rather than a 'breach' option because the information allows the fiduciary to calculate that the former option maximises subjective expected utility). The additional benefits flowing from the substantive decision, moreover, must be greater than the costs (including opportunity

115 Thus, individuals frequently know little of the law. In general, lay people are ignorant of much of the law which is intended to regulate their conduct: see Robert Ellickson, *Order without Law: How Neighbours Settle Disputes* (Harvard University Press 1991) 144–5; John Darley, Kevin Carlsmith and Paul Robinson, 'The *Ex Ante* Function of the Criminal Law' (2001) 35 Law and Society Review 165. Professionals similarly are not immune from ignorance of laws addressed to them. For instance, despite heavy publicity drives in the sector, recent research shows a quarter of those working in the construction industry have no awareness of the Bribery Act 2010. In smaller organisations (employees<200) 50 per cent have no awareness of the requirements of the legislation: Chartered Institute of Building (n 95) 17.

116 Gerd Gigerenzer, *Rationality for Mortals: How People Cope with Uncertainty* (Oxford University Press 2008) 4; Posner (n 24) §1.1.

117 George Stigler, 'The Economics of Information' (1961) 69 Journal of Political Economy 213, 213.

118 See, for example, Thomas Sargent, *Bounded Rationality in Microeconomics* (Oxford University Press 1993).

119 Stigler (n 117); Sargent (n 118).

costs) incurred by the fiduciary allocating time and other resources to information search. Additionally, since the formal legal sanction is but one element of the overall sanction for disloyalty, and since the probability of being sanctioned may be low, the value of information about the legal consequences of disloyalty will be discounted accordingly. This suggests a rational fiduciary is perhaps less likely to seek out information about the remedial implications of disloyalty than proponents of the deterrence thesis assume.

More importantly, optimal search probably is impossible. Optimising criteria, it has been pointed out, create 'an infinite and seemingly intractable regress'.[120] Individuals seeking optimal information for the purpose of making a particular decision require information about how much information they need to collect and, if they are to collect optimal information about how much information they need to collect, they require further information, and so on *ad infinitum*.[121] It follows that optimal search is, arguably, logically impossible: the net value of information-gathering is 'unknown and rationally unknowable'.[122] At any rate, optimal information search is impractical and unrealistic. In most contexts (including the present one) it is not possible for actors to estimate the value of an additional unit of information before it is known.[123] Moreover, while optimal search theory assumes individuals are able to recognise the limits of their knowledge, in reality individuals tend to be poor at calibrating their own knowledge and understanding.[124] To assume optimal search is possible thus invites the omniscient hyper-rational actor of early neo-classical economics to 'sneak in through the back door'.[125]

5.2 Realistic limits to fiduciary knowledge

In fact, the behavioural evidence suggests fiduciary knowledge is likely to be curtailed by the operation of biases and the adoption of non-optimising search strategies. Under such conditions, which are explored further below, fiduciaries contemplating disloyalty are much less likely to be cognisant of the properties of the constructive trust than proponents of the deterrence thesis assume.

5.2.1 Biases and inadvertent ignorance

Information search may be limited by inadvertent ignorance. Psychological research suggests there is a general tendency for people to assume that things are simpler than they really are. Frequently, they fail to appreciate the existence of relevant information that they do not possess ('unknown unknowns') and they fail to appreciate their own lack of understanding of the information they do possess. For instance, people exhibit a strong tendency to overestimate their understanding of how things work (the 'illusion of

120 John Conlisk, 'Why Bounded Rationality?' (1996) 34 Journal of Economic Literature 669, 687.

121 See, generally, Jon Elster, *Sour Grapes: Studies in the Subversion of Rationality* (Cambridge University Press 1983) 17–18; Philippe Mongin and Bernard Walliser, 'Infinite Regressions in the Optimizing Theory of Decision' in Bertrand Munier (ed), *Risk, Decision and Rationality* (Reidel 1987) 435; Conlisk (n 120) 686–8.

122 Jon Elster, 'Excessive Ambitions' (2009) 4 Capitalism and Society, Article 1 (DOI: 10.2202/1932–0213.1055) 5.

123 Jon Elster, *Nuts and Bolts for the Social Sciences* (Cambridge University Press 1989) 35; Jon Elster, 'The Nature and Scope of Rational Choice Explanations' in Michael Martin and Lee McIntyre (eds), *Readings in the Philosophy of Social Science* (MIT Press 1994) 311, 318.

124 See nn 126–33 and text.

125 Gigerenzer et al (n 67) 11.

explanatory depth')[126] and thereby lack awareness of the complexity of the world around them.[127] Similarly, people generally are poor at evaluating, and therefore appreciating the limits of, their own knowledge and understanding, believing that comprehension of a given matter has been attained when in fact it has not.[128] In experiments on text comprehension, for example, subjects asked to read simple expository texts expressed high confidence in their comprehension of the texts, but were unable to identify basic mistakes or contradictions,[129] or to make simple inferences from central propositions contained within the texts.[130] This 'illusion of knowing' may persist even when novel or technical information is encountered,[131] and it is exacerbated by the ease with which large amounts of information can be accessed through modern technology.[132] The operation of such illusions may be compounded by the tendency of individuals to make overly optimistic assessments of their own abilities, competencies and personal characteristics.[133]

It follows that in many situations there is a significant gap between what individuals believe they know and what they really do know. This has implications for information-gathering: individuals who believe they are better informed than they really are will cease search and deliberation prematurely.

5.2.2 The 'satisficing' search strategy

When we search for information, it is said, 'we satisfice, we do not maximise'.[134] That is, we tend to be concerned not with a search for optimal information but with the identification of information that is satisfactory given our needs and circumstances. Thus, decision-makers identify a target or aspiration level of satisfaction and search until they find an alternative that reaches that level.[135] Aspiration levels are dynamic, not static; they

126 Leonid Rozenblit and Frank Keil, 'The Misunderstood Limits of Folkscience: An Illusion of Explanatory Depth' (2002) 26 Cognitive Science 521; Frank Keil, 'Folkscience: Coarse Interpretations of a Complex Reality' (2003) 7 Trends in Cognitive Sciences 368; Frank Keil, 'Getting to the Truth: Grounding Incomplete Knowledge' (2008) 73 Brooklyn Law Review 1035.

127 See, for example, Rebecca Lawson, 'The Science of Cycology: Failure to Understand How Everyday Objects Work' (2006) 34 Memory and Cognition 1667.

128 Arthur Glenberg, Alex Wilkinson and William Epstein, 'The Illusion of Knowing: Failure in the Self-assessment of Comprehension' (1982) 10 Memory and Cognition 597. For an overview of the experimental literature identifying the illusion, see Arthur Glenberg et al, 'Enhancing Calibration of Comprehension' (1987) 116 Journal of Experimental Psychology: General 119, 119–21.

129 Glenberg et al, 'The Illusion of Knowing' (n 128); William Epstein, Arthur Glenberg and Margaret Bradley, 'Coactivation and Comprehension: Contribution of Text Variables to Illusion of Knowing' (1984) 12 Memory and Cognition 355.

130 Arthur Glenberg and William Epstein, 'Calibration of Comprehension' (1985) 11 Journal of Experimental Psychology: Learning, Memory and Cognition 702.

131 Arthur Glenberg and William Epstein, 'Inexpert Calibration of Comprehension' (1987) 15 Memory and Cognition 84. See also Regina Jucks and Elisabeth Paus, 'What Makes a Word Difficult? Insights into the Mental Representation of Technical Terms' (2012) 7 Metacognition and Learning 91.

132 Matthew Fisher, Mariel Goddu and Frank Keil, 'Searching for Explanations: How the Internet Inflates Estimates of Internal Knowledge' (2015) 144 Journal of Experimental Psychology: General 674.

133 See Mark Alicke and Olesya Govorun, 'The Better-than-Average Effect' in Mark Alicke, David Dunning and Joachim Kruger (eds), *The Self in Social Judgment* (Taylor & Francis/Psychology Press 2005) 85.

134 Russell Harding, *Morality and the Limits of Reason* (University of Chicago Press 1990) 4. See also, James Bowen and Zi-Lei Qiu, 'Satisficing When Buying Information' (1992) 51 Organizational Behavior and Human Decision Processes 471; Andrew Caplan, Mark Dean and Daniel Martin, 'Search and Satisficing' (2011) 101 American Economic Review 2899.

135 Herbert A Simon, 'Rational Choice and the Structure of the Environment' (1956) 63 Psychological Review 129, 136; Simon, 'Behavioral Model' (n 64). See also William Baumol, 'On Rational Satisficing' in Mie Augier and James March (eds), *Models of a Man: Essays in Memory of Herbert A Simon* (MIT Press 2004) 57.

vary with context and may be fine-tuned during search. Thus, in benign environments aspiration levels will rise; in challenging environments they will fall.[136] Since search is terminated when the individual identifies the first alternative that meets the satisfaction threshold, choice is determined in part by the order in which alternatives are evaluated.[137]

In economics circles satisficing generally is viewed with scepticism, as an elusive 'moving target' with too little predictive value because an individual's satisfaction level is determined subjectively.[138] However, the environmental features of, and psychological processes triggered by, an individual's situation may permit broad predictions about likely satisfaction thresholds and search outcomes. Satisficing may be unable to provide the clear, elegant and precise predictions favoured by economists; but sometimes it is better to be 'messy and vaguely right' than 'elegant and precisely wrong'.[139]

5.2.3 The fiduciary's search

We can now revisit the question: what is a fiduciary contemplating disloyalty likely to know of the legal implications of his or her intended disloyal act? For the reasons offered below, the answer in most cases is likely to be 'very little'.

Initial aspiration levels

A number of factors suggest initial aspiration levels may be modest:

1 fiduciaries have limited time to search;

2 obtaining legal advice about the implications of an intended breach is likely to be financially expensive;

3 if fiduciaries perceive there is little or no risk their contemplated disloyalty will be detected and sanctioned, information about the legal implications of breach will be perceived as being of limited value;

4 the formal legal sanction may not loom as large in the mind of the fiduciary as other elements of the sanction – in particular, the risk of being compelled to give up future gain is unlikely to be as psychologically proximate as the loss of an existing endowment (for instance, loss of reputation, loss of position by termination of the relationship, or loss of liberty);[140]

5 the fiduciary is likely to (a) appreciate that the law may be complex and that he or she lacks the requisite skills to access and to understand much legal information; or (b) believe the law is simpler than it is and therefore set out to find a clear but simple answer.

The search environment

The search environment is relatively inhospitable to a fiduciary embarking upon a quest for information about the proprietary implications of a breach of fiduciary obligation.

136 Herbert A Simon, 'Rational Decision Making in Business Organizations' (1979) 69 American Economic Review 493, 503.

137 John Payne, James Bettman and Eric Johnson, *The Adaptive Decision Maker* (Cambridge University Press 1993) 26.

138 Foka-Kavalieraki and Hatzis (n 73) 23.

139 Richard Thaler, *The Winner's Curse: Paradoxes and Anomalies of Economic Life* (Princeton University Press 1994) 198.

140 This is the result of the so-called 'endowment effect': people value things that are already part of their endowment more highly than things that they may acquire but which are not yet part of their endowment: see Thaler (n 62) ch 2.

Short of buying tailored legal advice from an expert, which is likely to be relatively expensive, fiduciaries seeking to understand the legal implications of a contemplated breach of duty may adopt a number of strategies. First, they may identify and search a relevant legal source such as a textbook or legal encyclopaedia. This strategy is likely to yield the most accurate and reliable information, but such sources are not easily comprehended by non-lawyers.

Second, if available, the fiduciary might consult general guidance produced by an information intermediary. Guidance provided by information intermediaries will be more accessible but, for reasons which are explored further below,[141] is likely to omit consideration of the proprietary implications of breach of fiduciary obligation.

Third, the fiduciary may undertake a general web search for relevant material. In principle, the world wide web offers quick and low-cost access to a vast information repository. However, finding appropriate information may be difficult and time-consuming. Search engines are key but typically result in an 'information flood'.[142] It follows that a systematic review of search engine results pages (SERPs) is likely to be prohibitive in terms of time and cognitive effort. Users are more likely to select which links to follow by relying on heuristic processes that focus on a limited range of information. Such processes are quick but can lead to poor evaluation and selection outcomes due to the limited information focus.[143] For example, users often focus selectively on key words in the highlighted link for each result or on information which is consistent with expectations.[144] Perhaps most importantly, users also tend to rely heavily on SERP rankings, paying greatest attention to the results at the top of the first SERP and rarely moving to the second SERP or beyond.[145] Since search engines rank pages by reference to the relevance of a page to the search terms and by quality,[146] the highest-ranked pages (which are most likely to be selected) will not necessarily be the most accessible.

Much will depend on the adequacy of the search terms employed. Searching a technical field without a technical vocabulary may prove difficult. In the context of corrupt payments, for example, a fiduciary who searches for 'bribery', 'receipt of bribe', 'agent receiving bribe' and 'corrupt payment' will be faced with a SERP displaying links relating mostly to the definition of bribery and criminal liability.[147] By contrast, the first

141 See nn 159–64 and text.

142 Soo-Young Rieh, Yong-Mi Kim and Karen Markey, 'Amount of Invested Mental Effort (AIME) in Online Searching' (2012) 48 Information Processing and Management 1136.

143 Miriam Metzger, Andrew Flanagin and Ryan Medders, 'Social and Heuristic Approaches to Credibility Evaluation Online' (2010) 60 Journal of Communication 413.

144 Metzger et al (n 143).

145 Bing Pan et al, 'In Google We Trust: Users' Decisions on Rank, Position, and Relevance' (2007) 12 Journal of Computer Mediated Communication 801 (finding rank is a better predictor of link selection than the relevance of the link, with most attention given to the top of the first search page). See also Mark Keane, Maeve O'Brien and Barry Smyth, 'Are People Biased in their Use of Search Engines?' (2008) 51 Communications of the ACM 49; Yvonne Kammerer and Peter Gerjets, 'The Role of Search Result Position and Source Trustworthiness in the Selection of Web Search Results When Using a List or a Grid Interface' (2014) 30 International Journal of Human–Computer Interaction 177 (Study 1); Patricia Wallace, *The Psychology of the Internet* (2nd edn, Cambridge University Press 2016) 7 (noting that the first page of results is 'about as far as most people ever look').

146 Wallace (n 145) 7–8.

147 In other contexts, such as the appropriation of a business opportunity, the most obvious search terms (e.g. 'business opportunity', 'taking a business opportunity', 'appropriation of business opportunity' or 'misappropriation of business opportunity') return either nothing of legal relevance or pages discussing liability and the corporate opportunities doctrine (searches conducted on Google on 7 March 2018).

SERP for 'bribes and secret commissions' contains numerous links to pages discussing the availability of proprietary claims, although the content of the linked pages – predominantly academic articles[148] and update notes written by solicitors – is not particularly accessible to lay readers. Moreover, reference to the implications of proprietary claims (namely, tracing and following) is limited to one or two lines tucked away towards the end of the pages, with little or no explanation of the terminology. Whether such discussion would be noticed by most (non-legally trained) readers,[149] let alone its significance appreciated, is doubtful.[150]

Stopping search

Faced with such an environment, fiduciaries in general cannot be expected to cognise the implications of the constructive trust. Recall choice is influenced by the order in which alternatives are evaluated. In addition to possessing some rudimentary understanding of their basic duty not to profit from their position,[151] during their search for information fiduciaries likely will view statements to the effect that a fiduciary is liable to 'account for', 'disgorge' or 'give-up' disloyal gain. Such statements often are accompanied by statements of the immateriality of good faith, impossibility arguments and harm to the principal. These statements encapsulate the fundamental principle that fiduciaries must not make unauthorised gain; if they do they must give it up. This notion, moreover, is consistent with the general legal and moral principle, which may have been acquired through social learning, that one ought not to be permitted to profit from one's own wrongdoing.

It must be questionable whether a fiduciary possessing such information would consider further search beneficial since the legal consequences of breach *appear* to be clearly known (this is especially so where the fiduciary *expects* to find a simple legal answer). In the absence of *actual* knowledge about the peculiar and potentially far-reaching consequences of proprietary claims, the *possibility* of such consequences will be

148 E.g. Millett, 'Bribes and Secret Commissions' (n 1).

149 Accessing material via the internet tends to make people more cursory and inattentive readers: see Harald Weinreich et al, 'Not Quite the Average: An Empirical Study of Web Use' (2008) 2 ACM Transactions on the Web, Article 5, 18–20 (DOI: 10.1145/1326566).

150 The reviewer of this article, for example, suggested searchers may soon find themselves on Wikipedia. The second result for the Wikipedia search 'bribes and secret commissions' links to a page on the *FHR* case, which notes that a proprietary claim 'will allow tracing into the assets of the agent and any relevant third parties in order to claim any fruits of the fraud': 'FHR European Ventures v Cedar Capital Partners LLC' <https://en.wikipedia.org/wiki/FHR_European_Ventures_LLP_v_Cedar_Capital_Partners_LLC>. This, the reviewer suggests, surely is a red flag indicating to the fiduciary that asset-shielding through the use of a shell company or other third party will not do. But (1) what is clearly visible to lawyers who know what they are looking for and find what they expect to find is not necessarily visible to those untrained in the art who are unsure of what they are looking for. (2) Different search terms lead to different results; search terms that are most obvious to those with knowledge of the field will not necessarily be employed by those with little or no knowledge of the field. We must be wary of the 'curse of knowledge' – the cognitive bias which makes it difficult for us to imagine that others do not share the same knowledge or apply it in the same way as we do: see Colin Camerer, George Loewenstein and Mark Weber, 'The Curse of Knowledge in Economic Settings: An Experimental Analysis' (1989) 97 Journal of Political Economy 1232; Richard H Thaler, 'From Homo Economicus to Homo Sapiens' (2000) 14 Journal of Economic Perspectives 133, 133–4. (3) Recall too that in deciding whether to follow a link users tend to focus on key words in the link (see n 144 and text). A linked case name is perhaps much less likely to be followed than a link containing terms that are more salient to a non-lawyer. (4) A fiduciary who follows the link will need to navigate over 3000 words of relatively technical text before the pertinent line of text is reached. One suspects most will have given up by this stage or skim over the relevant text given the cursory attention often paid to web pages: see Weinreich et al (n 149).

151 Most fiduciaries aim to comply with their duties, at least initially, therefore must be cognisant of the basic demands of their office.

difficult to imagine (they are 'unknown unknowns').[152] That would involve asking questions such as how one would give up one's gains and what would be the implications if the initial gain were exchanged, mixed in bank accounts, invested or passed to third parties. Such questions involve additional, more complex, levels of inquiry that evidence and experience tells us people are not very good at making.[153]

Similarly, search may be stopped where a fiduciary perceives their contemplated action will attract criminal sanctions.[154] Here, the deterrence work is likely to be done (if at all) by the criminal law: if, as we might expect, the fiduciary is deflected from the contemplated act by the threat of criminal sanction, further search for information on the legal implications of the act is unnecessary. If, on the other hand, the fiduciary is not moved by the threat of criminal sanction, arguably the private law implications of their actions will be of little interest or exert little influence on their behaviour.[155]

What of fiduciaries whose searches disclose that disloyal gain is held 'on constructive trust'? Such terminology is unhelpful to those unskilled in the art, so further information is necessary. This may cause fiduciaries to:

1 accept ignorance of the term and satisfice with a basic understanding of disgorgement;
2 attribute meaning to the term, for instance, by equating it with the fiduciary's own subjective notion of disgorgement or otherwise by 'filling in the gaps' by reference to existing knowledge;[156] or
3 search for further explanation.

The first option will leave the fiduciary with a basic understanding of the disgorgement principle; the second option is unlikely to take things much further. Additional search is likely to be time-consuming. Explanations of the concept of a 'trust' will generate new terms and concepts such as 'tracing' and 'following', giving rise to the same three options, and so on until a satisfactory understanding is obtained. In many cases we might expect the time and cognitive costs of such a comprehensive search to be prohibitive given the likely modesty of the initial aspiration levels.

Adjustment of aspirations

A final and related point is that the information environment perhaps is more likely to lead to a downward adjustment of an initially high satisfaction threshold than to an uplift of an initially low satisfaction threshold. As is evident from the above discussion, an individual seeking a clear understanding of the properties of constructive trust does not

152 See nn 126–33 and text.

153 Thaler (n 150), 134–5; Rozenblit and Keil (n 126) 523 (discussing how people conflate higher-level general analysis of a system, or functional glosses, with lower-level detailed analysis).

154 See the results of the searches discussed above: n 147 and text.

155 Craig Rotherham, 'Deterrence as a Justification for Awarding Accounts of Profits' (2012) 32 Oxford Journal of Legal Studies 537, 550–2.

156 It is, in fact, more common than we may imagine for people to overestimate their comprehension of technical and unfamiliar terms: see Jucks and Paus (n 131). It is initially puzzling why a person who encounters a novel term of art would be overly confident about their understanding of the term. One possibility is that meaning is inferred from the context in which the term is used or a familiar meaning is attributed, causing the individual to underestimate the complexity beneath its lexical surface. This explanation is consistent with theories suggesting feelings of knowledge are elicited by cue familiarity or the ease of access of information prompted by the cue: Asher Koriat and Ravit Levy-Sadot, 'The Combined Contribution of the Cue-Familiarity and Accessibility Heuristics to Feelings of Knowledge' (2001) 27 Journal of Experimental Psychology: Learning, Memory and Cognition 34.

face a benign search environment. Information is complex, voluminous and dispersed; there is likely a dearth of accessible accounts provided by information intermediaries; and fiduciaries generally are not skilled in the relevant art, hence will find legal information difficult and time-consuming to navigate and understand. Furthermore, the more effortful it is to process information, the more likely it will be simplified or ignored altogether to avoid 'cognitive overload'.[157] This process may not be entirely conscious but a part-automatic response to negative affect generated by excessive cognitive load.[158] Since negative affect is generated by cognitive load and is unrelated to the significance of the information, there may be downward adjustment of aspiration levels even where information is available and highly relevant.

5.3 Information intermediaries

Frequently, third parties mediate the communication of information to information users, providing information specifically tailored to the users' needs. We might expect professional bodies, regulators and employers to provide appropriately tailored legal information for fiduciaries by way of guidance notes, handbooks or codes of practice.[159] Targeted information of this kind may limit inadvertent ignorance by making relevant information more visible and increase a satisficer's satisfaction threshold by creating a more benign information environment. However, information provided by intermediaries necessarily is limited by two factors.

5.3.1 The accuracy/accessibility trade-off

First, the information must be selected and packaged to meet the needs of the information user. In the present context, the information must be accessible to a predominantly non-legally trained audience at a low enough cost. Reducing complex legal information to concise, relatively simple formulations involves a trade-off between accuracy and accessibility. A complete and accurate account of the implications of a breach of fiduciary obligation necessarily would be detailed and lengthy, hence costly to access and difficult to understand. We therefore might expect intermediaries to provide simplified statements of broad principle that are accessible at lower cost, such as a clear statement of the disgorgement principle indicating fiduciaries will be required to give up any benefit derived from a breach of fiduciary obligation, but omitting more complicated aspects such as how the gain will be identified/quantified.[160] This would be accessible and convey the basic message that proponents of the deterrence rationale would like to see conveyed: 'breach and the law removes your gain'.

However, this says nothing about apparently key deterrent aspects of proprietary claims, such as the recourse to third parties that the constructive trust provides. Further, the function of an account of profits tends to be described in remarkably similar

157 Melvin Eisenberg, 'Text Anxiety' (1986) 59 Southern California Law Review 305.

158 Ellen Garbarino and Julie Edell, 'Cognitive Effort, Affect, and Choice' (1997) 24 Journal of Consumer Research 147.

159 We might also imagine official, authoritative communications of legal information, such as official pamphlets or accessible, plain language statutory statements. For discussion of these and similar 'official' options, see Law Commission, *Company Directors: Regulating Conflicts of Interest and Formulating a Statement of Duties* (CP 153, 1999) paras 14.8–14.40.

160 Such an approach was considered the most appropriate by the Company Law Review Steering Group in its consideration of a possible statutory statement of remedies for breach of directors' duties: Sarah Worthington, 'Reforming Directors' Duties' (2001) 64 Modern Law Review 439, 457.

terms.[161] While lawyers make sharp crystalline distinctions between personal and proprietary disgorgement, inevitably the boundaries blur in the process of communication to lay persons. The need to trade accuracy for accessibility, in the end, probably will result in the communication to fiduciaries of a broadly similar 'end message' regardless of the availability of proprietary claims.

5.3.2 Limited demand for remedy law

The second limitation regarding information provided by intermediaries relates to the low demand for information about remedies. Most fiduciaries aim to comply with their legal duties. Thus, understanding the content of their duties is more important than understanding the legal consequences of failing to comply with them.[162] In other words, for most fiduciaries, 'duty law' is highly relevant while 'remedy law' is not. This is important since the supply of non-relevant information increases the cost of observing relevant information by increasing total information-processing costs.[163] While the supply of remedy law would reduce the search costs of the small number for whom it is salient (predominantly those contemplating breach), it would increase the cost of access for those seeking duty law. The cost may be minimal if remedy law is dealt with in broad, summary fashion. But we have noted already how this is unlikely to convey to fiduciaries the important properties of the constructive trust. In practice, we find limited supply of remedy law in information products for fiduciaries, still less consideration of the implications of proprietary disgorgement.[164]

5.4 Big breaches and well-informed fiduciaries

None of this is to suggest that fiduciaries *never* will be well informed of the legal (including proprietary) consequences of disloyalty. Indeed, in some contexts fiduciaries may possess a strong incentive to incur the costs of taking tailored legal advice or engaging in careful and thorough search. For example, fiduciaries who engage in large but infrequent breaches, or who plan 'one big breach', can be expected to be more motivated to become informed:[165] the stakes are higher and such fiduciaries may lack the excessive optimism of avoiding detection that small repeat wrongdoers can be expected to exhibit.[166] Nevertheless, fiduciaries who are well informed about the proprietary consequences of acquisitive breaches of fiduciary obligation are likely to be the exception, not the norm. Furthermore, there are good reasons to suspect that even well-informed fiduciaries may not be deterred by proprietary disgorgement any more than they would be by disgorgement effected by personal remedy.

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161 *Attorney-General v Guardian Newspapers (No 2)* [1990] 1 AC 109 (HL) 262 (Lord Keith); *United Pan Europe* (n 38) [47] (Morritt LJ) ('it is not in doubt that the object of the equitable remedies of an account or the imposition of a constructive trust is to ensure that the defaulting fiduciary does not retain the profit').

162 The relative importance of substantive duty law over remedy law is broadly recognised: see, for example, Company Law Review Steering Group, *Modern Company Law for a Competitive Economy: Completing the Structure* (URN 00/1335, 2000) para 13.9.

163 Increasing the volume of information also increases the risk that important information will be simplified, overlooked or ignored to avoid overload: nn 157–8 and text.

164 See, for example, Charity Commission, *Conflicts of Interest: A Guide for Charity Trustees* (CC 29, 2014) Part 5 (referring to regulatory, reputational and legal consequences of conflicts but limiting discussion of the latter to rescission of conflicted contracts, liability to compensate for loss, and restitution of money wrongly paid to trustees).

165 Although such motivation will not immunise the fiduciary from the possible effects of the 'illusion of knowledge', which may result in a failure to reach initially high search aspirations: see n 128–33 and text.

166 See n 105 and text.

First, an accurate understanding of proprietary disgorgement may be a double-edged sword: proprietary disgorgement may enhance profit-stripping, but its limitations can be exploited. For instance, an initial gain can be applied to generate subsequent wealth without leaving a transactional trail or identifiable assets, allowing the sophisticated fiduciary to defeat tracing rules and avoid accountability for secondary profits.[167] As Dale Oesterle noted long ago, rather than dissuade wrongdoing, transactional link-tracing is more likely to influence how knowledgeable wrongdoers transact *after* the commission of a wrong.[168]

Secondly, and perhaps more importantly, if the constructive trust is to operate as an effective deterrent, it is not only necessary for fiduciaries to perceive its properties but also to view those properties as relevant to a decision whether or not to breach. However, as has been explained already, excessive optimism about the prospects of avoiding detection, or avoiding the effects of particular sanctions, may render those sanctions behaviourally otiose.[169] Since well-informed fiduciaries are, by their very nature, more likely to be aware of the steps that can be taken to avoid detection and of the sophisticated laundering techniques that can be employed to obscure the trail of proceeds, they are likely candidates for over-optimism.[170] Optimism about avoiding sanction is also likely to be fostered by highly available instances of the non-detection of wrongdoing – as where a fiduciary previously has engaged in a breach of duty without being caught.[171] Instances of an isolated but very large breach of duty are likely to be relatively uncommon. Rather, more serious or significant forms of wrongdoing tend to emerge incrementally. Small transgressions often lead to larger transgressions, but few wrongdoers ever start with the large transgressions.[172] If this dominant account of how wrongdoing develops is correct, we might expect large acquisitive breaches of fiduciary obligation to be preceded, in general, by small breaches, thereby fostering excessive optimism by providing readily available instances of non-detection.

Finally, in the context of corrupt payments, fiduciaries who are well informed of the legal implications of their actions likely will appreciate the possibility of facing criminal sanctions if caught. A fiduciary who is not dissuaded by the possibility of criminal sanctions (including fines, imprisonment and confiscation measures) is unlikely to be

167 Tracing can be defeated by payments through overdrawn accounts; the knowledgeable wrongdoer might apply their gain to reduce or pay off overdrafts, since tracing cannot reach savings made from the reduction or elimination of a liability; and the wrongdoer may use the gain to purchase holidays, food and other consumables, freeing legitimate wealth to purchase profitable investments. Note, however, the increased judicial willingness to infer transactional links to defeat basic laundering attempts: see *Federal Republic of Brazil v Durant International Corporation* [2015] UKPC 35, [2015] 3 WLR 599, [38]–[41] (Toulson JSC); R*elfo Ltd (in liquidation) v Varsani* [2014] EWCA Civ 360, [2015] 1 BCLC 14, [56], [62]–[63] (Arden LJ). Defeating tracing, particularly where the amount of money involved is significant, therefore will be difficult.

168 Dale Oesterle, 'Deficiencies of the Restitutionary Right to Trace Misappropriated Property in Equity and in UCC § 9–306' (1983) 68 Cornell Law Review 172, 203.

169 See nn 93–8 and text.

170 See n 77 and text.

171 See n 105 and text.

172 Blake Ashford and Vikas Anand, 'The Normalization of Corruption in Organizations' (2003) Research in Organizational Behavior 1; John Darley, 'The Cognitive and Social Psychology of Contagious Organizational Corruption' (2005) 70 Brooklyn Law Review 1177; Max Bazerman and Francesca Gino, 'When Misconduct Goes Unnoticed: The Acceptability of Gradual Erosion in Others' Unethical Behavior' (2009) 45 Journal of Experimental Social Psychology 708; David Welsh et al, 'Slippery Slope: How Small Ethical Transgressions Pave the Way for Larger Future Transgressions' (2014) 99 Journal of Applied Psychology 114.

influenced by civil law remedies.[173] In such circumstances the deterrent role of the constructive trust is redundant.

6 Conclusion

The deterrence thesis initially appears as compelling as it is simple: a constructive trust can be expected to remove more of the fiduciary's gain than an account of profits therefore fiduciaries will have less incentive to behave disloyally. However, the deterrence thesis rests on unrealistic assumptions about fiduciary behaviour. Applying more nuanced behavioural tools, we find that the influence of proprietary disgorgement on fiduciary behaviour is likely to be negligible. Fiduciaries cannot be influenced by sanctions they do not know, and few fiduciaries will be cognisant of the properties of the constructive trust. Those who are may be relatively unresponsive to such properties because they perceive a low risk of detection. We might wonder whether the prospect of such negligible deterrence gains is sufficient, particularly given the potential impact of constructive trusts on innocent third parties.[174]

Ironically, the deterrence prospects of the constructive trust are bleakest in cases of bribe and commission-taking, the contexts in which calls for the recognition of a constructive trust on deterrence grounds have been at their loudest. Detection rates for bribery and commission-taking are particularly likely to be perceived as low, leaving fiduciaries with little incentive to become informed about sanctions and unresponsive to known sanctions.

For the avoidance of doubt, the claim is not that disgorgement does not play an important role in dissuading disloyalty. Most fiduciaries can be expected to be cognisant of the basic idea of disgorgement, although it may have little or no impact on the decisions of those who perceive a very low or zero risk that their disloyalty will be detected. The claim is that employing the constructive trust to effect disgorgement is unlikely to have a material effect on most fiduciary behaviour because fiduciaries cannot generally be expected to understand the legal consequences of disloyalty at the requisite level of detail and complexity. Since the same general disgorgement 'end message' is likely to reach fiduciaries regardless of whether an account of profits or constructive trust is adopted to effect disgorgement, the former is preferable given it is less disruptive to third parties.

173 See n 155 and text.

174 Rotherham (n 2) 534. See also Roy Goode, 'Proprietary Restitutionary Claims' in William Cornish et al (eds), *Restitution: Past, Present and Future: Essays in Honour of Gareth Jones* (Hart 1998) 63, 71–2; Vanessa Finch and Sarah Worthington, 'The *Pari Passu* Principle and Ranking Restitutionary Rights' in Francis Rose (ed), R*estitution and Insolvency* (Mansfield Press 2000) 1, 13–14; Penner (n 32) 1007.

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A little Parthenon no longer: the proportionality of tobacco packaging restrictions on autonomous communication, political expression and commercial speech

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Abstract

This paper evaluates the constitutionality of statutory restrictions upon tobacco packaging in Ireland. It concludes that public health and the protection of children constitute pressing and substantial reasons sufficient to justify the Public Health (Standardised Packaging of Tobacco) Act 2015 and part 5 of the Health (Miscellaneous Provisions) Act 2017 as proportionate restrictions upon tobacco companies' freedom of political expression protected by Article 40.6.1 of the Constitution and freedom of autonomous communication protected by Article 40.3.1.

Keywords: Irish Constitution; plain tobacco packaging; freedom of speech, political expression, autonomous communication; pressing and substantial reasons; proportionality.

1 Introduction

Attractive packaging is an important element of a product's effective marketing.[1] Indeed, so central has packaging been to the allure of smoking that Leonard Cohen could extol 'the little Parthenon / of an opened pack of cigarettes'.[2] Hence, the control of packaging has become an important plank in the public health responses to tobacco.

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1 Nora Lado Cousté, Mercedes Martos-Partal and Ester Martínez-Ros, 'The Power of a Package. Product Claims Drive Purchase Decisions' (2012) 52(3) Journal of Advertising Research 364; see generally Philip Kotler, Kevin Keller, Mairead Brady, Malcolm Goodman and Torben Hansen, *Marketing Management* (3rd edn, Pearson 2016) chs 10 and 17.

2 Leonard Cohen, 'The Cigarette Issue' in *Book of Longing* (McClelland & Stewart, Toronto 2006) 71. Cohen celebrated 'the beauty / and the salvation / of cigarettes' (ibid); he posed for many iconic photographs flourishing lit cigarettes, including for the cover of his valedictory album *You Want it Darker* (Columbia 2016); and, having given up smoking at 69, he restarted on his 80th birthday (Jason Karlawish, 'Too Young to Die, Too Old to Worry' *New York Times* (New York, 20 September 2014) SR5). On the other hand, his anthemic 'Everybody Knows', with his cigarette-gravelled voice, was used as the soundtrack to a famous anti-smoking television advertisement commissioned by the New South Wales government and first broadcast during coverage of the Beijing Olympics in 2008 ('Games Viewers Get Shock Anti-smoking Ad' *Sydney Morning Herald* (Sydney, 16 August 2008)).

On 10 March 2015, Ireland became the second country in the world – after Australia[3] – to enact legislation requiring standardised packaging of tobacco, when the President signed the Public Health (Standardised Packaging of Tobacco) Act 2015. On 16 February 2017, the standardised packaging rules were strengthened, when the President signed the Health (Miscellaneous Provisions) Act 2017, part 5 of which amends the 2015 Act.[4] Those parts of the 2015 Act that were not to be amended by the Bill which became the 2017 Act were brought into force on 20 May 2016;[5] the remainder – including some of the core packaging regulations – came into force on 29 September 2017.[6]

The regulations in the packaging legislation prohibit all forms of branding (including trade marks) from appearing on tobacco packaging, except for brand names, which will have to be presented in a standard typeface for every brand on the market. Moreover, all packs will have to be in the same prescribed plain neutral colour, except for mandatory health warnings.

Although early legislation mainly covered excise matters,[7] in Ireland – in common with the rest of the world[8] – tobacco is now increasingly being regulated for public health reasons,[9] and the current packaging legislation is simply the most recent example in a long line of tobacco control legislation. Hence, the regulation of tobacco advertising began in 1978,[10] and the regulation of the sale of tobacco products began in earnest in 1988.[11]

Following a report by a parliamentary committee in 1999 recommending a *National Anti-Smoking Strategy*,[12] and a report for the Department of Health in 2000 recommending

3 The Tobacco Plain Packaging Act 2011 (Cth) as implemented by the Tobacco Plain Packaging Regulations 2011 (Cth) (SLI 263/2011) (as amended); see also the Trade Marks Amendment (Tobacco Plain Packaging) Act 2011 (Cth).

4 The Public Health (Standardised Packaging of Tobacco) Act 2015 and part 5 of the Health (Miscellaneous Provisions) Act 2017 are hereafter referred to simply as the packaging legislation.

5 The Public Health (Standardised Packaging of Tobacco) Act 2015 (Commencement) Order 2016 (SI 270/2016) substantially commenced the 2015 Act. In terms of commencement, the Irish Act had been overtaken by the subsequently enacted equivalent UK provisions (see s 94 of the Children and Families Act 2014, commenced by the Children and Families Act 2014 (Commencement No 4) Order 2014 (SI 2609/2014) and the Children and Families Act 2014 (Commencement No 6) Order 2015 (SI 375/ 2015) and implemented by the Standardised Packaging of Tobacco Products Regulations 2015 (SI 829/2015) which came into force on the same day as the 2015 Act in Ireland.

6 See the Public Health (Standardised Packaging of Tobacco) Act 2015 (Commencement) Order 2017 (SI 115/2016); they were given significant further effect by the Public Health (Standardised Packaging of Tobacco) Regulations 2017 (SI 422/2017) (the 2017 Regulations) which came into effect on 30 September 2017. There is a transition period of one year, so that all tobacco products will have to conform with standardised packaging from 30 September 2018, though some conforming packages have already begun to appear in the shops: 'First of Plain Cigarette Packets Hit Shelves around the Country' *Irish Independent* (Dublin, 22 February 2018); 'The Future of Cigarette Packets Is Here and It's Plain' Press Release (Department of Health, 22 February 2018) <http://health.gov.ie/blog/press-release/the-future-of-cigarette-packets-is-here-and-its-plain>. Having been the second country to enact the necessary legislation, the relatively protracted process of amendment meant that Ireland was the fifth country to bring such legislation into force, after Australia, the UK (see n 5 above), Norway and France; see 'Plain Packs Proliferating' (Framework Convention Alliance, 29 August 2017) <www.fctc.org/fca-news/opinion-pieces/1520-plain-packs-proliferating>.

7 The Tobacco Act 1934; the Finance (Excise Duty on Tobacco Products) Act 1977.

8 See, generally, Geraint Howells, *The Tobacco Challenge: Legal Policy and Consumer Protection* (Ashgate, London 2011; republished Routledge, London 2016); Tania Voon, Andrew Mitchell and Jonathan Liberman (eds), *Regulating Tobacco, Alcohol and Unhealthy Foods: The Legal Issues* (Routledge, London 2014).

9 Peter Boyle, Nigel Gray, Jack Henningfield, John Seffrin and Witold Zatonski, *Tobacco, Science, Policy and Public Health* (2nd edn, Oxford University Press 2010).

10 The Tobacco Products (Control of Advertising, Sponsorship and Sales Promotion) Act 1978.

11 The Tobacco (Health Promotion and Protection) Act 1988. The government did not proceed with plans to include a ban on public smoking in that Act (see National Archives of Ireland, 2016/51/392).

12 The Oireachtas Joint Committee on Health and Children, *National Anti-Smoking Strategy* (Dublin 1999).

that Ireland should move towards a tobacco-free society,[13] the Public Health (Tobacco) Act 2002 banned advertising and sponsorship by tobacco companies, and it introduced a comprehensive system of regulation of sale and consumption of tobacco products. In particular, this Act included the world's first outright ban on smoking in the workplace.[14] And it is still the foundation for the current system of tobacco control in Ireland.[15] It was amended in 2004,[16] to implement two European directives,[17] and to give effect to the World Health Organization (WHO) Framework Convention on Tobacco Control 2003.[18] Most recently, following a report for the Department of Health in 2013 recommending a tobacco-free Ireland[19] by 2025, smoking is now prohibited in cars in which children are present,[20] the 2015 Act implemented another European directive,[21] and the packaging legislation now requires standardised packaging of tobacco products.

13 *Towards a Tobacco-Free Society* (Report of the Tobacco-Free Policy Review Group, Dublin 2000).

14 See s 47 of the 2002 Act, and the Tobacco Smoking (Prohibition) Regulations 2003 (SI 481/2003). *The Report on the Health Effects of Environmental Tobacco Smoke (ETS) in the Workplace* (Health and Safety Authority/Office of Tobacco Control, Dublin 2002) recommended this ban.

15 As amended, inter alia, by the Public Health (Tobacco) (Amendment) Act 2009, the Public Health (Tobacco) (Amendment) Act 2010, the Public Health (Tobacco) (Amendment) Act 2011 and the Public Health (Tobacco) (Amendment) Act 2013.

16 By the Public Health (Tobacco) (Amendment) Act 2004.

17 Directive 2001/37/EC of the European Parliament and of the Council of 5 June 2001 on the Approximation of the Laws, Regulations and Administrative Provisions of the Member States Concerning the Manufacture, Presentation and Sale of Tobacco Products ((2001) OJ L 194); and Directive 2003/33/EC of the European Parliament and of the Council of 26 May 2003 on the Approximation of the Laws, Regulations and Administrative Provisions of the Member States Relating to the Advertising and Sponsorship of Tobacco Products ((2003) OJ L 152).

18 Geneva, 21 May 2003; see 2302 *United Nations Treaty Series* 166. Ireland signed the Convention on 16 September 2003 and, by virtue of the 2004 Act, ratified it on 7 November 2005; see <https://treaties.un.org/pages/ViewDetails.aspx?src=TREATY&mtdsg_no=IX-4&chapter=9&clang=_en>. See generally Oscar Cabrera and Lawrence Gostin, 'Human Rights and the Framework Convention on Tobacco Control: Mutually Reinforcing Systems' (2011) 7(3) International Journal of Law in Context 285; Benn McGrady, *Trade and Public Health: The WTO, Tobacco, Alcohol, and Diet* (Cambridge University Press 2011); Kate Lannan, 'The WHO Framework Convention on Tobacco Control: The International Context for Plain Packaging' in Tania Voon, Andrew Mitchell and Jonathan Liberman, with Glyn Ayres (eds), *Public Health and Plain Packaging of Cigarettes. Legal Issues* (Edward Elgar, Cheltenham 2012) ch 2; Lawrence Gostin and Eric Friedman, 'Towards a Framework Convention on Global Health: A Transformative Agenda for Global Health Justice' (2013) 13 Yale Journal of Health Policy, Law and Ethics 1; Lawrence Gostin, *Global Health Law* (Harvard University Press 2014); Matthew Rimmer, 'The Global Tobacco Epidemic, the Plain Packaging of Tobacco Products, and the World Trade Organization' (2017) 17(2) Queensland University of Technology Law Review 131.

19 *Tobacco Free Ireland* (Report of the Tobacco Policy Review Group, Dublin 2013).

20 Protection of Children's Health (Tobacco Smoke in Mechanically Propelled Vehicles) Act 2014.

21 Directive 2014/40/EU of the European Parliament and of the Council of 3 April 2014 on the Approximation of the Laws, Regulations and Administrative Provisions of the Member States Concerning the Manufacture, Presentation and Sale of Tobacco and Related Products ((2014) OJ L 127). It repealed and replaced Directive 2001/37/EC, mentioned in n 17 above, and is in part directed to implementing the WHO Framework Convention mentioned in n 18 above. It is given further effect in Irish law by the European Union (Manufacture, Presentation and Sale of Tobacco and Related Products) Regulations 2016 (SI 271/2016) and the European Union (Manufacture, Presentation and Sale of Tobacco and Related Products) (Amendment) Regulations 2017 (SI 252/2017).

Further legislative restrictions are planned: a Public Health (Sale of Tobacco Products and Electronic Nicotine Delivery Systems) Bill – to prohibit the sale of tobacco products, inter alia from self-service vending services and to persons under 18 years of age; and to license the retail sales of tobacco products and nicotine delivery systems – is promised in the government's *Legislation Programme, Spring/Summer Session 2018* (Office of the Government Chief Whip 2018) 20 <https://merrionstreet.ie/en/ImageLibrary/Legislative_Programme_Spring_Summer_2018.pdf>.

In many respects, therefore, Ireland has been a world leader in tobacco control, from banning smoking in the workplace or in cars with children, to requiring standardised packaging. However, all of this has been in the teeth of intense opposition from the tobacco industry, which had fiercely opposed standardised packaging legislation, to the point of threatening to seek an injunction to prevent the Oireachtas from enacting the Bill that became the 2015 Act.[22] Article 26 of the Constitution provides a procedure by which the President may refer a Bill to the Supreme Court for an assessment of its constitutionality;[23] but, notwithstanding this controversy, it does not seem to have been suggested that this procedure might have been invoked. In the event, although the tobacco industry did not seek an injunction against the Bill, nevertheless, no sooner than the ink was dry on the President's signature, on 30 March 2015, the industry issued proceedings seeking declarations that the 2015 Act was contrary to European Union (EU) law. A reference to the Court of Justice of the EU was refused, and the case subsequently settled.[24]

At present, the EU law arguments are the tobacco industry's chosen battleground, but the Irish Constitution also provides some potential ammunition. When the Bill that became the 2015 Act was being considered by parliamentary committee,[25] the probability of a constitutional challenge was a theme of submissions, not only from the tobacco industry,[26] but also from the Law Society of Ireland.[27] The subsequent legal challenge concentrated on the EU issues rather than constitutional considerations. Nevertheless, the possibility of a constitutional challenge cannot be excluded,[28] and so it is to the

22 Arthur Beesley, 'Tobacco Giant Issues Legal Threat over Plain Packaging' *Irish Times* (Dublin, 17 February 2015); Arthur Beesley, 'Japan Tobacco's Packaging Objections Look Set for Courts' *Irish Times* (Dublin, 18 February 2015); Harry McGee, 'Government Prepared for Lawsuit as Tobacco Bill Passed' *Irish Times* (Dublin, 3 March 2015); Niall O'Connor, 'Tobacco Giants Threaten to "Undermine" Ireland's Economy in an Attempt to Block Plain-packaging Laws' *Irish Independent* (Dublin, 11 August 2017); 'Big Tobacco, Big Legal Threats' *Phoenix Magazine* (Dublin, 7 September 2017).

23 There have been 15 such references since the enactment of the Constitution in 1937; see <www.supremecourt.ie/supremecourt/sclibrary3.nsf/pagecurrent/5A270AE31790620C802575EB003DAC2C>.

24 In *JTI Ireland Ltd v Minster for Health* [2015] IEHC 481 (7 July 2015) Cregan J declined to make the reference, in part because precisely the same question had already been referred from the UK by Turner *J in R (Philip Morris Brands Sarl) v Secretary of State for Health* [2014] EWHC 3669 (Admin) (7 November 2014). On that reference, in Case C 547/14 R *(Philip Morris Brands Sarl) v Secretary of State for Health* (ECLI:EU:C:2016:325; CJEU, 4 May 2016), the CJEU held that member states are permitted to set packaging standards beyond those harmonised by Directive 2014/40/EU (n 21 above). In the UK, those additional standards are set out in the Standardised Packaging of Tobacco Products Regulations 2015 (SI 829/2015) (see n 5 above), the validity of which was upheld by Green J and the Court of Appeal in *British American Tobacco v Secretary of State for Health* [2016] EWHC 1169 (Admin) (19 May 2016) affd [2016] EWCA Civ 1182 (30 November 2016) (hereafter: *BAT*); see, generally, Jonathan Griffiths, 'The Tobacco Industry's Challenge to the United Kingdom's Standardised Packaging Legislation – Global Lessons for Tobacco Control Policy?' (2017) 17(2) Queensland University of Technology Law Review 66. *JTI Ireland Ltd v Minster for Health* was settled after a directions hearing on 9 November 2016.

25 See Debates of the Joint Committee on Health and Children (13 February 2014), available at <https://www.oireachtas.ie/en/debates/debate/joint_committee_on_health_and_children/2014-02-13/2/>.

26 Company Submissions by the Irish Tobacco Manufacturers' Advisory Committee, available at <www.itmac.ie/company-submissions>; see also Written Submissions on behalf of Philip Morris International, available at <http://health.gov.ie/wp-content/uploads/2014/07/Philip-Morris-i.pdf>.

27 See e.g. the opening remarks of the President of the Law Society of Ireland to the Joint Oireachtas Committee on Health and Children, 13 February 2014, available at <www.lawsociety.ie/globalassets/documents/news/2014/opening-statement-plain-packaging--law-soc.pdf> and <https://www.oireachtas.ie/en/debates/debate/joint_committee_on_health_and_children/2014-02-13/2/>.

28 Perhaps the tobacco companies were waiting for the conclusion of their EU law case (see n 24 above); or perhaps they were keeping their powder dry for this battle until the detailed implementation of the packaging legislation became clear.

possible constitutional issues implicated by the packaging legislation that the analysis in this article is directed.

Part 2 of this article, on restrictions, describes the restrictions in the packaging legislation. Some packaging is prohibited, some is regulated and some is required; moreover, and in particular, there will be strict regulations upon, perhaps even prohibitions of, the use of trade marks and other branding.

Part 3 of this article, on rights, provides a conspectus of the Irish constitutional speech rights[29] engaged or burdened by these restrictions. In particular, prohibitions upon, and regulation of, what can be said in packaging and branding, are potential restrictions upon the tobacco companies' constitutional speech rights, in particular in the commercial context. In *PJ Carrolls v Minister for Health and Children*,[30] constitutional speech rights were one plank of the tobacco industry's challenge to tobacco advertising prohibitions in the Public Health (Tobacco) Act 2002, and they would be equally central to any challenge to the packaging legislation. This part therefore considers the speech authorities; it presents them as comprising a freedom of political expression in Article 40.6.1 of the Constitution and a freedom of autonomous communication in Article 40.3.1;[31] and it considers the extent to which either freedom is likely to be engaged or burdened by prohibitions upon, and regulation of, the tobacco companies' commercial speech. Moreover, these two rights carry concomitant rights to keep silent and to be informed. Part 3 therefore also considers the extent to which the tobacco companies' rights to keep silent are likely to be engaged or burdened by required speech on tobacco packaging, and the extent to which the tobacco companies' customers' rights to be informed are likely to be engaged or burdened by all of the restrictions in the packaging legislation.

Part 4 of this article, on reasons, considers the pressing and substantial reasons which the state may proffer to seek to justify the restrictions in the packaging legislation upon constitutional speech rights. The state's interest in the promotion of public health was central to meeting the challenge in *Carrolls*, and it would be equally central to meeting any challenge to the packaging legislation. So too would be the protection of children. These

29 Gerard Hogan and Gerry Whyte, *Kelly's the Irish Constitution* (4th edn, LexisNexis Butterworths, Dublin 2003) (hereafter: *Kelly*) ch 7.5.II.

30 [2003] IEHC 613 (17 January 2003) (Kelly J) (discovery motions); [2004] IEHC 310 (29 July 2004) (Kelly J) (inadmissibility of expert evidence) rvsd [2005] IESC 26 (03 May 2005) (evidence admissible; courts do not interpret statutes in a vacuum) (hereafter: *Carrolls*). The case was settled after a pre-trial conference before Kelly J on 31 January 2007, and the order was perfected on 6 June 2007.

Regulations on the use to which the property in the packaging can be put and restrictions on the use of trade marks are also potential restrictions upon constitutional property rights. Those rights also featured in *Carrolls*, and they have been the main ground of challenge in the UK (see n 24 above) and Australia (*JT International SA v Commonwealth of Australia* (2012) 250 CLR 1, [2012] HCA 43 (5 October 2012) [hereafter: *JTI*]); see generally Tania Voon, 'Acquisition of Intellectual Property Rights: Australia's Plain Tobacco Packaging Dispute' (2013) 2 European Intellectual Property Review 113; Sam Ricketson, 'Plain Packaging Legislation for Tobacco Products and Trade Marks in the High Court of Australia' (2013) 3 Queen Mary Journal of Intellectual Property 224; Daniel Fletcher, '*JT International SA v Commonwealth*: Tobacco Plain Packaging' (2013) 35 Sydney Law Review 827; Matthew Rimmer, 'The High Court of Australia and the Marlboro Man: The Battle over the Plain Packaging of Tobacco Products' in Voon et al (n 8) 337; Catherine Bond, 'Tobacco Plain Packaging in Australia: *JT International v Commonwealth* and Beyond' (2017) 17(2) Queensland University of Technology Law Review 1. On this issue under the European Convention on Human Rights and the Charter of Fundamental Rights of the EU, see Jonathan Griffiths, '"On the Back of a Cigarette Packet" – Standardised Packaging Legislation and the Tobacco Industry's Fundamental Right to (Intellectual) Property' [2015] Intellectual Property Quarterly 343.

On this issue at Irish law, see, generally, Eoin O'Dell, 'Property and Proportionality: Evaluating Ireland's Tobacco Packaging Legislation' (2017) 17(2) Queensland University of Technology Law Review 46.

31 The full text of these Articles is set out in an Appendix below (see page 211).

concerns have been relied upon to sustain important legislation in the past; this part considers the relevant authorities; and it analyses the extent to which they may be relied upon by the state to seek to justify the restrictions in the packaging legislation.

Part 5 of this article, on standards of review, considers the extent to which the restrictions in the packaging legislation, motivated by concerns relating to public health and the protection of children, satisfy the current Irish version of the principle of proportionality. It also considers the extent to which the restrictions might satisfy other standards of review or scrutiny.

Part 6 concludes this article. It brings together of all the strands of analysis in the previous parts. And it concludes that, if the restrictions on constitutional speech rights in the Public Health (Standardised Packaging of Tobacco) Act 2015 and in part 5 of the Health (Miscellaneous Provisions) Act 2017 are challenged by the tobacco companies, the courts will find that those Acts are constitutionally valid.

2 Restrictions

The packaging legislation deals with the packaging of cigarettes, roll-your-own tobacco, and other tobacco products, in practically identical terms;[32] and the restrictions are broadly of three kinds – some elements of packaging are prohibited, others are regulated and still others are required.

2.1 Prohibited packaging

Those elements of packaging that are prohibited by the legislation include decorative ridges, embossing or other embellishments, coloured adhesive, and items inserted in or affixed to the packaging.[33] Similarly prohibited on wrappers are colours, decorative ridges, embossing or other embellishments, branding and trade marks, and items affixed to the wrappers.[34] Barcodes are prohibited from conveying any information to the consumer.[35] Marks which are necessary for the automated manufacture of the packaging are prohibited from conveying any information to the consumer.[36] And tobacco packing is prohibited from promoting tobacco consumption.[37]

2.2 Regulated packaging

Those elements of packaging that are regulated by the Act include: the inks used;[38] the colour of linings;[39] the colour, dimensions, specifications and positioning of barcodes[40] and tear-strips;[41] the colour, font type, font size, positioning and appearance of

32 See s 7 (retail packaging of cigarettes), s 9 (retail packaging of roll-your-own tobacco) and s 10 (retail packaging of other tobacco products) of the 2015 Act, as amended by ss 13–15 of the 2017 Act.

33 Ss 7(1)(d)–(f), 9(1)(d)–(f) and 10(1)(d)–(f) 2015 Act. Ss 9(4C) and 10(4C) of the 2015 Act, inserted by ss 14(d) and 15(d) of the 2017 Act, permit plain re-sealing tabs for roll-your-own tobacco pouches and packaging of other tobacco products, provided that the tabs are transparent, uncoloured and unmarked, and do not have decorative ridges, embossing or other embellishments.

34 Ss 7(8)(b)–(e), 9(8)(b)–(e) and 10(7)(b)–(e) of the 2015 Act.

35 Ss 7(5), 9(5) and 10(5) of the 2015 Act, as implemented by reg 14 of the 2017 Regulations.

36 See ss 7(4B)(b), 9(4B)(b) and 10(4B)(b) of the 2015 Act, inserted respectively by ss 13(d), 14(d) and 15(d) of the 2017 Act.

37 See s 13 of the 2015 Act, as amended by s 16 of the 2017 Act.

38 S 14(b)(i)–(iii) of the 2015 Act.

39 S 11 of the 2015 Act, as implemented by reg 16 of the 2017 Regulations.

40 Ss 7(5), 9(5) and 10(5) of the 2015 Act, as implemented by reg 14 of the 2017 Regulations.

41 Ss 7(8)(d), 7(9), 9(8)(d), 9(9),10(7)(d) and 10(8) of the 2015 Act, as implemented by reg 15 of the 2017 Regulations.

branding;[42] and the location of brand names.[43] This enabled the minister to make regulations[44] requiring that all of these matters be presented in a standardised fashion by every brand on the market.

Moreover, tobacco packaging shall 'not bear a mark or trade mark' except as permitted pursuant to the 2015 Act.[45] The general powers relating to the regulation of packing, and the specific rules relating to trade marks, will certainly control the use of trade marks upon – and potentially even effectively ban trade marks from – tobacco packing.

Furthermore, the Act emphasises that any permitted brand names cannot obscure or interfere with health warnings on cigarette packets.[46] The Act also regulates the appearance of individual cigarettes.[47]

In prescribing the colours of sections of packaging, and in regulating branding, the minister is required to have regard to the need to decrease the appeal of tobacco products, to increase the effectiveness of health warnings, and to reduce the ability of packaging to mislead consumers about the harmful effects of smoking.[48]

2.3 Required packaging

Finally, those elements of packaging that are required by the Act include: the colours of the sections of packaging;[49] the shape of packets;[50] and the transparency of wrappers.[51]

42 Ss 7(3)–(4), 7(10)–(11), 9(3)–(4), 9(10)–(11), 10(3)–(4) and 10(9)–(10) of the 2015 Act, as implemented by regs 9–12 of the 2017 Regulations.

43 Ss 7(3)–(4), 9(3)–(4) and 10(3)–(4) of the 2015 Act, as extended by ss 13–15 of the 2017 Act, as implemented by reg 7 of the 2017 Regulations.

44 Ss 3, 7(10)–(11), 9(10)–(11) and 10(9)–(10) of the 2015 Act, as implemented by the 2017 Regulations, *passim*.

45 Ss 7(1)(c), 7(8)(d), 9(1)(c), 9(8)(d), 10(1)(c) and 10(7)(d) of the 2015 Act. However, these restrictions or prohibitions upon the use of trade marks in packaging cannot go so far as to prohibit the registration of a trade mark or provide grounds for the revocation a trade mark (see s 5(1)).

46 Ss 7(4), 9(4) and 10(4) of the 2015 Act. Regulations relating to the size and location of health warnings are provided by the EU (Manufacture, Presentation and Sale of Tobacco and Related Products) Regulations 2016 (SI 271/2016), implementing the Act and Directive 2014/40/EU (see n 21 above). To the extent that the Directive is valid (see n 24 above), then the statutory instrument implementing it, as a measure 'necessitated by the obligations of membership' of the EU, is immune from constitutional challenge (Article 29.4.6 of the Constitution; see *Lawlor v Minister for Agriculture* [1990] 1 IR 356, [1988] ILRM 400 (SC); *Meagher v Minister for Agriculture* [1994] 1 IR 329 (SC); *Maher v Minister for Agriculture, Food and Rural Development* [2001] 2 IR 139, [2001] 2 ILRM 481, [2001] IESC 32 (30 March 2001); *Browne v Attorney General* [2003] 3 IR 205, [2003] IESC 43 (16 July 2003); *Quinn v Ireland (No 2)* [2007] 3 IR 395, [2007] 2 ILRM 101, [2007] IESC 16 (29 March 2007)). Consequently, the regulations relating to health warnings are not considered further in this article.

47 S 8 of the 2015 Act, as implemented by reg 8 of the 2017 Regulations.

48 Ss 7(11), 9(11) and 10(10) of the 2015 Act; compare s 8(3).

49 Ss 7(1)(a)–(b), 9(1)(a)–(b) and 10(1)(a)–(b) of the 2015 Act, as implemented by regs 5 and 6 of the 2017 Regulations, prescribing 'Pantone reference 448C', which has been dubbed the world's ugliest colour; see Laura Slattery, 'How Sludgy Olive Green Became the Official Colour of Cigarettes' *Irish Times* (Dublin, 27 May 2016). This follows the Australian example (see reg 2.2.1(2) of the Tobacco Plain Packaging Regulations 2011 (Cth) (SLI 263/2011); 'Market Research to Determine Effective Plain Packaging of Tobacco Products' (Department of Health, Government of Australia, 18 June 2012) <www.health.gov.au/internet/publications/publishing.nsf/Content/mr-plainpack-mr-tob-products>. Pantone 448C has also been adopted in the UK (see reg 3(2) of the Standardised Packaging of Tobacco Products Regulations 2015 (SI 829/2015)).

50 Ss 7(6) and 9(6) of the 2015 Act. Whilst it is feasible to control the shape of boxes of cigarettes (s 7(6)) and of pouches of roll-your-own tobacco (s 9(6)), the scores of other tobacco products come in so many shapes and sizes that it would be infeasible to seek to control of the shape of all of their packets. Hence, there is no equivalent sub-s in s 10; and this is the only real difference between the three sections.

51 Ss 7(8)(a), 9(8)(a) and 10(7)(a) of the 2015 Act.

The prohibitions, regulations and requirements relating to packaging in the packaging legislation therefore take their place alongside the extensive rules on health warnings,[52] the comprehensive ban on advertising and sponsorship, and the strict regulation of sales that are provided in other legislation.[53] This wide-ranging suite of reforms gives effect to government policy to reduce smoking and its harmful effects and to move Ireland towards a tobacco-free society.[54]

3 Rights

Since these prohibitions, regulations and requirements relating to packaging in the packaging legislation are all restrictions on what tobacco companies can say on the packets of their products, they certainly engage the rights in the Irish Constitution relating to speech, expression and communication.[55]

3.1 Freedom of speech

In Ireland, two Articles of the Constitution are concerned with the protection of freedom of speech[56] – Article 40.6.1(i) and Article 40.3.1. The right 'to express freely . . . convictions and opinions' contained in Article 40.6.1(i) of the Constitution is a freedom of political expression, concerned with the public activities of the citizen in a democratic society.[57] An unenumerated right to communicate, implied in Article 40.3.1[58] as one of the most basic of human rights, is a freedom of autonomous communication concerned with conveying one's needs and emotions by words or gestures, as well as by rational discourse.[59] Both are likely to be implicated in any consideration of the constitutionality of the packaging legislation.

3.2 Political expression

Article 40.6.1(i) has been relied upon to strike down legislation on three occasions (though none is entirely unambiguous). In the final stage of *Dunnes Stores v Ryan*,[60]

52 See n 46 above.

53 See nn 10–21 above.

54 As to the effectiveness of standardised packaging as an element of that strategy, see part 4.2 below.

55 This has been the chosen battleground in the USA and Canada. On the USA, see e.g. *Lorillard Tobacco Co v Reilly* 533 US 525 (2001); *RJ Reynolds Tobacco Co v United States Food and Drugs Administration* 696 F3d 1205 (DC Cir, 2012); n 123 below. On Canada, see e.g. *RJR-MacDonald Inc v Canada (Attorney General)* [1995] 3 SCR 199, 1995 CanLII 64 (SCC) (21 August 1995); *Canada (Attorney General) v JTI-Macdonald Corp* [2007] 2 SCR 610, 2007 SCC 30 (CanLII) (28 June 2007).

56 *Irish Times v Ireland* [1998] 1 IR 359, [1998] 2 ILRM 161; *Murphy v Irish Radio and Television Commission* [1999] 1 IR 12, [1998] 2 ILRM 360; *Holland v Governor of Portlaoise Prison* [2004] 2 IR 573, [2004] IEHC 97 (11 June 2004); *Mahon v Post Publications* [2007] 3 IR 338, [2007] 2 ILRM 1, [2007] IESC 15 (29 March 2007); *Kivlehan v Radio Teilifís Éireann* [2016] IEHC 88 (15 February 2016).

57 *Murphy v Irish Radio and Television Commission* [1999] 1 IR 12, 24–5, [1998] 2 ILRM 360, 372 (Barrington J; Hamilton CJ, O'Flaherty, Denham, and Keane JJ concurring).

58 On the identification and location of unenumerated rights in Article 40.3.1, see *Ryan v Attorney General* [1965] IR 294; *Fleming v Ireland* [2013] 2 IR 417, 444–8, [2013] IESC 19, [109]–[115] (Denham CJ, for the court); Gerard Hogan, 'Unenumerated Personal Rights. *Ryan*'s Case Re-evaluated' (1990–1992) 25–7 Irish Jurist (ns) 95; Desmond Clarke, 'Unenumerated Rights in Constitutional Law' (2011) 34 Dublin University Law Journal (ns) 101; David Kenny, 'Recent Developments in the Right of the Person in Article 40.3: *Fleming v Ireland* and the Spectre of Unenumerated Rights' (2011) 34 Dublin University Law Journal (ns) 101; Gerard Hogan, 'Unenumerated Personal Rights: the Legacy of *Ryan v Attorney General*' in Laura Cahillane, James Gallen and Tom Hickey (eds), *Judges, Politics and the Irish Constitution* (Manchester University Press 2017) ch 4.

59 *Murphy v Irish Radio and Television Commission* [1999] 1 IR 12, 24–5, [1998] 2 ILRM 360, 372 (Barrington J; Hamilton CJ, O'Flaherty, Denham, and Keane JJ concurring).

60 [2002] 2 IR 60 (HC; Kearns J); see [2002] IEHC 61 (5 June 2002), striking down s 19(6) of the Companies Act 1990, on the grounds that it infringed either the right to trial in due course of law in Article 38 or the right to silence implied into Article 40.6.1(i) (on which see nn 62, 69, 76, 86, 96–8, 123 and 151 below).

Kearns J in the High Court struck down a provision requiring a company or its officers to provide an explanation or make a statement to an officer making inquiries about the company. In *Dillon v DPP*,[61] de Valera J in the High Court struck down a vague statutory restriction upon begging. And in *Sweeny v Ireland*,[62] Baker J struck down a wide statutory offence of withholding material information from Gardaí.

Article 40.6.1(i) has been successfully invoked in other ways on (at least) 20 further occasions: six times to shape the application of common law or equitable doctrines;[63] four times to justify the protection of journalists' sources;[64] twice to support the exercise of democratic speech;[65] twice to constrain the interpretation of a statute;[66] twice in

61 [2007] IEHC 480 (4 December 2007), striking down s 3 of the Vagrancy (Ireland) Act 1847 on the grounds that it infringed various provisions of the Constitution, including Article 40.6.1(i) (compare *Coleman v Power* (2004) 220 CLR 1, [2004] HCA 39 (1 September 2004)). However, the best explanation of the case is probably that the section was unconstitutionally vague: see *Douglas v DPP* [2013] 1 IR 510, [2013] IEHC 343 (26 July 2013); *McInerney and Curtis v DPP* [2014] 1 IR 536, [2014] IEHC 181 (9 April 2014); *Sweeny v Ireland* [2017] IEHC 702 (23 November 2017); David Prendergast, '*Douglas v DPP* and the Constitutional Requirement for Certainty in Criminal Law' (2013) 50 Irish Jurist (ns) 235; contrast *Cox v DPP* [2015] IEHC 642 (20 October 2015); *McNamee v DPP* [2016] IEHC 286 (12 May 2016) affd [2017] IECA 230 (25 July 2017)). On the offensiveness and vagueness arguments, compare *Monis v The Queen* (2013) 249 CLR 92, [2013] HCA 4 (27 February 2013) and *Shreya Singhal v Union of India* AIR 2015 SC 1523, 2015 SCC Online SC 248 (24 March 2105).

62 [2017] IEHC 702 (23 November 2017) striking down s 9(1)(b) of the Offences Against the State (Amendment) Act 1998 on the grounds that it infringed the right to silence derived from the right to freedom of expression in Article 40 ([39]–[43]). Baker J said that O'Flaherty J in Supreme Court in *Heaney v Ireland* [1996] 1 IR 580, [1997] 1 ILRM 117 dealt with the right to silence as a corollary of freedom of expression 'by reference to Article 40.3.1', whereas he in fact dealt with it by reference to Article 40.6.1(i). Consequently, Baker J's judgment should be understood to refer to the latter Article and not to the former. On the right to silence, see generally n 60 above, and nn 69, 76, 86, 96–98, 123, and 151 below.

63 *Attorney General for England and Wales v Brandon Book Publishers* [1986] IR 597, [1987] ILRM 135 (breach of confidence); *Hunter v Gerald Duckworth and Co Ltd* [2003] IEHC 81 (31 July 2003) (qualified privilege); *Mahon v Post Publications* [2007] 3 IR 338, [2007] 2 ILRM 1, [2007] IESC 15 (29 March 2007) (breach of confidence); *Herrity v Associated Newspapers (Ireland) Ltd* [2009] 1 IR 316, [2008] IEHC 249 (18 July 2008) (invasion of privacy); *Hickey v Sunday Newspapers Ltd* [2011] 1 IR 228, [2010] IEHC 349 (8 October 2010) (same); *Leech v Independent Newspapers (Ireland) Ltd* [2014] IESC 79 (19 December 2014) (defamation damages; but see n 79 below).

Dawson and Sons v Irish Brokers' Association (Supreme Court, unreported, 27 February 1997) (defamation damages), *M v Drury* [1994] 2 IR 8, [1995] 1 ILRM 108 (O'Hanlon J) (invasion of privacy), *Foley v Sunday Newspapers Ltd* [2005] IEHC 14 (28 January 2005) (Kelly J) (defamation, interlocutory injunction refused), *Cogley v Radio Telifís Éireann* [2005] 4 IR 79, [2005] IEHC 180 (8 June 2005) (Clarke J) (invasion of privacy, interlocutory injunction refused), *Murray v Newsgroup Newspapers Ltd* [2011] 2 IR 156, [2010] IEHC 248 (18 June 2010) (Irvine J) (same), and the injunction denied *McKillen v Times Newspapers Ltd* [2013] IEHC 150 (30 March 2013) (breach of confidence) are probably further examples, but in none of them do the judges tie their rhetorical references to freedom of expression specifically to Article 40.6.1(i), though that is almost certainly what they had in mind.

64 *Mahon Tribunal v Keena* [2010] 1 IR 336, [2009] IESC 78 (26 November 2009); *Cornec v Morrice* [2012] 1 IR 804, [2012] IEHC 376 (18 September 2012); *Boyle v Governor of St Patrick's Institution* [2015] IEHC 410 (25 June 2015); *Ryanair Ltd v Channel 4 Television Corporation* [2017] IEHC 651 (5 October 2017); see, generally, Eoin Carolan, 'The Implication of Media Fragmentation and Contemporary Democratic Discourse for "Journalistic Privilege" and the Protection of Sources' (2013) 49(1) Irish Jurist (ns) 138; Eoin Carolan, 'Protecting Public Interest Reporting: What is the Future of Journalistic Privilege in Irish Law?' (2017) 57 Irish Jurist (ns) 187.

65 *Hyland v Dundalk Racing* (1999) Ltd [2014] IEHC 60 (19 February 2014) affd [2017] IECA 172 (1 June 2017) [122] (Finlay Geoghegan, Peart and Irvine JJ in a joint judgment); *O'Brien v Financial Services Ombudsman* [2014] IEHC 268 (7 May 2014).

66 *Philpott v Irish Examiner Ltd* [2016] IEHC 62 (8 February 2016) (s 33 of the Defamation Act 2009); *Muwema v Facebook Ireland Ltd* [2016] IEHC 519 (23 August 2016) (same).

contempt proceedings;[67] once to strike down a ban on prisoner correspondence;[68] once to find that a criminal conviction was unsafe;[69] and once to support the freedom of expression of a tribunal of inquiry.[70]

On the other hand, Article 40.6.1(i) has been unsuccessfully relied upon to challenge legislation on (at least) eight occasions. In *State (Lynch) v Cooney*,[71] the Supreme Court upheld the power of the minister to preclude from broadcast any matter that 'would be likely to promote, or incite to, crime or would tend to undermine the authority of the State'. In *Murphy v Irish Radio and Television Commission*,[72] the Supreme Court upheld a ban on religious advertising. In *Colgan v Independent Radio and Television Commission*, the High Court upheld a similar ban on political advertising.[73] In *Melton Enterprises Ltd v Censorship of Publications Board*,[74] the Supreme Court upheld the power to prohibit the publication of indecent or obscene periodicals. And in *Cooney v Minister for the Environment*,[75] the Supreme

67 *Desmond v Glackin* [1993] 3 IR 1; *DPP v Independent News and Media plc* [2017] IECA 333 (21 December 2017) [14], [20]–[21], [27]–[28], [40]–[41] (Hogan J; Finlay Geoghegan J concurring). Moreover, *Cullen v Toibín* [1984] ILRM 577 (SC) and *DPP v Independent Newspapers (Ireland) Ltd* [2005] 2 ILRM 453, [2005] IEHC 128 (3 May 2005) are probably further examples, but the judges did not tie their rhetorical references to freedom of expression specifically to Article 40.6.1(i), though that is very likely what they had in mind.

68 *Holland v Governor of Portlaoise Prison* [2004] 2 IR 573, [2004] IEHC 97 (11 June 2004) (blanket refusal of prison governor to allow prisoner to communicate with media about his case amounted to unconstitutional 'total and absolute abolition' ([2004] 2 IR 573, 603, [2004] IEHC 97 [47] (McKechnie J)) of prisoner's rights, including Article 40.6.1(i)).

69 In *DPP v Finnerty* [1999] 4 IR 364, [1999] IESC 130 (17 June 1999), Keane CJ for the Supreme Court held that inferences drawn from the appellant's silence infringed the constitutionally guaranteed right to remain silent that has been implied into Article 40.6.1(i) as a corollary of the right to freedom of expression (see nn 60 and 62 above, and nn 76, 86, 96–8, 123 and 151 below). In *People (DPP) v Coddington* (Court of Criminal Appeal, unreported, 31 May 2001), *People (DPP) v McCowan* [2003] 4 IR 349 and *People (DPP) v Bowes* [2004] 4 IR 223, [2004] IECCA 44 (22 November 2004), *Finnerty* was followed, and inferences were held to infringe the right to silence, but that right was not expressly located in Article 40.6.1(i).

70 *Desmond v Moriarty* [2004] 1 IR 334, [2004] IESC 3 (20 January 2004) (free speech of respondent tribunal outweighed good name and privacy of applicant).

71 [1982] 1 IR 337, upholding s 31(1) of the Broadcasting Authority Act 1960; see David Gwynn Morgan, 'Section 31: The Broadcasting Ban' (1990–1992) 25–7 Irish Jurist (ns) 117; Gerard Hogan, 'The Demise of the Irish Broadcasting Ban' (1994) 1 European Public Law 69; Patrick Twomey, 'Freedom of Expression – Talking About "the Troubles"" in Tim Murphy and Patrick Twomey (eds), *Ireland's Evolving Constitution, 1937–1997: Collected Essays* (Hart, Oxford 1998) ch 15.

72 [1999] 1 IR 12, [1998] 2 ILRM 360, upholding the ban on religious advertising in s 10(3) of the Radio and Television Act 1988. The European Court of Human Rights upheld that outcome in *Murphy v Ireland* 44179/98 (2003) 38 EHRR 212, [2003] ECHR 352 (10 July 2003).

73 [2000] 2 IR 490, [1999] 1 ILRM 22, [1998] IEHC 117 (20 July 1998), upholding the ban on political advertising in s 10(3) of the Radio and Television Act 1988. The House of Lords reached a similar conclusion in *R (Animal Defenders International) v Secretary of State for Culture, Media and Sport* [2008] AC 1312, [2008] UKHL 15 (12 March 2008). The European Court of Human Rights upheld that outcome in *Animal Defenders International v UK* 48876/08 (2013) 57 EHRR 21, [2013] ECHR 362 (22 April 2013). Contrast *Australian Capital Television Pty v Commonwealth* (1992) 177 CLR 106, [1992] HCA 45 (30 September 1992).

74 [2003] 3 IR 623, [2003] IESC 55 (4 November 2003), upholding s 9 of the Censorship of Publications Act 1946.

75 [2007] 1 IR 296, [2006] IESC 61 (13 November 2006) upholding s 46(5) of the Electoral Act 1992; compare *Burdick v Takushi* 504 US 428 (1992) (prohibition on write-in voting does not infringe the First Amendment); *Timmons v Twin Cities Area New Party* 520 US 351 (1997) (prohibition on a candidate from one political party from appearing on the ballot as an endorsed candidate for another party does not infringe the First Amendment). On the power to restrict speech in the electoral context, see Frederick Schauer and Richard Pildes, 'Electoral Exceptionalism and the First Amendment' (1999) 77 Texas Law Review 1803; Geoffrey Stone, 'Electoral Exceptionalism and the First Amendment: A Road Paved with Good Intentions' (2011) 35 New York University Review of Law and Social Change 665.

Court upheld a requirement that general election candidates who are not members of registered political parties should be described on nomination and ballot papers as 'Non-Party' (rather than 'independent') candidates. Furthermore, three statutory limitations on Article 40.6.1(i)'s concomitant right to silence have similarly survived.[76]

Article 40.6.1(i) has been unsuccessfully invoked on (at least) 13 further occasions. For example, notwithstanding countervailing constitutional speech considerations, three findings of contempt have been made;[77] two injunctions restraining publication have been granted;[78] one high defamation damages award has been upheld;[79] and an attempt to shape the application of the common law defence of justification in a defamation action failed.[80]

76 In *Heaney v Ireland* [1996] 1 IR 580, [1997] 1 ILRM 117, the Supreme Court upheld a requirement to account for movements in s 52 of the Offences Against the State Act 1939; the European Court of Human Rights disapproved of that outcome in *Heaney* and *McGuinness v Ireland* 34720/97 (2001) 33 EHRR 12, [2000] ECHR 684 (21 December 2000) and *Quinn v Ireland* 36887/97 [2000] ECHR 690 (21 December 2000). In *Rock v Ireland* [1997] 3 IR 484, [1998] 2 ILRM 35 the Supreme Court upheld provisions permitting inferences in ss 18 and 19 of the Criminal Justice Act 1984. In *Re National Irish Bank Ltd (No 1)* [1999] 3 IR 145, [1999] 1 ILRM 321, [1999] IESC 18 (21 January 1999) the Supreme Court upheld the duty to produce books and documents to a company inspector in s 10(1) of the Companies Act 1990. See generally Gerard Hogan, 'The Right to Silence after *National Irish Bank* and *Finnerty*' (1999) 21 Dublin University Law Journal (ns) 176; Donal O'Donnell, 'A Comparison of Article 6 of European Convention on Human Rights and the Due Process Requirements of the Constitution of Ireland' [2004] Judicial Studies Institute Journal 37; and see nn 60, 62 and 69 above, and nn 86, 96–8, 123 and 151 below.

77 *Kelly v O'Neill* [2000] 1 IR 354, [2000] 1 ILRM 507, [1999] IESC 81 (2 December 1999); *Murphy v British Broadcasting Corporation* [2005] 3 IR 336, [2004] IEHC 420 (21 December 2004); *DPP v Independent Newspapers (Ireland) Ltd* [2006] 1 IR 366, [2005] IEHC 353 (21 July 2005).

78 *Evans v Carlyle* [2008] IEHC 143 (8 May 2008); *O'Brien v Radio Telefís Éireann* [2015] IEHC 397 (21 May 2015) (and see the later stage of the proceedings [2015] IEHC 379 (12 June 2015)).

The injunctions restraining publication granted in *X (an Infant) v Sunday Newspapers Ltd* [2014] IEHC 696 (24 October 2014) (Gilligan J) (invasion of privacy) and *McKillen v Times Newspapers Ltd* [2013] IEHC 150 (30 March 2013), those against demonstrations granted in *Marine Terminals Ltd v Loughman* [2009] IEHC 620 (15 September 2009), and the discovery order granted, notwithstanding journalistic privilege, in *Walsh v News Group Newspapers Ltd* [2012] 3 IR 136, [2012] IEHC 353 (10 August 2012) are probably further examples, but the judges did not tie their rhetorical references to freedom of expression to Article 40.6.1(i), though that is almost certainly what they had in mind. See also n 83 below.

79 *de Rossa v Independent Newspapers* [1999] 4 IR 432, [1999] IESC 63 (30 July 1999). The European Court of Human Rights upheld that outcome in *Independent News and Media v Ireland* 55120/00 (2006) 42 EHRR 46, [2005] ECHR 402 (16 June 2005). However, although *Leech v Independent Newspapers (Ireland) Ltd* [2014] IESC 79 (19 December 2014) relied, inter alia, on constitutional considerations to reduce defamation damages (see n 63 above), in *Independent Newspapers (Ireland) v Ireland* 28199/15 [2017] ECHR 567 (15 June 2017) the European Court of Human Rights held that the damages in *Leech* were much higher than permitted by *Independent News and Media* (2005); and in *McDonagh v Sunday Newspapers Ltd (No 2)* [2017] IESC 59 (27 July 2017), the Supreme Court would have substantially reduced a defamation damages award, in part by reference to the European Court of Human Rights decision in *Independent Newspapers* (2017).

80 *McDonagh v Sunday Newspapers Ltd (No 1)* [2017] IESC 46 (28 June 2017).

The Supreme Court has held that no right could constitutionally arise under Article 40.6.1(i) to obtain information for the purpose of defeating the constitutional right to life of the unborn child.[81] The Article has not precluded a state post office monopoly,[82] or statements by the Referendum Commission during the course of a referendum campaign,[83] or an extradition to face charges relating to unlawful communications,[84] and it did not require the participation of a political leader in a television debate.[85] Finally, the right to silence in criminal cases also located in Article 40.6.1(i) is not infringed by the practical necessity to file an affidavit in a linked civil case.[86]

81 *Attorney General (Society for the Protection of the Unborn Child) v Open Door Counselling* [1988] IR 593, 625 (Finlay CJ) affirming [1988] IR 593, 617 (Hamilton P); James Friedman, 'On the Dangers of Moral Certainty and Sacred Trusts' (1988) 10 Dublin University Law Journal (ns) 71. The European Court of Human Rights disapproved of that outcome in *Open Door and Dublin Well Woman v Ireland* 14234/88 and 14235/88 (1993) 15 EHRR 244, [1992] ECHR 68 (29 October 1992). Nevertheless, the Supreme Court followed its own decision here in *Society for the Protection of Unborn Children v Grogan* [1989] IR 753, 764 (Finlay CJ), *Re Article 26 and the Regulation of Information (Services outside the State for the Termination of Pregnancies) Bill 1995* [1995] 1 IR 1, 28–31, [1995] IESC 9 (12 May 1995) (Hamilton CJ) and *Society for the Protection of Unborn Children v Grogan (No 5)* [1998] 4 IR 343, 361–2 (Hamilton CJ). The right to life of the unborn child had been inserted into Article 40.3.3 of the Constitution by the Eighth Amendment in 1983 (see *Attorney General v X* [1992] 1 IR 1, [1992] ILRM 401, [1992] IESC 1 (5 March 1992)), but it was subsequently amended by the Fourteenth Amendment in 1995, to include a freedom to provide information relating to services lawfully available in another state. In *Grogan (No 5)*, the Supreme Court affirmed that *Open Door Counselling* was correctly decided having regard to the terms of the Eighth Amendment, but it also held that its prohibition had to be modified in the light of the Fourteenth Amendment. However, Article 40.6.1(i) does not feature in any of these subsequent cases.

82 *Attorney General v Paperlink* [1984] ILRM 373, [1983] IEHC 1 (15 July 1983); see Gerard McCormack, 'Constitutional Law – Monopoly Power in the High Court' (1984) 6 Dublin University Law Journal (ns) 144.

83 *Doherty v the Referendum Commission* [2012] IEHC 211 (6 June 2012) (process of robust political debate from an informed public not infringed by respondent's statements); indeed, though it was not argued in the case, the proper role of Article 40.6.1(i) would have been to support the respondent's statements (compare *Desmond v Moriarty* (n 70 above)). Similarly, the 'freedom to express opinions incorporates the corollary right that in the democratic process of free elections, public funds should not be used to fund one side of an electoral process, whether it be a referendum or a general election, to the detriment of the other side of the argument' (*McKenna v An Taoiseach (No 2)* [1995] 2 IR 10, 53, [1995] IESC 11 (17 November 1995) (Denham J); see also *Hanafin v Minister for the Environment* [1996] 2 IR 321, 448, [1996] 2 ILRM 161, 204, [1996] IESC 6 (12 June 1996) (Denham J); *McCrystal v Minister for Children and Youth Affairs* [2012] 2 IR 726, 754-755, 766, [2013] I ILRM 217, 237, 246, [2012] IESC 53 (8 November 2012), [37](viii)–(ix), [77](viii)–(ix) (Denham CJ); *Jordan v Minister for Children and Youth Affairs* [2015] 4 IR 232, 266, [2015] IESC 33 (24 April 2015), [129] (Denham CJ)). As with the judges referred to in n 78 above, Denham CJ did not tie her references to freedom of expression in these cases to Article 40.6.1(i), though that is almost certainly what she had in mind. To the extent that it is, then these cases lend support both to the political expression reading of that Article (see e.g. nn 57 and 65 above, and n 95 below) and to the derivation of corollary rights from it (see e.g. nn 98–99 below).

84 *Minister for Justice, Equality and Law Reform v Hill* [2009] IEHC 159 (3 April 2009) (no infringement of Article 40.6.1(i) by extradition to face charges relating to communications to a trial judge and jury foreman to influence the outcome of a trial).

85 *Kivlehan v Radio Teilifís Éireann* [2016] IEHC 88 (15 February 2016) (Article 40.6.1(i), among other constitutional provisions, informed the interpretation of ss 39, 42 and 114 of the Broadcasting Act 2009).

86 *Wicklow County Council v O'Reilly Brownfield Restoration Ireland Ltd* [2006] 3 IR 623, [2006] IEHC 273 (8 September 2006). Moreover, in *People (DPP) v MK* [2005] 3 IR 423, [2005] IECCA 93 (19 July 2005), *DPP v Bullman* [2009] IECCA 84 (28 July 2009), *DPP v Brian Kearney* [2009] IECCA 112 (9 October 2009), *DPP v White* [2011] IECCA 78 (19 October 2011), *DPP v O'Shea* [2014] IECCA 49 (27 November 2014) and *DPP v MacCarthaigh* [2015] IECA 234 (3 November 2015), the decision of the Supreme Court in *DPP v Finnerty* [1999] 4 IR 364, [1999] IESC 130 (17 June 1999) (n 69 above) was followed, and inferences were held not to infringe the right to silence, but that right was not expressly located in Article 40.6.1(i). On that right to silence, see generally nn 60, 62, 69 and 76 above and nn 96–8, 123 and 151 below.

There are some neutral references to Article 40.6.1(i) which are at best window dressing;[87] in particular, defamation cases are increasingly replete with comments stating the need to balance that right with the constitutional right to a good name in Article 40.3.1,[88] but they have very little impact on the analysis or outcome. There are also some cases in which it has been held not to have been engaged or burdened on the facts.[89]

Although early cases took a narrow approach to Article 40.6.1(i), tending to focus on its weaknesses and limitations,[90] the courts are now taking an increasingly expansive approach. If Homer can make the *Iliad* from a local row,[91] and if the US Supreme Court can spell out the most luxuriant theories of free speech protections from the arid, thin soil of 14 words in the First Amendment,[92] then the Irish courts can coax some growth from the stony, grey soil[93] of Article 40.6.1(i). For example, though its protection is directed to 'convictions and opinions', the courts have held that it is not confined to them and also protects the right to express facts and information.[94]

On the other hand, the courts have not yet fully worked out the consequences of reading Article 40.6.1(i) as a freedom of political expression concerned with the public

87 In *Irish Times v Ireland* [1998] 1 IR 359, [1998] 2 ILRM 161 (see n 94 below) it was very important window dressing, supporting the principle of open justice in Article 34.1 of the Constitution. In *O'Brien v Mirror Group Newspapers Ltd* [2000] IESC 70 (25 October 2000) the Supreme Court reduced a defamation damages award; in *K (A Minor) v Independent Star* [2010] IEHC 500 (3 November 2010) Hedigan J held that the cause of action of invasion of privacy had not been established; in *Desmond v Doyle* [2013] IESC 59 (17 December 2013) the Supreme Court declined to dismiss defamation proceedings on the basis of delay; and, in all three cases, references to Article 40.6.1(i) made no difference to the outcome.

88 See e.g. *Hynes-O'Sullivan v O'Driscoll* [1988] IR 436, 450, [1989] ILRM 349, 361 (Henchy J); *Foley v Independent Newspapers Ltd* [1994] 2 ILRM 61, 67 (Geoghegan J); *O'Brien* (n 87); *de Rossa v Independent Newspapers* [1999] 4 IR 432, 456, [1999] IESC 63 (30 July 1999) (Hamilton CJ); *Burke v Associated Newspapers (Ireland) Ltd* [2010] IEHC 447 (10 December 2010), [32] (Hogan J); *Leech v Independent Newspapers (Ireland) Ltd* [2014] IESC 79 (19 December 2014) (Dunne J; Murray J concurring), [12], [58]–[59] (McKechnie J); *Rooney v Shell E&P Ireland Ltd* [2017] IEHC 63 (20 January 2017), [31]–[32] (Ní Raifeartaigh J); C*hristie v TV3 Television Networks Ltd* [2017] IECA 128 (4 May 2017), [33]–[35] (Hogan J; Peart and Irvine JJ concurring); *McDonagh v Sunday Newspapers Ltd (No 2)* [2017] IESC 59 (27 July 2017), [38]–[40] (O'Donnell J), [4] (Dunne J), [7] (MacMenamin J). See also *Jones v Coolmore Stud* [2017] IECA 164 (25 May 2017), [26], [36], [52] ((Ryan P; Irvine and Barr JJ concurring).

89 See e.g. *Attorney General v Paperlink* [1984] ILRM 373, 381, [1983] IEHC 1 (15 July 1983), [31] (Costello J); *Oblique Financial Services Ltd v The Promise Production Co Ltd* [1994] 1 ILRM 74, 78 (Keane J); *Carrigaline Community Television Broadcasting Co Ltd v Minister for Transport, Energy and Communications* [1997] 1 ILRM 241, 288 (Keane J). These cases have now been overtaken by the subsequent development of the freedom of political communication and its more expansive approach to Article 40.6.1(i); see e.g. n 94 below.

90 See the cases in the previous footnote; see also *The State (Lynch) v Cooney* [1982] 1 IR 337 (see n 71 above); *Report of the Constitution Review Group* (Pn 2632, Dublin, 1996) 291–2.

91 See 'Epic' by Patrick Kavanagh in Antoinette Quinn (ed), *Patrick Kavanagh: Collected Poems* (Penguin 2005) 184.

92 'Congress shall make no law . . . abridging the freedom of speech, or of the press . . .'.

93 See 'Stony Grey Soil' by Kavanagh in Quinn (ed) (n 91) 38.

94 *Irish Times v Ireland* [1998] 1 IR 359, 395, [1998] 2 ILRM 161, 181 (O'Flaherty J), [1998] 1 IR 359, 399 [1998] 2 ILRM 161, 185 (Denham J), [1998] 1 IR 359, 405, [1998] 2 ILRM 161, 193 (Barrington J); *Murphy v Irish Radio and Television Commission* [1999] 1 IR 12, 24–5, [1998] 2 ILRM 360, 372 (Barrington J; Hamilton CJ, O'Flaherty, Denham, and Keane JJ concurring); *Mahon v Post Publications* [2007] 3 IR 338, 377, [2007] 2 ILRM 1, 15–16, [2007] IESC 15 (29 March 2007), [51] (Fennelly J; Murray CJ and Denham J concurring). The contrary conclusion in the cases in n 89 is no longer good law. For one view of the consequences of such an expansion, see Eoin O'Dell, 'Does Defamation Value Free Expression? The Possible Influence of *New York Times v Sullivan* on Irish Law' (1990) 12 Dublin University Law Journal (ns) 50. The German courts have adopted a similarly expansive interpretation of the constitutional protections of the expression of opinions in Article 5 Grundgesetz; see e.g. 93 BVerfGE 93, 266 (1 BvR 1476/91, First Senate, 10 October 1995) (*Soldaten sind Mörder*/Soldiers Are Murderers).

activities of the citizen in a democratic society.[95] In particular, deriving a right to silence as a concomitant of the right in Article 40.6.1(i) predates the emergence of a political speech reading of that right,[96] and the two lines of authority are hard to reconcile – the right to silence is a matter of due process and criminal procedure, and it covers more than silence about political matters. It would therefore be best if the due process right to silence in criminal proceedings were to be located in (or relocated to) Article 38.1 of the Constitution, which protects trial in due course of law.[97] The due process right to silence in criminal proceedings would have a more appropriate and secure constitutional location, and the freedom of political expression would be able to develop in a coherent fashion. In appropriate cases, it should support the derivation of a concomitant right to keep silent on political matters,[98] as well as a concomitant right to be informed on political

95 Guidance on what counts as 'political' for these purposes might be found, for example, in *Lange v Australian Broadcasting Corporation* (1997) 189 CLR 520, [1997] HCA 25 (8 July 1997); *Coleman v Power* (2004) 220 CLR 1, [2004] HCA 39 (1 September 2004); *Wotton v Queensland* (2012) 246 CLR 1, [2012] HCA 2 (29 February 2012); *Monis v The Queen* (2013) 249 CLR 92, [2013] HCA 4 (27 February 2013); *McCloy v New South Wales* (2015) 257 CLR 178, [2015] HCA 34 (7 October 2015).

96 See nn 60, 62, 69, 76 and 86 above, and nn 123 and 151 below. The right to silence cases start in 1996 with *Heaney v Ireland* [1996] 1 IR 580, [1997] 1 ILRM 117, whilst the political speech reading starts in 1998 with *Irish Times v Ireland* [1998] 1 IR 359, [1998] 2 ILRM 161 and *Murphy v Irish Radio and Television Commission* [1999] 1 IR 12, [1998] 2 ILRM 360.

97 This was the view of Costello J at first instance in *Heaney* [1994] 3 IR 593, 605–6, [1994] 2 ILRM 420, 429–31. In *Re National Irish Bank*, both Shanley J at first instance ([1999] 3 IR 145, 156, [1999] 1 ILRM 321, 331, [1998] IEHC 116 (13 July 1998), [11]) and Barrington J on appeal ([1999] 3 IR 145, 187, 188, [1999] 1 ILRM 321, 359, 360, [1999] IESC 18 [53], [56] (21 January 1999) (Barrington J; O'Flaherty, Murphy, Lynch and Barron JJ concurring)) kept the door resolutely open to locating the right to silence in a criminal trial in Article 38.1 (see also *Sweeny v Ireland* [2017] IEHC 702 (23 November 2017), [40] (Baker J). In *Dunnes Stores v Ryan* [2002] IEHC 61 (5 June 2002) Kearns J was studiedly ambiguous as to whether the right to silence which was infringed by s 19(6) of the Companies Act 1990 was located in Article 38 or Article 40.6.1(i). In *DPP v Roihu* [2012] IEHC 421 (7 June 2012), [5.4] Hedigan J held that there was 'an interference with the appellant's right to silence which is protected under Article 38.1 of the Constitution'. In *Donnelly v Judges of Dublin Metropolitan District Court* [2015] IEHC 125 (3 March 2015), upholding the shifting of the evidential burden of proof in s 9(6) of the Firearms and Offensive Weapons Act 1990, Noonan J dealt with the right to silence in the context of Article 38.1 and made no reference to Article 40.6.1. In *Redmond v Ireland* [2015] IESC 98 (17 December 2015), [21] Charleton J (Denham CJ, Hardiman, McKechnie and MacMenamin JJ concurring) expressly approved of Costello J's approach to Article 38.1 in *Heaney*. In *DPP v McD* [2016] IESC 71 (14 December 2016), [79] McKechnie J (Denham CJ, O'Donnell and O'Malley JJ concurring) held that the right to silence 'is firmly anchored' in Article 38.1, so that it was not necessary to say where in other circumstances the right can also be found, such as Article 40.3.1 or Article 40.6.1(i). In *DPP v M* [2018] IESC 21 (21 March 2018), [37] O'Malley J (Clarke CJ and O'Donnell, Dunne and Charleton JJ concurring) held that, notwithstanding *Heaney*, the right to silence '*also* belongs to the group of fair trial rights protected by Article 38' (emphasis added).

98 The Supreme Court has held that the right to associate in Article 40.6.1(iii) carries with it a correlative right to disassociate (*Educational Company of Ireland v Fitzpatrick (No 2)* [1961] IR 345 (SC); *Meskell v Coras Iompair Éireann* [1973] IR 121 (SC)). This was the basis on which O'Flaherty J in *Heaney v Ireland* [1996] 1 IR 580, 585, [1997] 1 ILRM 117, 123 derived the right to silence from Article 40.6.1(i). That right to silence should now be regarded as an element of due process secured by Article 38 (see nn 60, 62, 69, 76, and 96–7 above; see also nn 123 and 151 below). Nevertheless, a similar process of reasoning would derive a correlative right to keep silent on political matters from the recast Article 40.6.1(i) freedom of political expression. Compare *West Virginia State Board of Education v Barnette* 319 US 624 (1943) (right not to recite Pledge of Allegiance); *Wooley v Maynard* 430 US 705 (1977) (right not to display New Hampshire's state motto 'Live Free or Die' on licence plates); *Pacific Gas and Electric Co v Public Utilities Commission of California* 475 US 1 (1986) (right of utility to decline to carry third-party comments on bills' envelopes); *Riley v National Federation of the Blind of North Carolina* 487 US 781 (1988) (right of professional fundraisers to refuse to disclose percentage of charitable contributions actually turned over to charity).

matters.[99] Finally, here, it is an open question of whether this freedom extends beyond political matters and, if so, how far it might go.

Against this background, two questions arise concerning the restrictions in the packaging legislation. First, do they in fact restrict the tobacco companies' speech? And second, if so, is the freedom of political expression in Article 40.6.1(i) engaged or burdened by these restrictions?

The restrictions in the packaging legislation do indeed restrict tobacco companies' speech, in four ways. First, the restrictions in the Act impose extensive prohibitions not only upon what tobacco companies may print on the packaging of their products, but also upon how they may present that packaging more generally,[100] and these are plainly restrictions upon those companies' speech.

Second, the restrictions in the packaging legislation go further and contain significant regulations concerning not only what tobacco companies may print on the packaging of their products, but also how they may present that packaging more generally.[101] To the extent that these regulations amount to prohibitions, then they too are plainly restrictions upon those companies' speech. And, to the extent that these regulations control what tobacco companies may print on and otherwise present the packaging of their products, they too amount to restrictions upon those companies' speech. These restrictions may be less than complete prohibitions upon their speech, but they are still restrictions all the same.[102]

Third, these regulations on packaging in the packaging legislation include controls on branding, which will certainly restrict – and, likely, ultimately ban – the use of trade marks from tobacco packing.[103] To the extent that the use of the trade marks represents a specific example of the companies' speech, then the restrictions on the use of those trade marks would amount to a restriction on the companies' exercise of their speech rights.[104]

Fourth, the restrictions in the packaging legislation contain several elements of packaging that are required of the tobacco companies.[105] These restrictions compel speech, and thus amount to restrictions upon the companies' right to keep silent on such matters.

Finally, some of these restrictions upon the companies' rights (in particular, the prohibitions upon what they can say) could also amount to restrictions upon the companies' customers' rights to be informed.

However, although restrictions in the packaging legislation do restrict tobacco companies' speech (and may also restrict their customers' rights), it is not clear how far, if at all, the freedom of political expression in Article 40.6.1(i) would be engaged or burdened by these restrictions. Since it is the usual port of call in speech cases, it would

99 In *Cullen v Toibín* [1984] ILRM 577, 582 McCarthy J mentioned that citizens have the right to be informed, but he did not tie this specifically to Article 40.6.1(i), though that is very likely what he had in mind. In *Irish Times v Ireland* [1998] 1 IR 359, 405, [1998] 2 ILRM 161, 193, Barrington J approved this *dictum* during the course of his discussion of Article 40.6.1(i). In *K (A Minor) v Independent Star* [2010] IEHC 500 (3 November 2010), [83] Hedigan J commented that Article 40.6.1(i) includes the right to receive information.

100 See part 2.1 above.

101 See part 2.2 above.

102 The fact that a restriction upon a right is a regulation of the right rather than a complete prohibition upon it may make the restriction more proportionate or otherwise have an impact upon the review or scrutiny of the restriction, but it does not mean that the regulation is not a restriction; see part 5.2 below.

103 See nn 44–5 above.

104 Compare *Matal v Tam* 582 US __ (2017) (Alito J, for the court) (restrictions on registration of trade marks infringed First Amendment speech rights).

105 See part 2.3 above.

almost certainly be invoked in any challenge to the packaging legislation. However, the expression restricted by that legislation is commercial rather than political in nature, and if the political reading of Article 40.6.1(i) is to be taken seriously, then the Article may not be engaged or burdened by the restrictions in the packaging legislation. Before the emergence of the political expression reading of the Article, there were some attempts to bring commercial speech within its reach,[106] and there have been some suggestions that the language of some of the political speech cases does not entirely preclude this development,[107] so it may be that commercial speech cases could drive the further expansion of the Article. But if they do not, then, to seek constitutional protection for commercial speech,[108] analysis would have to turn to the second speech right in the Irish constitutional order – the freedom of autonomous communication in Article 40.3.1.

3.3 Autonomous communication

In *Attorney General v Paperlink*, Costello J held that, since the act of communication is the exercise of such a basic human faculty, 'a right to communicate must inhere in the citizen by virtue of his human personality and must be guaranteed by the Constitution . . . [as] one of those personal unspecified rights of the citizen protected by Article 40.3.1'.[109] In *Dillon v DPP*, de Valera J struck down a vague statutory restriction upon begging, and he referred to the freedom of autonomous communication.[110] Moreover, the freedom of autonomous communication in Article 40.3.1 has been successfully invoked in other ways on (at least) three further occasions: twice to strike down restrictions on prisoners' correspondence,[111] and once to shape the application of the equitable doctrine of breach of confidence.[112]

On the other hand, Article 40.3.1 has been unsuccessfully relied upon to challenge legislation on three occasions. In *Carrigaline Community Television Broadcasting Co Ltd v Minister for Transport, Energy and Communications*,[113] Keane J in the High Court upheld key elements of the state's television broadcasting regime. In *Murphy v Irish Radio and Television*

106 Gerard Quinn, 'The Right of Lawyers to Advertise in the Market for Legal Services: A Comparative American, European and Irish Perspective' (1991) 20 Anglo-American Law Review 403, 434–6; Gerard Quinn, 'Comparative Commercial Speech' in Liz Heffernan and James Kingston (eds), *Human Rights: A European Perspective* (Round Hall Press, Dublin 1994) ch 6.5.

107 *Kelly* [7.5.12] 1728; Ailbhe O'Neill, 'Corporate Freedom of Expression' (2005) 27 Dublin University Law Journal (ns) 184, 191.

108 See, generally, Roger A Shiner, *Freedom of Commercial Expression* (Oxford University Press 2003); Victor Brudney, 'The First Amendment and Commercial Speech' (2012) 53 Boston College Law Review 1153; Joanna Krzeminska-Vamvaka, *Freedom of Commercial Speech in Europe* (Verlag Dr Kovač, Hamburg 2008).

109 *Attorney General v Paperlink* [1984] ILRM 373, 381, [1983] IEHC 1 (15 July 1983), [31]. In *Holland v Governor of Portlaoise Prison* [2004] 2 IR 573, [2004] IEHC 97 (11 June 2004), [20] McKechnie J noted that the right 'appears to have been accepted, rather than established' in *The State (Murray) v Governor of Limerick Prison* (High Court, unreported 23 August 1978), where Darcy J held that prison regulations restricting communications between a husband and wife who were both convicted prisoners did not render their respective detentions unlawful.

110 [2007] IEHC 480 (4 December 2007); however, the case probably turned on Article 40.6.1(i), and the best explanation is now probably that the section was unconstitutionally vague; see n 61 above.

111 *Kearney v Minister for Justice* [1986] IR 116, [1987] ILRM 52; *Holland v Governor of Portlaoise Prison* [2004] 2 IR 573, [2004] IEHC 97 (11 June 2004) (blanket refusal of prison governor to allow prisoner to communicate with media about his case amounted to unconstitutional 'total and absolute abolition' ([2004] 2 IR 573, 603, [2004] IEHC 97 [47] (McKechnie J)) of prisoner's rights, including the freedom of autonomous communication in Article 40.3.1).

112 *Mahon v Post Publications* [2007] 3 IR 338, [2007] 2 ILRM 1, [2007] IESC 15 (29 March 2007) (breach of confidence).

113 [1997] 1 ILRM 241, upholding ss 5 and 6 of the Wireless Telegraphy Act 1926 and s 17 of the Broadcasting and Wireless Telegraphy Act 1988.

Commission,[114] the Supreme Court upheld a ban on religious advertising. In *Colgan v Independent Radio and Television Commission*,[115] the High Court upheld a similar ban on political advertising. And the Article has been unsuccessfully invoked in other ways on (at least) four further occasions. For example, the freedom of autonomous communication did not prevent the grant of two injunctions restraining publication,[116] or require the participation of a political leader in a television debate.[117] Moreover, in *Paperlink* itself, it did not preclude a state post office monopoly.[118]

It is one of the bases upon which the High Court granted leave to challenge the validity of the Irish and EU data retention regimes, but the full trial has not yet been heard.[119] There are some neutral references to Article 40.3.1, which are at best window dressing;[120] in particular, it has been referred to but not relied upon in several cases.[121]

The freedom of autonomous communication was implied into Article 40.3.1 as a response to a narrow approach to Article 40.6.1(i),[122] but the courts have now committed to a stable pair of freedoms, and they are taking an increasingly expansive approach to both of them. Nevertheless, they have not yet fully worked out the consequences of innovating a basic right to communicate one's needs and emotions by words or gestures, as well as by rational discourse. Nevertheless, its foundations are sufficiently secure that it should be able to develop in a coherent fashion. In appropriate cases, it should support

114 [1999] 1 IR 12, [1998] 2 ILRM 360.

115 [2000] 2 IR 490, [1999] 1 ILRM 22, [1998] IEHC 117 (20 July 1998).

116 *Oblique Financial Services Ltd v The Promise Production Co Ltd* [1994] 1 ILRM 74; *O'Brien v Radio Telefís Éireann* [2015] IEHC 397 (21 May 2015).

117 *Kivlehan v Radio Teilifís Éireann* [2016] IEHC 88 (15 February 2016) (Article 40.3, among other constitutional provisions, informed the interpretation of ss 39, 42 and 114 of the Broadcasting Act 2009).

118 See nn 82, 89 and 109 above.

119 *Digital Rights Ireland Ltd v Minister for Communications, Marine and Natural Resources* [2010] 3 IR 251, [2010] IEHC 221 (5 May 2010). On a reference in that case to the Court of Justice of the EU, in Joined Cases C-293/12 and C-594/12 *Digital Rights Ireland Ltd v Minister for Communications, Marine and Natural Resources* and *Seitlinger v Austria* [2014] ECR I-238 (ECLI:EU:C:2014:238; CJEU, 8 April 2014) the CJEU struck down the Data Retention Directive (Directive 2006/24/EC of the European Parliament and of the Council of 15 March 2006 on the Retention of Data Generated or Processed in Connection with the Provision of Publicly Available Electronic Communications Services or of Public Communications Networks ((2006) OJ L 105)) on privacy grounds. When the matter returned to Austria, the Constitutional Court struck down the Austrian laws on data retention (G 47/2012 (Verfassungsgerichtshof, 27 June 2014)), also on privacy grounds. The matter has only recently been recommenced in the Irish High Court (in *Digital Rights Ireland v Minister for Communications, Marine and Natural Resources* [2017] IEHC 307 (19 July 2017) Costello J rejected an application for the trial of a preliminary issue) so the question of whether Irish data retention laws are constitutional on privacy or communication grounds has not yet been decided.

120 In *Irish Times v Ireland* [1998] 1 IR 359, [1998] 2 ILRM 161, it was important window dressing, supporting the principle of open justice in Article 34.1 of the Constitution. In *Jonathan v Ireland* [2002] IEHC 59 (31 May 2002) it was pleaded, but Murphy J dismissed the claim on the grounds of mootness.

121 In *Hunter v Gerald Duckworth and Co Ltd* [2003] IEHC 81 (31 July 2003), Article 40.3.1 was mentioned but not relied upon by Ó Caoimh J in considering the impact of the Constitution on the defamation defence of qualified privilege. In *Domican v Axa Insurance Ltd* [2007] 2 IR 682, [2007] IEHC 14 (19 January 2007), it was mentioned but not relied upon by Clarke J in holding that the defendant insurer was entitled to copy its correspondence concerning the plaintiff's claim directly to the plaintiff notwithstanding his written instructions that all such correspondence should be addressed only to his solicitors. In *Devoy v Governor of Portlaoise Prison* [2009] IEHC 288 (22 June 2009) it was mentioned but not relied upon by Edwards J in holding that a restriction on a prisoner's correspondence was ultra vires. In *M v Minister for Justice and Equality* [2018] IESC 14 (7 March 2018), [10.41] it was referred to by Clarke CJ, and O'Donnell, McKechnie, MacMenamin, Dunne, O'Malley and Finlay Geoghegan JJ, in a joint judgment, as one of a list of unenumerated rights in Article 40.3.

122 See the cases cited in nn 89 and 94 above.

the derivation of a concomitant right to keep silent,[123] as well as a concomitant right to be informed.[124]

Against this background, two questions arise concerning the restrictions in the packaging legislation. First, do they in fact restrict the tobacco companies' speech? And second, if so, is the freedom of autonomous communication in Article 40.3.1 engaged or burdened by these restrictions?

The prohibitions upon, and regulations concerning, what tobacco companies may print on and otherwise present the packaging of their products are restrictions upon those companies' speech; requirements about packaging amount to restrictions upon the companies' right to keep silent on such matters; and these restrictions may also amount to restrictions upon the companies' customers' rights to be informed. It is very likely that the freedom of autonomous communication in Article 40.3.1 would be engaged or burdened by these restrictions. It would almost certainly be invoked in any challenge to the packaging legislation. Unlike with Article 40.6.1(i), the fact that the speech at issue here is commercial is less likely to bring it outside the ambit of Article 40.3.1. Although the essence of the right is that it is concerned with human personality, needs and emotions,[125] nevertheless, in several cases, the courts have held that the right is engaged or burdened by restrictions upon commercial communications of various kinds,[126] and it is no stretch from those cases to the conclusion that the right is engaged or burdened by the restrictions in packaging legislation.[127]

123 See *Rock v Ireland* [1997] 3 IR 484, [1998] 2 ILRM 35 (Hamilton CJ); see, generally, nn 60, 69, 76, 86 and 96–8 above and n 151 below. In *Sweeny v Ireland* [2017] IEHC 702 (23 November 2017) Baker J referred to the right to silence derived from Article 40.3; but, for the reasons given in n 62, this should be read as a reference to Article 40.6.1.

However, in the context of commercial rather than political speech, the US Supreme Court has upheld requirements to disclose purely factual and uncontroversial information (see e.g. *Zauderer v Office of Disciplinary Counsel of Supreme Court of Ohio* 471 US 626 (1985); *Milavetz, Gallop and Milavetz PA v United States* 559 US 229 (2010); see generally Robert Post, 'Transparent and Efficient Markets: Compelled Commercial Speech and Coerced Commercial Association' 40 Valparaiso University Law Review 1 (2005); Ellen P Goodman, 'Visual Gut Punch: Persuasion, Emotion, and the Constitutional Meaning of Graphic Disclosure' 99 Cornell Law Review 513 (2014); Robert Post, 'Compelled Commercial Speech' (2015) 117 West Virginia Law Review 867; Micah L Berman, 'Clarifying Standards for Compelled Commercial Speech' 50 (2016) Washington University Journal of Law and Policy 53) which has been followed in lower courts in the context of warnings on tobacco packaging (see e.g. *Discount Tobacco City & Lottery, Inc v United States* 674 F3d 509 (6th Cir, 2012); contrast n 55 above).

124 In *Society for the Protection of Unborn Children v Grogan* (No 5) [1998] 4 IR 343, 390 Keane J held that it is 'a necessary corollary' of *Paperlink* 'that other citizens have a constitutional right to receive such information'; compare *Virginia Board of Pharmacy v Virginia Citizens Consumer Council* 425 US 748 (1976) (hearer autonomy); *Ford v Quebec* [1988] 2 SCR 712, 1988 CanLII 19 (SCC) (15 December 1988) (commercial expression protects listeners as well as speakers).

125 See nn 59 and 109 above.

126 *Attorney General v Paperlink* [1984] ILRM 373 (courier services); *Oblique Financial Services Ltd v The Promise Production Co Ltd* [1994] 1 ILRM 74 (financial information); *Carrigaline Community Television Broadcasting Co Ltd v Minister for Transport, Energy and Communications* [1997] 1 ILRM 241 (rebroadcaster); *Murphy v Irish Radio and Television Commission* [1999] 1 IR 12, [1998] 2 ILRM 360 (advertising); *Colgan v Independent Radio and Television Commission* [2000] 2 IR 490, [1999] 1 ILRM 22, [1998] IEHC 117 (20 July 1998) (same); *Digital Rights Ireland Ltd v Minister for Communications, Marine and Natural Resources* [2010] 3 IR 251, [2010] IEHC 221 (5 May 2010) (telecommunications).

127 Though it may have an impact upon the application of the proportionality test or other standard of review or scrutiny of the restriction; see part 4.3 below.

3.4 Speech, expression, communication

The Irish Constitution contains two speech rights – a freedom of political expression in Article 40.6.1(i) and a freedom of autonomous communication in Article 40.3.1. Notwithstanding that it began in a narrow reading of Article 40.6.1,[128] this bifurcated protection now reflects the two general justifications for the protection of freedom of expression, rooted respectively in considerations of democracy and autonomy.[129] For all that there are strong arguments that the narrow reading of Article 40.6.1(i) and the implication of an unenumerated right into Article 40.3.1 were unnecessary, and that all of the constitutional protections for freedom of speech should be (re-)integrated into Article 40.6.1(i),[130] it is exceedingly unlikely that the Supreme Court would extirpate a constitutional right to which it has – several times – afforded its imprimatur.[131] Indeed, there are advantages to this separation: the commingling or conflating of these justifications can be avoided; their different consequences can be independently explored; and their different ambits of application can be clearly identified. All of this ensures that they each can develop in an appropriate fashion; and the Supreme Court should therefore devote its analytical energies to continuing the increasingly expansive approach it is taking to both rights.

In many cases, the coverage of the two rights will be coterminous, or will at least overlap substantially.[132] So, from the perspective of whether the rights are engaged or burdened, it will often make very little difference which one is invoked.[133] For example, in both cases, the constitutional text confines the rights to citizens: Article 40.6.1(i) refers to the 'right of the *citizens* to express freely their convictions and opinions', and Article 40.3.1 refers to 'the personal rights of the *citizen*'. These provisions could have confined the enjoyment of the constitutional protections of speech to natural persons who are citizens. However, whatever the case for natural persons who are not citizens,[134] it is now

128 See nn 89 and 94 above.

129 Wojciech Sadurski, *Freedom of Speech and its Limits* (Kluwer 1999) ch 1; Eric Barendt, *Freedom of Speech* (2nd edn, Oxford University Press 2005) chs 1 and 2; contrast Larry Alexander, *Is There a Right to Freedom of Expression?* (Cambridge University Press 2005) chs 7 and 8.

130 Tom Daly, 'Strengthening Irish Democracy: A Proposal to Restore Free Speech to Article 40.6.1(i) of the Constitution' (2009) 31 Dublin University Law Journal (ns) 228; Robert Noonan, 'The Ontology of the Subject of Rights: Post-Modern Perspectives on the Irish Constitution through a Case Study on the Right to Free Speech' (2014) 13(1) Cork Online Law Review 71.

131 On this imprimatur, see nn 112, 114 and 120 above. On the consequent unwillingness to extirpate the right, in *NHV v Minister for Justice and Equality* [2017] 2 ILRM 105, 113, [2017] IESC 35 (30 May 2017), [12] O'Donnell J (Denham CJ, and Clarke, MacMenamin, Laffoy, Charleton and O'Malley JJ concurring) would have wished to consider afresh whether an unenumerated right to work ought to be implied into Article 40.3, but did not do so because that right was so well established.

132 *Murphy v Irish Radio and Television Commission* [1999] 1 IR 12, 24–5, [1998] 2 ILRM 360, 372 (Barrington J); *Holland v Governor of Portlaoise Prison* [2004] 2 IR 573, 590, [2004] IEHC 97 (11 June 2004), [25] (McKechnie J); *Mahon v Post Publications* [2007] 3 IR 338, 377, [2007] 2 ILRM 1, 15–16, [2007] IESC 15 (29 March 2007), [51] (Fennelly J; Murray CJ and Denham J concurring).

133 Though, again, it may have an impact upon the application of the proportionality test or other standard of review or scrutiny of the restriction; see part 5.3 below.

134 Compare *NHV v Minister for Justice and Equality* [2017] 2 ILRM 105, 115–116, [2017] IESC 35 (30 May 2017), [17]–[19] (O'Donnell J; Denham CJ, and Clarke, MacMenamin, Laffoy, Charleton and O'Malley JJ concurring) (legitimate distinctions may be drawn between citizens and non-citizens in the application of Article 40.3.1).

well established that such protections may be enjoyed by corporate entities.[135] A challenge by the tobacco companies to the packaging legislation would not therefore be excluded on this ground.

However, such a challenge could provide a context in which it could very well matter which speech right is invoked. If the restrictions upon the cigarette companies' commercial speech in the packing legislation do not engage or burden the freedom of political expression in Article 40.6.1(i) but do engage or burden the freedom of autonomous communication in Article 40.3.1, then, in this important context, the coverage of the two rights will diverge, and it will make a very great deal of difference indeed which one is invoked. Many of the commercial speech cases involve advertisements;[136] and the issue almost arose in *Dunnes Stores v Mandate*,[137] where the Supreme Court refused an application for an injunction restraining publication of a misleading advertisement.[138] However, the extent of the constitutional protection of a commercial advertisement under either right was not considered by the court,[139] and the question of the extent to which the freedom of political expression in Article 40.6.1(i), and the freedom of autonomous communication in Article 40.3.1, as they are now understood, would be engaged or burdened by restrictions upon commercial speech still awaits an appropriate case.

Although these rights have been successfully relied upon in various ways,[140] they have been successfully relied upon to strike down legislation in very few cases. For example, the freedom of political expression in Article 40.6.1(i) has been relied upon to challenge

135 *Carrigaline Community Television Broadcasting Co Ltd v Minister for Transport, Energy and Communications* [1997] 1 ILRM 241, 287–8 (Keane J). Almost all of the parties which have successfully invoked Article 40.6.1(i) have been companies (see nn 60–70 above), and it has never been objected that they are not citizens (many of them are not media companies which might qualify for protection as 'organs of public opinion'; see *State (Lynch) v Cooney* [1982] 1 IR 337, 361 (O'Higgins CJ, for the Court)). Moreover, Article 40.3.1 has been successfully invoked on at least one occasion by a (media) company (see n 112 above); see, generally, Ailbhe O'Neill, *The Constitutional Rights of Companies* (Thomson Round Hall, Dublin 2007) part III.

136 See nn 108, and 114–15 above, and 203, 249–50 below.

137 [1996] 1 IR 55, [1996] 1 ILRM 384.

138 The court held that the European Communities (Misleading Advertising) Regulations 1988 (SI 134/1988) did not apply to a trade dispute between an employer and a union.

139 The plaintiffs had submitted that there is no constitutionally guaranteed freedom to communicate misleading matters ([1996] 1 IR 55, 58); and the defendants submitted in turn that the plaintiffs could reply to the advertisement in the same newspaper in accordance with their own constitutional rights in Article 40.6.1(i) and Article 40.3 (ibid). However, having rejected the application for the injunction on the basis that the regulations did not apply, the court did not need to consider the constitutional arguments.

140 If the numbers here are right, Article 40.6.1(i) has been expressly invoked successfully in 23 cases (see nn 60–70 above) and unsuccessfully in 21 (see nn 71–86 above), which is a success rate of a shade over 52 per cent; and Article 40.3.1 has been expressly invoked successfully in four cases (see nn 110–112 above) and unsuccessfully in seven (see nn 113–118 above), which is a success rate of a shade over 36 per cent.

legislation in eleven cases; it has been successful in three[141] and unsuccessful in eight, which gives it a success rate of a shade over 27 per cent. Again, the freedom of autonomous communication in Article 40.3.1 has been relied upon to challenge legislation in three cases, but it has not been successful in any of them, which gives it a 0 per cent success rate. Hence, whichever right is engaged or burdened, the chances of success for any challenge are not great; if only Article 40.3.1 is in play, then the chances look particularly bleak. Either way, the chances of survival for the packaging legislation look especially auspicious.

Of course, in any challenge to the packaging legislation on speech grounds, both the expression and communication freedoms are likely to be invoked; and, given the divergence in their ranges, any such challenge would provide the perfect opportunity to continue the development of the engagement or burdening, inter-relationship and interoperability of the two speech rights as separate protections for political expression and autonomous communication.

4 Reasons

Where there is a restriction upon a right, the state may advance 'pressing and substantial'[142] reasons to seek to justify the restriction. The prohibitions, regulations and requirements relating to packaging in the packaging legislation may potentially be justified by many reasons, but two in particular stand out: public health and the protection of children.

4.1 Pressing and substantial reasons

In the case of rights protected by the European Convention on Human Rights, a list of pressing and substantial reasons is often provided in the second paragraph of articles protecting rights. For example, Article 10(1) protects 'freedom of expression', and Article 10(2) sets out a list of legitimate aims on foot which restrictions may be justified. However, other similar constitutional documents are not as helpful. For example, the First Amendment to the US Constitution simply states a protection of 'freedom of speech', and the US Supreme Court assesses whether an appropriate or sufficient state or governmental interest has been established.[143] Similarly, s 2(b) of the Canadian Charter of Rights and Freedoms secures 'freedom of . . . expression', and s 1 envisages 'reasonable limits' on Charter rights, but it is for the Supreme Court of Canada to assess whether a particular reason is a sufficiently pressing and substantial social objective to

141 See nn 60–62 above. Gerard Hogan, David Kenny and Rachael Walsh, 'An Anthology of Declarations of Unconstitutionality' (2015) 54(2) Irish Jurist (ns) 1, identify 93 such declarations between the adoption of the Constitution in 1937 and the completion of their anthology at the end of 2014. Since the completion of the anthology, one of the listed declarations has been reversed on appeal (*Bederev v Ireland* [2016] IESC 34 (22 June 2016)); there have been declarations of unconstitutionality in four further cases (*Moore v DPP* [2016] IEHC 244 (19 April 2016); *NHV v Minister for Justice and Equality* [2017] 2 ILRM 105, [2017] IESC 35 (30 May 2017) (declaration suspended); [2017] IESC 82 (30 November 2017) (declaration made effective); *Sweeny v Ireland* [2017] IEHC 702 (23 November 2017); *AB v Clinical Director of St Loman's Hospital* [2018] IECA 123 (3 May 2018) (declaration suspended)); and one is expected in *PC v Minister for Social Protection* [2017] IESC 63 (27 July 2017) where the matter was put back for submissions as to remedy. Including all five of these cases, this gives a total of 97 declarations, of which three are presented here as having been granted on the basis of constitutional protections of expression and communication, which is a shade over 3 per cent of the total number of declarations of unconstitutionality.

142 *Heaney v Ireland* [1996] 1 IR 580, 607, [1994] 2 ILRM 420, 431 (Costello J) affd [1996] 1 IR 580, [1997] 1 ILRM 117.

143 E.g. *Reed v Town of Gilbert* 576 US __ (2015) (slip op, at 14–15); (Thomas J, for the court) (comprehensive Sign Code regulating the display of outdoor signs unconstitutional; Town did not demonstrate that the Code furthered a compelling governmental interest).

justify a reasonable limit.[144] The Irish constitutional protections of speech fall somewhere in the middle, containing some guidance from the text of the relevant Articles, but also including others that can be established in court.

The right to freedom of political expression in Article 40.6.1(i) is hedged with many textual exceptions. According to the first line of Article 40.6, 'liberty for the exercise' of all of the rights in that Article is guaranteed 'subject to public order and morality'.[145] The middle sentence of Article 40.6.1(i) permits restrictions on the 'rightful liberty of expression' of the 'organs of public opinion' to ensure that they are not 'used to undermine public order or morality or the authority of the State'.[146] And the final sentence of Article 40.6.1(i) provides that blasphemy, sedition and indecency shall be 'offences . . . punishable in accordance with law'.[147] This gives six grounds on the face of the text. Furthermore, since the exercise of constitutional rights 'may be regulated by the Oireachtas when the common good requires this',[148] the right to freedom of political expression in Article 40.6.1(i) 'can, in certain circumstances, be limited in the interests of the common good',[149] as well as on other grounds.[150] Moreover, the concomitant rights derived from Article 40.6.1(i) are also subject to the same limitations.[151]

On the other hand, the freedom of autonomous communication in Article 40.3.1 is expressly guaranteed 'as far as practicable', and it – as well as concomitant rights derived from it – may also be limited in the interests of the common good.[152]

144 E.g. *R v Butler* [1992] 1 SCR 452, 491–9, 1992 CanLII 124 (SCC) (27 February 1992) (Sopinka J; Lamer CJ, La Forest, Cory, McLachlin, Stevenson and Iacobucci JJ concurring) (objective of the avoidance of harm to society sufficiently pressing and substantial; prohibition on obscene material proportionate to that objective); *R v KRJ* [2016] 2 SCR 31, 2016 SCC 31 (21 July 2016), [61]–[66] (Karakatsanis J; McLachlin CJ, Cromwell, Moldaver, Wagner, Gascon and Côté JJ concurring) (objective of protection of children).

145 These are 'overriding considerations' (*State (Lynch) v Cooney* [1982] IR 337, 361; [1983] ILRM 89, 91 (O'Higgins CJ, for the court)); see also *Redmond v Ireland* [2015] IESC 98 (17 December 2015), [18] (Charleton J).

146 See *State (Lynch) v Cooney* [1982] IR 337, 361; [1983] ILRM 89, 94 (O'Higgins CJ, for the court) (authority of the state); *Desmond v Glackin* [1993] 3 IR 1, 28 (O'Hanlon J) (restriction 'sufficiently wide to comprehend . . . authority and impartiality of the judiciary', by analogy with Article 10(2) European Convention on Human Rights).

147 See e.g. *Corway v Independent Newspapers (Ireland) Ltd* [1999] 4 IR 485, [2000] 1 ILRM 426, [1999] IESC 5 (30 July 1999) (blasphemy); s 36 of the Defamation Act 2000 (blasphemy); ss 11, 12 and 26 of the Offences Against the State Act 1939 (sedition); s 7 of the Censorship of Films Act 1923 (blasphemy, sedition, indecency, public morality); ss 6 and 7 of the Censorship of Publications Act 1929; *Irish Family Planning Association v Ryan* [1979] IR 295 and *Melton Enterprises Ltd v Censorship of Publications Board* [2003] 3 IR 623, [2003] IESC 55 (4 November 2003) (indecency, obscenity).

148 *Ryan v Attorney General* [1965] IR 294, 312–13 (Kenny J), affd [1965] IR 294, 345, [1965] IESC 1 [23] (3 July 1965) (Ó Dálaigh CJ, for the court); *O'Callaghan v Ireland* [1994] 1 IR 555, 562 (Finlay CJ, for the court); *North Western Health Board v HW* [2001] 3 IR 622, 740, [2001] IESC 90 (8 November 2001), [228] (Murray J), [2001] 3 IR 622, 760, [2001] IESC 90 [212] (Hardiman J); *Dellway Investments v National Asset Management Agency (No 3)* [2011] 4 IR 1, 209, [2011] IESC 14 (12 April 2011) [53] (Murray CJ), [2011] 4 IR 1, 225, [2011] IESC 14 [110] (Denham J).

149 *Murphy v Irish Radio and Television Commission* [1999] 1 IR 12, 25, [1998] 2 ILRM 360, 373 (Barrington J; Hamilton CJ, O'Flaherty, Denham and Keane JJ concurring).

150 In *Equality Authority v Portmarnock Golf Club*, O'Higgins J in the High Court, in the course of interpreting s 9(1)(a) of the Equal Status Act 2000, held that the Article 40.6.1 right of association could be circumscribed by considerations other than public order and morality ([2005] IEHC 235 (10 June 2005)); the Supreme Court approved his interpretation of s 9(1)(a), but held that he need not have reached the constitutional issue ([2010] 1 IR 671, [2010] 1 ILRM 237, [2009] IESC 73 (3 November 2009)).

151 *Heaney v Ireland* [1996] 1 IR 580, 589, [1997] 1 ILRM 117, 127 (O'Flaherty J) (correlative right to silence subject to public order and morality); *Rock v Ireland* [1997] 3 IR 484, 496, [1998] 2 ILRM 35, 45 (Hamilton CJ, for the court) (same); on that right to silence, see nn 60, 62, 69, 76, 86, 96–8 and 123 above.

152 *Ryan* (n 148 above); *Murphy* (n 149 above).

The state can lead expert evidence on these issues.[153] Indeed, it may be fatal not to.

And so, the question here is simply whether there are 'pressing and substantial' reasons upon which the state may rely to seek to justify the restrictions upon speech contained in the packaging legislation. Public health and the protection of children are the two most likely such reasons.

4.2 Public health

Public health is the main reason for the packaging legislation.[154] In introducing the Bill that became the Public Health (Standardised Packaging of Tobacco) Act 2015,[155] the Minister for Health, Dr James Reilly, said that tobacco kills 5200 Irish citizens and 700,000 European citizens every year,[156] and that the aim of the legislation:

> . . . is to make all tobacco packs look less attractive to consumers, to make health warnings more prominent and to prevent packaging from misleading consumers . . . about the harmful effects of tobacco.[157]

There is a great deal of evidence that plain packaging will help achieve this aim.[158] In particular, the Australian measures do seem to be contributing to a decline in tobacco use.[159]

In several leading constitutional decisions, the state has put forward public health reasons to support legislation, often with success. For example, in *Ryan v Attorney General*,[160] the court upheld the Health (Fluoridation of Water Supplies) Act 1960 on the grounds that the plaintiff had not established that fluoridation involved any danger to life

153 *PJ Carrolls v Minister for Health and Children* [2005] IESC 26 (3 May 2005); *Digital Rights Ireland v Minister for Communications, Marine and Natural Resources* [2017] IEHC 307 (19 July 2017), [19], [26] (Costello J).

154 Compare *BAT* [2016] EWHC 1169 (Admin) (19 May 2016), [60]–[76] (Green J); affd [2016] EWCA Civ 1182 (30 November 2016), [21]–[27] (Lewison, Beatson and Richards LJJ) (public health concerns underpinning the UK legislation and regulations in n 5 above); *JTI* (2012) 250 CLR 1, [2012] HCA 43 [4] (French CJ), [145] (Gummow J); [253]–[254] (Crennan J), [308]–[309], [316]–[317] (Kiefel J) (public health concerns underpinning the Australian legislation in n 3 above); but see [193], [209], [227] (Heydon J, dissenting).

155 The minister's statements in the Oireachtas are not admissible (*Crilly v Farrigton* [2001] 3 IR 251, [2002] 1 ILRM 161, [2001] IESC 60 (11 July 2001)), but they nevertheless constitute a useful guide to what the state would likely argue in defence of the Act.

156 See Seanad Debates (17 June 2014) 40 <https://www.oireachtas.ie/en/debates/debate/seanad/2014-06-17/11/>. He returned to this theme at Final Stage: 'every year 5,200 Irish people die prematurely from smoking. This year alone, more people in this country will die from smoking than died during 30 years of the Troubles in Northern Ireland' (see Seanad Debates (3 March 2015) 2 <https://www.oireachtas.ie/en/debates/debate/seanad/2015-03-03/10/>.

157 See Seanad Debates (17 June 2014) 39 <https://www.oireachtas.ie/en/debates/debate/seanad/2014-06-17/11/>.

158 Final Regulatory Impact Analysis for the Public Health (Standardised Packaging of Tobacco) Bill 2014 <http://health.gov.ie/wp-content/uploads/2013/12/Standardised-Packaging-RIA-July-2014-FINAL.doc>; *David Hammond, Standardized Packaging of Tobacco Products (Evidence Review prepared on behalf of the Irish Department of Health)* (March 2014) <http://health.gov.ie/wp-content/uploads/2014/06/2014-Ireland-Plain-Pack-Main-Report-Final-Report-July-26.pdf>. Similarly, an independent review undertaken for the UK government concluded that standardised packaging is 'very likely over time to contribute to a modest but important reduction in smoking prevalence'; see Sir Cyril Chantler, *Standardised Packaging of Tobacco* (3 April 2014) [6.11] 40 <http://webarchive.nationalarchives.gov.uk/20140911094224/http:/www.kcl.ac.uk/health/packaging-review.aspx>.

159 The Department of Health, *Post-implementation Review of Tobacco Plain Packaging* (26 February 2016) <http://ris.pmc.gov.au/2016/02/26/tobacco-plain-packaging>. See also *The Economics of Tobacco and Tobacco Control* (National Cancer Institute Tobacco Control Monograph Series 21 2017) 302 <http://who.int/tobacco/publications/economics/nci-monograph-series-21/en>.

160 [1965] IR 294, [1965] IESC 1 (3 July 1965).

or health.[161] In *McGee v Attorney General*,[162] while the court struck down s 17 of the Criminal Law Amendment Act 1935 that prohibited the import or sale of contraceptives, Walsh J accepted that there 'may be many reasons, grounded on considerations of public health . . .' for such a prohibition.[163] And in *Norris v Attorney General*,[164] the court dismissed a challenge to legislation criminalising male homosexual acts, which the state successfully justified on the grounds, inter alia, of public health.[165]

In *Re Philip Clarke*,[166] the court upheld the power of the police to take a person of unsound mind into custody, because it was intended not only for the benefit of such persons but also 'for the safety and well-being of the public generally'.[167] And in *Bederev v Ireland*,[168] the court upheld the power of the government to declare any substance to be a controlled drug for the purposes of the Misuse of Drugs Act 1977. Charleton J said that the Act is 'concerned with the risks to human well-being of allowing dangerous drugs to be available'[169] and that its primary aim is 'to protect against the dangers of harm caused by these types of substances'.[170] Furthermore, broader public health concerns have informed various *dicta*[171] in the Supreme Court and have been relied upon to uphold

161 [1965] IR 294, 348–9, [1965] IESC 1 (3 July 1965), [28]–[33] (Ó Dálaigh CJ, for the court) (in particular to protect against dental cavities) (not an unconstitutional infringement of the plaintiff's unenumerated right to bodily integrity implied in Article 40.3.1).

162 [1974] IR 284, [1973] IESC 2 (19 December 1973).

163 [1974] IR 284, 308, [1973] IESC 2 (19 December 1973) (Walsh J) (unconstitutional infringement of the plaintiff's unenumerated right to marital privacy implied in Article 40.3.1).

164 [1984] IR 36, [1983] IESC 3 (22 April 1983), upholding ss 61 and 62 of the Offences Against the Person Act 1861, and s 11 of the Criminal Law Amendment Act 1885. The European Court of Human Rights disapproved of that outcome in *Norris v Ireland* 10581/83 (1988) 13 EHRR 186, [1988] ECHR 22 (26 October 1988) and the offence was abolished by s 2 of the Criminal Law (Sexual Offences) Act 1993; but see *DPP v Devins* [2012] IESC 7 (8 February 2012).

165 [1984] IR 36, 48 (McWilliam J), affd [1984] IR 36, 62, 63, 65 (O'Higgins CJ; Finlay P and Griffin J concurring), 77, 79 (Henchy J, dissenting), 94, 102, 104 (McCarthy J, dissenting), [1983] IESC 3 (22 April 1983).

166 [1950] IR 235, upholding s 165 of the Mental Treatment Act 1945.

167 [1950] IR 235, 247 (O'Byrne J, for the court). The 1945 Act was amended several times and was ultimately repealed and replaced by the Mental Health Act 2001, and *Clarke*'s paternalism has been followed throughout; see *Re Gallagher* [1991] 1 IR 31, 38 (McCarthy J); *Gallagher v Director of the Central Mental Hospital (No 2)* [1996] 3 IR 10, 17–18 (Geoghegan J), 36 (Laffoy J) ('protect the public'); *Croke v Smith (No 2)* [1998] 1 IR 101, 112, 132 (Hamilton CJ); *Gooden v St Otteran's Hospital* (2001) [2005] 3 IR 617, 634 (McGuinness J); *VTS v Health Service Executive* [2009] IEHC 106 (11 February 2009) (Edwards J); *EH v Clinical Director of St Vincent's Hospital* [2009] 3 IR 774, 790, [2009] IESC 46 (28 May 2009) (Kearns J); *AB v Clinical Director of St Loman's Hospital* [2018] IECA 123 (3 May 2018), [39] (Hogan J; Peart and Gilligan JJ concurring); see Claire Murray, 'Reinforcing Paternalism within Irish Mental Health Law' (2010) 17(1) Dublin University Law Journal (ns) 273.

168 [2016] 2 ILRM 340, [2016] IESC 34 (22 June 2016), upholding s 2(2) of the Misuse of Drugs Act 1977 and the Misuse of Drugs Act 1977 (Controlled Drugs) (Declaration) Order 2011 (SI 551/2011).

169 [2016] 2 ILRM 340, 366, [2016] IESC 34 (22 June 2016), [30] (Charleton J; Denham CJ, and O'Donnell, McKechnie, Clarke, MacMenamin and Dunne JJ concurring).

170 Ibid.

171 *Re a Ward of Court* [1996] 2 IR 79, 125, [1995] 2 ILRM 401, 427, [1995] IESC 1 (27 July 1995), [149]–[150] (Denham J) (in the case of contagious diseases, the claims of the common good might well justify restrictions on the exercise of a constitutionally protected right to refuse medical treatment) (court permitted withdrawal of medical treatment from ward); Rachel O'Sullivan, 'The Patient's Duties to Others: Limitations to the Principle of Autonomy in Healthcare Decision Making' (2015) 14(1) Cork Online Law Review 7; *North Western Health Board v HW* [2001] 3 IR 622, 762, [2001] IESC 90 (8 November 2001), [316]–[317] (Hardiman J) (major public health policy decisions are matters in the first place for the legislature, and then for the courts to assess constitutionality) (court upheld parental refusal to consent to blood test on child); Simon Mills, 'Constitutional Law – PKU: Please Keep Unclear?' (2001) 23 Dublin University Law Journal (ns) 180.

other impugned legislation.[172] Moreover, the state may also argue that such public health concerns implicate not just matters of important public policy, but also the state's duty to vindicate the rights of its citizens. In *Ryan*, Kenny J in the High Court and Ó Dálaigh CJ in the Supreme Court accepted that the right to bodily integrity is among the unenumerated personal rights guaranteed by Article 40.3.1 of the Constitution.[173] That capacious and accommodating article might in an appropriate case also provide a home for a right to health.[174] And the duty to vindicate these rights could reinforce the state's interest in public health.[175]

In the context of constitutional protections of freedom of speech, the courts have held that the right to life can, in principle, limit such rights.[176]

The state has been permitted to rely on public health concerns in many cases to defend legislation, often with success; and similar concerns have been relied upon in the context of speech rights. Moreover, the state's interest in the promotion of public health was central to *PJ Carrolls v Minister for Health and Children*,[177] in which the Supreme Court held that the state could lead expert evidence of the harmful effects of smoking to meet a challenge to tobacco advertising prohibitions in the Public Health (Tobacco) Act 2002. For all of these reasons, therefore, the public health concerns underpinning the packaging legislation undoubtedly constitute pressing and substantial reasons upon which the state may seek to justify standardised packing restrictions.

172 *Re Article 26 and the Health (Amendment) (No 2) Bill 2004* [2005] 1 IR 105, 174, [2005] IESC 7 (16 February 2005) [63] (provision of health services); *BUPA Ireland Ltd v Health Insurance Authority* [2006] IEHC 431 (23 November 2006), [242]–[247], [293]–[294] (McKechnie J) (private medical insurance involves major issues of national policy, including state interest in functioning and fair health insurance market).

173 [1965] IR 294, [1965] IESC 1 (3 July 1965), [23]; see also *McGee v Attorney General* [1974] IR 284, [1973] IESC 2 (19 December 1973); *Re a Ward of Court* [1996] 2 IR 73, [1995] 2 ILRM 401, [1995] IESC 1 (27 July 1995).

174 See e.g. Allen Buchanan, *Justice and Health Care* (Oxford University Press 2009); John Tobin, *The Right to Health in International Law* (Oxford University Press 2012); Jonathan Wolff, *The Human Right to Health* (Norton, New York 2012); John Tasioulas and Effy Vayena, 'The Place of Human Rights and the Common Good in Global Health Policy' (2016) 37 Theoretical Medicine and Bioethics 365. The Supreme Court has rejected the justiciability of economic, social and cultural rights (*Sinnott v Minister for Education* [2001] 2 IR 545; *TD v Minister for Education* [2001] 4 IR 259); but there are strong arguments the other way (see e.g. Gerry Whyte, *Social Inclusion and the Legal System: Public Interest Law in Ireland* (Institute of Public Administration, Dublin 2002); Anne Hughes, *Human Dignity and Fundamental Rights in South Africa and Ireland* (Pretoria University Law Press 2014)). In particular, Article 45 includes a reference to 'the strength *and health* of workers, men and women' (Article 45.4.2; emphasis added); on the justiciability of Article 45, see Gerard Hogan, 'Directive Principles, Socio-Economic Rights and the Constitution' (2001) 36 Irish Jurist (ns) 174. The development of a justiciable constitutional right to health, perhaps as an unenumerated right to health implied into Article 40.3.1, cannot therefore be excluded (though in *NHV v Minister for Justice and Equality* [2017] 2 ILRM 105, 113, [2017] IESC 35 (30 May 2017), [12] O'Donnell J (Denham CJ, and Clarke, MacMenamin, Laffoy, Charleton and O'Malley JJ concurring) seemed particularly unwilling to countenance the implication of socio-economic rights into that Article). Note that in 2014 the Constitutional Convention voted to afford greater constitutional protection to such rights (see <www.constitution.ie/AttachmentDownload.ashx?mid=adc4c56a-a09c-e311-a7ce-005056a32ee4>).

175 It might also lighten the applicable standard of review; see part 5.7 below.

176 *Attorney General (Society for the Protection of the Unborn Child) v Open Door Counselling* [1988] IR 593, 625 (Finlay CJ) (see n 80 above) (right to life of the unborn child); *Foley v Sunday Newspapers Ltd* [2005] IEHC 14 (28 January 2005) (Kelly J) (defamation, interlocutory injunction to protect plaintiff's life refused); *Murray v Newsgroup Newspapers Ltd* [2011] 2 IR 156, [2010] IEHC 248 (18 June 2010) (Irvine J) (invasion of privacy, interlocutory injunction to protect plaintiff's life refused).

177 [2005] IESC 26 (3 May 2005); see also *BUPA Ireland v Health Insurance Authority* [2006] IEHC 431 (23 November 2006), [246] (McKechnie J); *Ryan v Attorney General* [1965] IR 294, 343, [1965] IESC 1 (3 July 1965) [15] (Ó Dálaigh CJ, for the court) (admissibility of scientific evidence in constitutional challenge).

4.3 Protection of children

The protection of children is an important reason for the 2015 Act. In introducing the Bill that became the 2015 Act, the Minister for Health, Dr James Reilly, said that tobacco 'will kill one in two of the children seduced by its packaging and gimmicks into taking up the killer habit',[178] and that the aim of the legislation was to 'prevent packaging from misleading consumers, *particularly children*, about the harmful effects of tobacco'.[179] Hence, limiting youth access to tobacco products is a tobacco control imperative worldwide.[180]

In *Landers v Attorney General*,[181] Finlay J upheld a prohibition upon children performing in licensed premises after 9pm, on the ground, inter alia, that the protection of children must be part of the common good.[182] Moreover, the state may also argue that such concerns implicate not just matters of important public policy, but also the state's duty to vindicate children's rights,[183] which are expressly secured by Article 42A.1 of the Constitution.[184]

For these reasons, the concerns to protect children underpinning the packaging legislation undoubtedly constitute pressing and substantial reasons upon which the state may seek to justify standardised packing restrictions. So, too, do the state's interests in the promotion of public health. These conclusions hold, whether those concerns or interests are described as exigencies of the common good, strong public policies, legitimate aims, or pressing and substantial reasons.

5 Review

It is clear that, where there is a restriction upon a right, the state may advance 'pressing and substantial' reasons to seek to justify the restriction. However, it is not enough for the state to advance such reasons; those reasons must support and justify the restrictions, and not go too far in doing so. In the case of rights protected by the European Convention on Human Rights, this question of review or scrutiny arises because the rights that it protects may often be limited for reasons that are 'necessary in a democratic society'. In the case of rights protected by the Canadian Charter of Rights and Freedoms, this question arises because the rights that it protects may be limited for reasons that 'can be demonstrably justified in a free and democratic society'. Hence, in

178 See Seanad Debates (17 June 2014) 40 (n 156 above).

179 See Seanad Debates (17 June 2014) 39 (emphasis added) (n 157 above).

180 See *The Economics of Tobacco and Tobacco Control* (n 159) ch 11.

181 *Landers v Attorney General* (1975) 108 ILTR 1, 5 (Finlay J) upholding s 2(b)–(c) of the Prevention of Cruelty to Children Act 1904; see also *Norris v Attorney General* [1983] IESC 3 (22 April 1983), [1984] IR 36, 79 (Henchy J, dissenting), 104 (McCarthy J, dissenting) (protection of young is an aspect of the common good).

182 (1975) 108 ILTR 1, upholding s 2(b) and (c) of the Prevention of Cruelty to Children Act 1904.

183 It might also lighten the applicable standard of review; see part 5.7 below.

184 The text is set out after n 259 below. It was inserted by the 31st Amendment of the Constitution, which came into effect in 2015; as to the prior position, compare *G v An Bord Uchtála* [1980] IR 32, 55 (O'Higgins CJ); *Eastern Health Board v An Bord Uchtála* [1994] 3 IR 207, 230 (O'Flaherty J); *DG v Eastern Health Board* [1997] 3 IR 511, 525 (Hamilton CJ), 533–6 (Denham J); *North Western Health Board v HW* [2001] 3 IR 622, 719–20 (Denham J).

both the European Court of Human Rights[185] and the Supreme Court of Canada,[186] this standard has been interpreted to require that the restriction must be proportionate to the reason for it.[187]

Following this lead,[188] the Irish Supreme Court has strongly committed to a proportionality test to review or scrutinise legislative restrictions upon constitutional rights; the impugned legislation must:

(a) be rationally connected to the objective and not be arbitrary, unfair or based on irrational considerations;

(b) impair the right as little as possible; and

(c) be such that its effects on rights are proportional to the objective.[189]

The court has applied this test across the constitutional board, including in the context of the freedom of political expression in Article 40.6.1,[190] and of the freedom of

185 *Handyside v UK* 5493/72 (1976) 1 EHRR 737, [1976] ECHR 5 (7 December 1976), [49]; Jeremy McBride, 'Proportionality and the European Convention on Human Rights' in Evelyn Ellis (ed), *The Principle of Proportionality in the Laws of Europe* (Hart, Oxford 1999) ch 2; Yutaka Arai-Takahashi, *The Margin of Appreciation Doctrine and the Principle of Proportionality in the Jurisprudence of the ECHR* (Intersentia 2002); Andrew Legg, *The Margin of Appreciation in International Human Rights Law. Deference and Proportionality* (Oxford University Press 2012); Mattias Klatt and Moritz Meister, *The Constitutional Structure of Proportionality* (Oxford University Press 2012); contrast Stijn Smet , *Resolving Conflicts between Human Rights: The Judge's Dilemma* (Routledge, London 2017).

186 *R v Oakes* [1986] 1 SCR 103, 1986 CanLII 46 (SCC) (28 February 1986), [70] (Dickson CJ; Chouinard, Lamer, Wilson and Le Dain JJ concurring); Sujit Choudry, 'So What is the Real Legacy of *Oakes*? Two Decades of Proportionality Analysis under the Canadian Charter's Section 1' (2006) 34 Supreme Court Law Review (2d) 501; David Bilchitz, 'Necessity and Proportionality: Towards a Balanced Approach' in Liora Lazarus, Christopher McCrudden and Nigel Bowles (eds), *Reasoning Rights. Comparative Judicial Engagement* (Hart, Oxford 2016) ch 3; Dwight Newman, 'Canadian Proportionality Analysis: 5½ Myths' (2016) 73 Supreme Court Law Review (2d) 93.

187 Aharon Barak, *Proportionality: Constitutional Rights and Their Limitations* (Cambridge University Press 2012).

188 And contributing to international dialogue on the issue; see Kai Möller, 'Constructing the Proportionality Test: An Emerging Global Conversation' in Lazarus et al (n 186) 31; contrast Oran Doyle, 'Constitutional Cases, Foreign Law and Theoretical Authority' (2016) 5(1) Global Constitutionalism 85 (defending judicial use of foreign law as a matter of persuasive authority, but not as a matter inter-jurisdictional judicial dialogue).

189 *Heaney v Ireland* [1996] 1 IR 580, 607, [1994] 2 ILRM 420, 431 (Costello J), affd [1996] 1 IR 580, [1997] 1 ILRM 117 (SC); *Rock v Ireland* [1997] 3 IR 484, 500, [1998] 2 ILRM 35, 49–50 (Hamilton CJ, for the court); *Re National Irish Bank* [1999] 3 IR 145, 178–80, [1999] 1 ILRM 321, 352, [1999] IESC 18 [26]–[31] (21 January 1999) (Barrington J; O'Flaherty, Murphy, Lynch and Barron JJ concurring); *Blehein v Minister for Health and Children* [2009] 1 IR 275, 281, [2008] IESC 40 (10 July 2008), [18] (Denham J; Hardiman, Geoghegan, Kearns and Macken JJ concurring); *Leech v Independent Newspapers (Ireland) Ltd* [2014] IESC 79 (19 December 2014) [20]–[24] (McKechnie J); see, generally, Brian Foley, 'The Proportionality Test: Present Problems' [2008] Judicial Studies Institute Journal 67. See, in particular, *DK v Crowley* [2002] 2 IR 744, 757–8 (Keane CJ, for the court), striking down the procedures for barring orders in s 4(3) of the Domestic Violence Act 1996 as a disproportionate infringement of applicant's constitutional right to fair procedures.

190 *Murphy v Irish Radio and Television Commission* [1999] 1 IR 12, 26, [1998] 2 ILRM 360, 373 (Barrington J; Hamilton CJ, O'Flaherty, Denham, and Keane JJ concurring); *Colgan v Independent Radio and Television Commission* [2000] 2 IR 490, 508–9, [1999] 1 ILRM 22, 41–2, [1998] IEHC 117 (20 July 1998), [41]–[42] (O'Sullivan J); *Dunne Stores v Ryan* [2002] IEHC 61 (5 June 2002), [40], [68] (Kearns J); *K (A Minor) v Independent Star* [2010] IEHC 500 (3 November 2010), [83]–[85] (Hedigan J); Robert Cannon, 'Does Expression Have Any Freedom Left? *Murphy v Independent Radio and Television Commission*' (1998) 1 Trinity College Law Review 126; Rachel Joyce, 'A New Approach to Freedom of Expression? The Doctrine of Proportionality and Article 40.6.1(i) of the Constitution' (2003) 3 Hibernian Law Journal 85.

autonomous communication in Article 40.3.1.[191] And it would almost[192] certainly be applied in any challenge by tobacco companies to the packaging legislation.

5.1 Rational connection

The first of the three steps in the proportionality test is a requirement of a rational connection, that the impugned legislation must be rationally connected to the pressing and substantial reasons advanced by the state, and not be arbitrary, unfair or based on irrational considerations. Hence, restrictions that were struck down as being 'impermissibly wide and indiscriminate'[193] are now explained as being disproportionate,[194] as are 'unreasonable' or 'unnecessary' restrictions.[195]

The requirement of a rational connection assesses the strength or weakness of the state's reasons for the restriction. The less pressing and substantial they are, the less likely a restriction is to be proportionate. For example, regulations that were 'neither capricious nor arbitrary'[196] have been easily upheld. Conversely, the more pressing and substantial they are, the more likely a restriction is to be proportionate. For example, an 'extreme financial crisis or fundamental disequilibrium in the public finances'[197] could justify very significant restrictions indeed.

The question here, then, is whether the packaging legislation passes the requirement of a rational connection. Subject to the evidence on this point that might be run in any challenge, the answer would seem to be yes. The state's interests in the promotion of public health and in the protection of children[198] are unquestionably pressing and substantial reasons; the packaging legislation is clearly rationally connected to them; and it does not seem to be arbitrary, unfair or based on irrational considerations.

5.2 Minimal impairment

The second of the three steps in the proportionality test is a requirement of minimal impairment, that the impugned legislation must impair the engaged or burdened right as little as possible: the interference must not exceed what is necessary to meet the pressing

191 *Murphy* (n 190); *Colgan* (n 190); *Holland v Governor of Portlaoise Prison* [2004] 2 IR 573, [2004] IEHC 97 (11 June 2004), [32]–[33] (McKechnie J).

192 Subject to part 5.7 below.

193 *Cox v Ireland* [1992] 2 IR 503, 524 (Finlay CJ, for the court), striking down s 34 of the Offences Against the State Act 1939; see also *PC v Minister for Social Protection* [2017] IESC 63 (27 July 2017), [57], ('punitive, retributive, indiscriminate, and disproportionate') (MacMenamin J; Denham CJ and McKechnie, Clarke J and O'Malley JJ concurring).

194 *Heaney v Ireland* [1996] 1 IR 580, 607, [1994] 2 ILRM 420, 431 (Costello J) (*Cox* (ibid) an 'example of . . . disproportionate means'); *Rock v Ireland* [1997] 3 IR 484, 500, [1998] 2 ILRM 35, 49 (Hamilton CJ, for the court) (proportionality 'surfaced obliquely' in *Cox*); *McCann v Minister for Education* [1997] 1 ILRM 1, 10–11 (Costello P); *Re Article 26 and the Employment Equality Bill 1996* [1997] 2 IR 321, 342–3, 383 (Hamilton CJ, for the Court).

195 *DK v Crowley* [2002] 2 IR 744, 762 (Keane CJ, for the court); *Aughey v Ireland* [1989] ILRM 87, 93 (Walsh J; Henchy J, Griffin, Hederman and McCarthy JJ concurring) (no 'unreasonable or disproportionate' restriction of constitutional right to associate). Other synonymous descriptions of restrictions (see e.g. nn 237, 240 below) should also be accommodated in this way.

196 *Lawlor v Minister for Agriculture* [1990] 1 IR 356, 377, [1988] ILRM 400, 418 (HC, Murphy J).

197 *Re Article 26 and the Health (Amendment) (No 2) Bill 2004* [2005] 1 IR 105, 208, [2005] IESC 7, [132] (Murray CJ, for the court); *J&J Haire v Minister for Health* [2010] 2 IR 615, 654–5, [2009] IEHC 562, [122]–[123] (McMahon J), upholding ss 2 and 9 of the Financial Emergency Measures in the Public Interest Act 2009; *Dellway Investment v National Asset Management Agency* [2011] 4 IR 1, 120, [287], [2010] IEHC 364 (1 November 2010) [10.20] (Kearns P, Kelly and Clarke JJ, in a joint judgment).

198 See part 4 above.

and substantial concerns in question and must be the least possible interference with the right consistent with the advancement of those concerns.[199] Hence, the imposition of 'relatively minor'[200] burdens or 'limited'[201] intrusions upon rights have been held to be minimal and thus proportionate interferences with those rights. On the other hand, in *Dunnes Stores v Ryan*,[202] Kearns J in the High Court struck down a provision requiring a company to provide a statement to an officer making inquiries about the company on the grounds that it failed the minimal impairment step of the proportionality test because it did not immunise those statements from later use in criminal proceedings.

The court has not always applied this requirement with strictness. In *Murphy v Irish Radio and Television Commission*, Barrington J held that the impugned advertising restrictions were 'minimalist', notwithstanding that a 'more selective administrative system' could have been possible.[203]

The requirement of minimal impairment assesses the strength or weakness of a restriction upon a right. A regulation of speech is less intrusive than a ban upon speech, so regulation is more likely to be a proportionate restriction than an outright ban. On the one hand, in *Murphy v Irish Radio and Television Commission*, Barrington J held that the restrictions did not involve the complete removal of all means of expression and stressed that the applicant could advance his views in other ways.[204] On the other hand, in *Holland v Governor of Portlaoise Prison*, McKechnie J struck down a 'total and absolute abolition'[205] of the plaintiff's Article 40.6.1(i) rights.

The question here, then, is whether the packaging legislation passes the requirement of minimal impairment. Again, subject to the evidence on this point that might be run in any challenge, the answer would seem to be yes. These are unquestionably pressing and substantial reasons; the packaging legislation, whilst extensive, seems to impair the engaged or burdened speech rights as little as possible; in particular, there do not seem to be any plausible less restrictive means available to the state to the achieve the same ends.

5.3 Proportional effects

The third of the three steps in the proportionality test is a requirement of proportional effects, that the effects of the impugned legislation on the engaged or burdened rights must be proportional to the pressing and substantial reasons advanced by the state.

199 *Reid v Industrial Development Agency* [2015] IESC 82 (5 November 2015), [44](iv) (McKechnie J; Denham CJ, O'Donnell, Laffoy and Charleton JJ concurring); *Keane v An Bord Pleannála (No 3)* [1998] 2 ILRM 241, 262 (Keane J; Hamilton CJ and Barrington J concurring) (abridgements of property rights must go no further than required by the exigencies of the common good).

200 *Electricity Supply Board v Gormley* [1985] IR 129, 152, [1985] ILRM 494, 502 (Finlay CJ, for the court); compare *Canadian Pacific Railway Co v Vancouver (City)* [2006] 1 SCR 227, 2006 SCC 5 (23 February 2006), [30], [34] (McLachlin CJ; Bastarache, Binnie, LeBel, Deschamps, Fish and Abella JJ concurring) (does not involve the complete removal of *all* reasonable uses) (emphasis added); see, generally, Sarah Hamill, 'Common Law Property Theory and Jurisprudence in Canada' (2015) 40(2) Queen's Law Journal 679.

201 *Chestvale Properties Ltd v Glackin* [1993] 2 IR 35, 45 (Murphy J); *Dellway Investments v National Asset Management Agency (No 3)* [2011] 4 IR 1, 327, [2011] IESC 14 (12 April 2011), [456] (Fennelly J).

202 [2002] IEHC 61 (5 June 2002); see nn 60–1 above.

203 [1999] 1 IR 12, 26–7, [1998] 2 ILRM 360, 374 (Barrington J; Hamilton CJ, O'Flaherty, Denham, and Keane JJ concurring). This conclusion may be explained as a strong example of judicial deference to legislative judgment; see part 5.4 below.

204 Ibid.

205 [2004] 2 IR 573, 603, [2004] IEHC 97, [47].

Hence, where even a minor transgression has an excessive consequence,[206] the legislation will be disproportionate and unconstitutional.

The requirement of proportional effects assesses the strength or weakness of the right which the state has pressing and substantial reasons to restrict: the more central the restricted activity is to the enjoyment of the right in question, the less likely the restriction will be proportionate, whereas the further the restricted activity is from the core of the right, the more likely a restriction is to be proportionate.

To the extent that the speech restrictions in the packaging legislation restrict commercial speech, the freedom of political expression in Article 40.6.1(i) may not be engaged or burdened at all,[207] though the freedom of autonomous communication in Article 40.3.1 may be.[208] However, as with speech clauses elsewhere,[209] commercial speech is not central to that freedom.[210]

The question here, then, is whether the packaging legislation passes the requirement of proportionate effects. Again, subject to the evidence on this point that might be run in any challenge, the answer would seem to be yes. In particular, their speech rights are not central to the freedoms or protections engaged or burdened by the restrictions in the packaging legislation.

5.4 Deference

The courts are particularly reluctant to second guess legislative judgments on controversial[211] or sensitive[212] social, economic and medical matters and on major issues of national policy. Accordingly, in applying the three steps of the proportionality test, courts often afford a great deal of deference to the state.[213] Hence, in a strong (perhaps overly strong) example of judicial deference to legislative judgment, in *Murphy v Independent Radio and Television Commission*, Barrington J for the Supreme Court held that:

> . . . once the Statute is broadly within the area of the competence of the Oireachtas and the Oireachtas has respected the principle of proportionality, it is not for this Court to interfere simply because it might have made a different decision.[214]

206 *Cox v Ireland* [1992] 2 IR 503, 524 (Finlay CJ, for the court), as explained in *Murphy v Irish Radio and Television Commission* [1999] 1 IR 12, 26–7, [1998] 2 ILRM 360, 374 (Barrington J; Hamilton CJ, O'Flaherty, Denham, and Keane JJ concurring); see also *PC v Minister for Social Protection* (n 193 above) [33] (MacMenamin J).

207 See text in paragraph with n 106 above.

208 See text in paragraph with n 126 above.

209 See text in paragraph with n 136 above and with nn 249–50 below.

210 See n 108 above.

211 *Ryan v Attorney General* [1965] IR 294, 312 (Kenny J); *Dellway Investment v National Asset Management Agency* [2011] 4 IR 1, 119–20, [284]–[287], [2010] IEHC 364 (1 November 2010), [10.17]–[10.20] (Kearns P, Kelly and Clarke JJ, in a joint judgment) affd *Dellway Investments v National Asset Management Agency (No 3)* [2011] 4 IR 1, 225 [2011] IESC 14 (12 April 2011), [110] (Denham J).

212 *MD v Ireland* [2012] IESC 10 (23 February 2012), [50] (Denham CJ; Murray, Hardiman, Fennelly and Macken JJ concurring).

213 *BUPA Ireland v Health Insurance Authority* [2006] IEHC 431 (23 November 2006), [247] (McKechnie J); but see David Dyzenhaus, 'Proportionality and Deference in a Culture of Justification' in Grant Huscroft, Bradley W Miller and Grégoire Webber (eds), *Proportionality and the Rule of Law. Rights, Justification, Reasoning* (Cambridge University Press 2014) ch 11.

214 [1999] 1 IR 12, 27, [1998] 2 ILRM 360, 374 (Barrington J; Hamilton CJ, O'Flaherty, Denham, and Keane JJ concurring). In *Colgan v Independent Radio and Television Commission* [2000] 2 IR 490, 512, [1999] 1 ILRM 22, 45 [1998] IEHC 117 (20 July 1998) O'Sullivan J explained this as reflecting an appropriate 'degree of judicial restraint'.

In *Colgan v Independent Radio and Television Commission*, O'Sullivan J in the High Court suggested that this judicial restraint 'may itself be an application of the presumption of constitutionality',[215] by which legislation enacted by the Oireachtas after the Constitution came into force in 1937 is presumed to be constitutional, unless and until the contrary is clearly established.[216] The court has applied this presumption in the context of the freedom of political expression in Article 40.6.1[217] and of the freedom of autonomous communication in Article 40.3.1.[218] The packaging legislation would certainly benefit from the presumption and from any attendant judicial deference to legislative judgment.

This presumption of constitutionality is certainly a strong force driving such deference. And it leads to two further presumptions. First, it is presumed that the Oireachtas intended a constitutional construction of legislation; so where constitutional and non-constitutional constructions are reasonably open, the court must choose the constitutional one.[219] And, again, the courts have applied this presumption in the context of political expression[220] and of autonomous communication.[221] The packaging legislation would certainly benefit from this presumption too.

Second, the presumption of constitutionality leads to the further presumption that a statutory discretion will be exercised constitutionally[222] and that fair procedures will be followed.[223] And, again, the courts have applied this presumption in the context of political expression.[224] The making of a statutory instrument by the Minister for Health, pursuant to the packaging legislation,[225] would certainly benefit from this presumption too.

5.5 Higher standards of review

In the case of rights protected by the US Constitution, the Supreme Court has developed several standards of review or scrutiny by which to assess the validity of legislative restrictions upon rights. The strictest level of scrutiny requires the state to demonstrate that impugned restrictions are narrowly tailored to serve compelling state interests.[226]

215 [2000] 2 IR 490, 512, [1999] 1 ILRM 22, 45, [1998] IEHC 117 (20 July 1998); see, generally, Brian Foley, Deference and the Presumption of Constitutionality (Institute of Public Administration, Dublin 2008).

216 The classic statements are *Pigs Marketing Board v Donnelly (Dublin) Ltd* [1939] IR 413, 417 (Hanna J); *McDonald v Bord na gCon* [1965] IR 217, 239 (Walsh J); *East Donegal Co-operative Livestock Mart Ltd v Attorney General* [1970] IR 317, 340–1 (Walsh J); see most recently *Collins v Minister for Finance* [2016] IESC 73 (16 December 2016), [70] (Denham CJ, and O'Donnell, McKechnie, Clarke, Dunne and Charleton JJ, in a joint judgment).

217 *Murphy v Independent Radio and Television Commission* [1999] 1 IR 12, 27, [1998] 2 ILRM 360, 374–5 (Barrington J; Hamilton CJ, O'Flaherty, Denham, and Keane JJ concurring).

218 Ibid; *Rock v Ireland* [1997] 3 IR 484, 500–1, [1998] 2 ILRM 35, 40 (Hamilton CJ, for the court).

219 *McDonald v Bord na gCon* [1965] IR 217, 239 (Walsh J); *East Donegal Co-operative Livestock Mart Ltd v Attorney General* [1970] IR 317, 340–1 (Walsh J).

220 *State (Lynch) v Cooney* [1982] 1 IR 337, 360 (O'Higgins CJ, for the court); see also nn 66, 74–6 and 85 above.

221 See n 117 above.

222 *East Donegal Co-operative Livestock Mart Ltd v Attorney General* [1970] IR 317, 340–1 (Walsh J).

223 *Garvey v Ireland* [1981] IR 75, 97 (O'Higgins CJ); *Dellway Investments v National Asset Management Agency (No 3)* [2011] 4 IR 1, 282, [2011] IESC 14 (12 April 2011), [311] (Hardiman J).

224 *State (Lynch) v Cooney* 1982 IR 337, 380 (Henchy J; O'Higgins CJ, Walsh, Griffin and Hederman JJ concurring); see n 71 above. By analogy, this presumption would also apply in the context of the right to autonomous communication.

225 See nn 5 and 6 above.

226 *RAV v St Paul* 505 US 377, 395 (1992) (Scalia J, for the court) (viewpoint discrimination restriction triggering strict scrutiny); *Citizens United v Federal Election Commission* 558 US 310, 340 (2010) (Kennedy J, for the court) (restriction on political speech triggering strict scrutiny); *Reed v Town of Gilbert* 576 US __ (2015) (slip op, at 14–15) (Thomas J, for the court) (content-based restriction triggering strict scrutiny).

This certainly resembles[227] the Irish proportionality test,[228] though with the burden of proof reversed.[229] There are some passing references to 'strict scrutiny' in Irish cases,[230] including some speech[231] cases. The Supreme Court may therefore come to embrace an enhanced proportionality rule, perhaps by analogy with strict scrutiny, that would cast a justificatory burden upon the state for particularly serious kinds of infringements of particularly important rights. However, the court has reserved the question of whether such an approach is required by, or compatible with, the Constitution.[232]

The tobacco companies may take up this invitation and seek to persuade the court to subject the packaging legislation to such strict scrutiny, in the hope that the legislation would not survive such a high degree of scrutiny. However, it is hard to see how strict scrutiny would square with the strong commitment to the presumption of constitutionality,[233] which plainly imposes the burden of proving the unconstitutionality of the statute upon the party affected by the statute rather than upon the state. So, unless that presumption is modified, this argument would not succeed. Moreover, even if it would, it is unlikely to avail the tobacco companies, for two reasons. First, if enhanced proportionality is triggered by particularly serious kinds of infringements of particularly important rights, it is hard to see how commercial speech meets this standard. Second, the public health and protection of children concerns[234] underpinning the packaging legislation would very likely meet any justificatory burden cast upon the state.

There is a second standard of review on which the tobacco companies might also seek to rely. In the US, legislation which restricts substantially more free speech than would be

227 Vicki C Jackson, 'Constitutional Law in an Age of Proportionality' (2015) 124 Yale Law Journal 2680, 3136; as to the nature and extent of the resemblance, see, generally, Jacco Bomhoff, *Balancing Constitutional Rights: The Origins and Meanings of Postwar Legal Discourse* (Cambridge University Press 2013); Moshe Cohen-Eliya and Iddo Porat, *Proportionality and Constitutional Culture* (Cambridge University Press 2013); Vicki C Jackson and Mark Tushnet, *Proportionality. New Frontiers, New Challenges* (Cambridge University Press 2017).

228 In *Rafferty v Minister for Agriculture, Food and Rural Development* [2014 IESC 61 (7 November 2014), [45] Denham CJ (Murray, Hardiman, O'Donnell and McKechnie JJ concurring) referred to both 'strict scrutiny' and 'proportionality' in the same sentence. The High Court ([2008] IEHC 344 (31 October 2008)) had held that a narrow interpretation of the word 'compensation' in s 17 of the Diseases of Animals Act 1966 was constitutional, but Denham CJ provided a broader interpretation without reference to constitutional considerations; compare *Dublin Corporation v Underwood* [1997] 1 IR 69 (SC).

229 David Kenny, 'Proportionality, the Burden of Proof, and Some Signs of Reconsideration' (2014) 52 Irish Jurist (ns) 141, arguing that, following the Canadian lead (see n 186 above) the state should (at least in some cases) bear the burden of demonstrating the proportionality of impugned legislation.

230 Certain comments of Keane J (Barrington J concurring) in the Supreme Court in *Simple Imports Ltd v Revenue Commissioners* [2000] 2 IR 243, 250, [2000] IESC 40 (19 January 2000), [19] have been represented as requiring 'strict scrutiny of warrants' (*LC Autolink Ltd v Feehily* [2008] IEHC 397 (12 December 2008), [50] (MacMenamin J); *Damache v DPP* [2011] IEHC 197 (13 May 2011) (Kearns P) rvsd without reference to this point [2012] IESC 11 (23 February 2012)). In *Rafferty v Minister for Agriculture, Food and Rural Development* [2014] IESC 61 (7 November 2014), [45] (Denham CJ; Murray, Hardiman, O'Donnell and McKechnie JJ concurring) referred to strict scrutiny of compulsory purchase. See also *An Blascaod Mór Teorenta v Commissioners of Public Works (No 3)* [1998] IEHC 38 (27 February 1998), [164] (Budd J) ('construe strictly' a compulsory purchase), discussing *Tormey v Commissioners of Public Works* (Supreme Court, unreported, 20 December 1968) (Ó Dálaigh CJ, for the court, at p 6 of the transcript) ('look strictly' at compulsory purchase).

231 *Mahon v Post Publications* [2007] 3 IR 338, [2007] 2 ILRM 1, [2007] IESC 15 (29 March 2007), [85] (Fennelly J; Murray CJ and Denham J concurring) (strict scrutiny of prior restraint).

232 *Fleming v Ireland* [2013] 2 IR 417, 454–5, [2013] IESC 19 [140] (Denham CJ, for the court). In the earlier *D (a Minor) v Ireland* [2010] IEHC 101 (26 March 2010) Dunne J had held that 'presumptive unconstitutionality' on the basis of 'strict scrutiny' was unsupported by the authorities cited to her.

233 See part 5.4 above.

234 See part 4 above.

justified by a statute's plainly legitimate sweep is overbroad[235] and unconstitutional, unless a limiting construction can be placed on the impugned provision.[236] In Ireland, references to overbreadth have largely been as synonyms for findings of a lack of proportionality,[237] and the stricter US doctrine does not seem to have gained a foothold.[238] Moreover, the current commitment to judicial deference, and the strong form of the double construction rule, both generated by the presumption of constitutionality, make such a development as unlikely as the development of an enhanced proportionality rule casting a justificatory burden upon the state. Besides, it is not clear that the packaging legislation is overbroad in any event.

It is, therefore, very unlikely that the packaging legislation would be subject to a higher level of review or scrutiny than the three-step proportionality test above. Moreover, even if it were, the legislation would be very unlikely to fail such review or scrutiny.

5.6 Alternative standards of review

In the US Supreme Court, alongside strict scrutiny, various factors trigger alternative standards of review.[239] To the extent that they feature at all in the case law of the Irish Supreme Court, they have been accommodated as examples of the application of the proportionality test.[240] The High Court of Australia is developing an alternative formulation of the proportionality test,[241] which the Supreme Court has not had the opportunity to consider. It is, therefore, very unlikely that the packaging legislation would be subject to any of these alternative standards of review or scrutiny.

235 *Broadrick v Oklahoma* 413 US 601 (1973) (recognising overbreadth, holding statute was not overbroad); *Virginia v Hicks* 539 US 113 (2003) (same).

236 *Osborne v Ohio* 495 US 103 (1990).

237 *Blehein v Minister for Health and Children* [2009] 1 IR 275, 281, [2008] IESC 40 (10 July 2008), [18] (Denham J; Hardiman, Geoghegan, Kearns and Macken JJ concurring) (limitation on a right 'should not be overbroad, should be proportionate, and should be necessary to secure the legitimate aim'). In *NHV v Minister for Justice and Equality* [2016] 1 ILRM 453, 501, [2016] IECA 86 (14 March 2016), [122]–[124] Hogan J (dissenting) held that the restriction failed the proportionality test and was invalid by reason of 'constitutional overbreadth'; on appeal ([2017] 2 ILRM 105, [2017] IESC 35 (30 May 2017)) the Supreme Court reversed the majority in the Court of Appeal, but did not reach this aspect of Hogan J's dissent. Compare *Open Door and Dublin Well Woman v Ireland* 14234/88 and 14235/88 (1993) 15 EHRR 244, [1992] ECHR 68 (29 October 1992), [74] (restriction 'over broad and disproportionate') (see n 83 above); *Obukhova v Russia* 34736/03 [2009] ECHR 4 (8 January 2009), [27] (restriction 'excessively broad and disproportionate'); on accommodating these cases within proportionality, see n 195 above.

238 David Kenny, 'A Dormant Doctrine of Overbreadth: Abstract Review and *Ius Tertii* in Irish Proportionality Analysis' (2010) 37(1) Dublin University Law Journal (ns) 24.

239 *Brandenburg v Ohio* 395 US 444, 447 (1969) (per curiam) (incitement of imminent lawless action; refashioning 'clear and present danger' test); *New York Times Co v United States* 403 US 713, 714 (1971) (per curiam) (prior restraints bear a 'heavy presumption' against constitutional validity).

240 *Mahon v Post Publications* [2007] 3 IR 338, 374, 381, [84]–[85], [109]–[110], [2007] 2 ILRM 1, 13, 19–20, [2007] IESC 15 [40]–[41], [65]–[66] (29 March 2007) (Fennelly J; Murray CJ and Denham J concurring).

241 *McCloy v New South Wales* (2015) 257 CLR 178, [2015] HCA 34 (7 October 2015); *Murphy v Electoral Commissioner* [2016] HCA 36 (5 September 2016).

5.7 Lower and variable standards of review

In the US Supreme Court, below strict scrutiny, various factors trigger intermediate[242] and lower levels of scrutiny.[243] Moreover, some few matters are historically[244] outside the protection of the Constitution altogether. In particular, commercial speech[245] is subject to its own specialist intermediate level of scrutiny.

Although the European Court of Human Rights starts from a unitary proportionality test, it achieves similar results by applying it and related doctrines[246] in a flexible or variable fashion,[247] often in the guise of balancing competing rights and interests.[248] In particular, commercial speech[249] is subject to such a light application of the proportionality test that restrictions for public health reasons routinely survive review.[250]

Irish law is adopting both of these strategies. It applies the proportionality test in a flexible or variable fashion, assessing the strengths and weaknesses of the restrictions, rights and reasons at issue in the cases.[251] And it is also clearly developing alternative, lower, standards of review.[252] In particular, where the Supreme Court considers that the Oireachtas is essentially engaged in a balancing of constitutional rights and duties, the role of the court is not to impose its view of the correct or desirable balance in substitution for the view of the legislature as displayed in its legislation, but rather to

242 *United States v O'Brien* 391 US 367, 377 (1968) (Warren CJ, for the court) (content-neutral regulations of symbolic speech); *Ward v Rock against Racism* 491 US 781, 797–8 (1989) (Kennedy J for the court) (content-neutral regulations of reasonable time, place, or manner regulations of speech).

243 *Miller v California* 413 US 15, 24–6 (1973) (Burger CJ, for the court) (obscenity); *International Society for Krishna Consciousness, Inc v Lee* 505 US 672 (1992) (restriction on expressive activity in an airport terminal, as a non-public forum, satisfied rational basis test).

244 *United States v Stevens* 559 US 460, 469–71 (2010) (Roberts CJ, for the court) (declining to extend the list of matters historically outside the First Amendment).

245 *Central Hudson Gas & Electric Corp v Public Service Commission of New York* 447 US 557, 566 (1980) (Powell J, for the court); *Sorrell v IMS Health Inc* 564 US 552, 572 (2011) (Kennedy J, for the court).

246 George Letsas, 'Two Concepts of the Margin of Appreciation' (2006) 26(4) Oxford Journal of Legal Studies 705; Matthew Saul, 'The European Court of Human Rights' Margin of Appreciation and the Processes of National Parliaments' (2015) 15(4) Human Rights Law Review 745.

247 *Murphy v Ireland* 44179/98 (2003) 38 EHRR 212, [2003] ECHR 352 (10 July 2003) (see n 74 above); *Mouvement Raëlien Suisse v Switzerland* 16354/06 (2013) 56 EHRR 14, [2012] ECHR 1598 (13 July 2012); see, generally, Julian Rivers, 'Proportionality and Variable Intensity of Review' (2006) 65(1) Cambridge Law Journal 174.

248 On the legitimacy of balancing as part of the proportionality test, see Kai Möller, *The Global Model of Constitutional Rights* (Oxford University Press 2012), and contrast Niels Petersen, 'Balancing and Judicial Self-empowerment: A Case Study on the Rise of Balancing in the Jurisprudence of the German Federal Constitutional Court' (2015) 4(1) Global Constitutionalism 49 with Jochen von Bernstorff, 'Proportionality without Balancing: Why Judicial Ad Hoc Balancing is Unnecessary and Potentially Detrimental to the Realisation of Individual and Collective Self-determination' in Lazarus et al (186) 63.

249 *Barthold v Germany* 8734/79 (1985) 7 EHRR 383, [1985] ECHR 3 (25 March 1985); *Markt Intern Verlag GmbH and Klaus Beermann v Germany* 10572/83 (1990) 12 EHRR 161, [1989] ECHR 21 (20 November 1989); Casado *Coca v Spain* 15450/89 (1994) 18 EHRR 1, [1994] ECHR 8 (24 February 1994); *Stambuck v Germany* 37928/97 (2003) 37 EHRR 42, [2002] ECHR 679 (17 October 2002).

250 See Amandine Garde, 'Freedom of Commercial Expression and the Protection of Public Health in Europe' (2010) 12 Cambridge Yearbook of European Legal Studies 225; Amandine Garde, 'Freedom of Commercial Expression and Public Health Protection: The Principle of Proportionality as a Tool to Strike the Balance' in Niamh Nic Shuibhne and Laurence W Gormley (eds), *From Single Market to Economic Union. Essays in Honour of John Usher* (Oxford University Press 2012) ch 6. See also C 547/14 *R (Philip Morris Brands Sarl) v Secretary of State for Health* (ECLI:EU:C:2016:325; CJEU, 4 May 2016), [146]–[162] (tobacco packing regulations proportionate restrictions on speech).

251 See parts 5.2 and 5.4 above.

252 Oran Doyle, 'Judicial Scrutiny of Legislative Classification' (2012) 47 Irish Jurist (ns) 175 ('differentiated tiers of scrutiny' and 'positions of relative deference').

determine from an objective stance whether the balance contained in the impugned legislation is so contrary to reason and fairness as to constitute an unjust attack on some individual's constitutional rights.[253]

In this rationality test, there are significant echoes both of the US rational basis test[254] and of the UK's ultimate balancing test,[255] and either of these lines of authority might influence its development. It is a lower, less stringent, more tractable standard of review or scrutiny than the three-step proportionality test. Even so, legislation can fail this test[256] and be found unconstitutional.

On the other hand, it has, on occasion, been treated as equivalent[257] to proportionality; and it might yet be absorbed into that test, perhaps as a context of deference to the Oireachtas[258] and a flexible application of the test. However, for the time being, it is better to treat it as a separate rationality standard of review or scrutiny.

If the packaging legislation is justifiable not only on the basis of the state's interests in public health and the protection children, but also on the basis of constitutional rights,[259] then the state may seek to argue that its constitutionality should be assessed on the basis of this rationality standard rather than on the basis of the stricter three-step proportionality standard. Article 42A.1 of the Constitution provides:

> The State recognises and affirms the natural and imprescriptible rights of all children and shall, as far as practicable, by its laws protect and vindicate those rights.

If the packaging legislation were to be seen as an aspect of the state's duty to vindicate the rights of all children, then the appropriate standard of review or scrutiny would be the rationality test rather than the proportionality test. And, if the rationality test were to applied, then the packaging legislation would certainly survive review or scrutiny; it could not be said that the balance of rights contained in the packaging legislation is 'so

253 *Touhy v Courtney* [1994] 3 IR 1, 47 (Finlay CJ, for the court); *Re Article 26 and the Regulation of Information (Services Outside the State for the Termination of Pregnancies) Bill, 1995* [1995] 1 IR 1, 45, [1995] 2 ILRM 81, 109 (Hamilton CJ, for the court); *Iarnród Éireann v Ireland* [1996] 3 IR 321, 376, [1996] 2 ILRM 500, 508 (O'Flaherty J, for the court); *In re Article 26 and the Employment Equality Bill, 1996* [1997] 2 IR 321, 334 (Hamilton CJ, for the court).

254 E.g. *Federal Communications Commission v Beach Communications, Inc* 508 US 307 (1993); *Romer v Evans* 517 US 620 (1996); *Lawrence v Texas* 539 US 558 (2003).

255 *Re S (a Child)* [2005] AC 593, 603, [2004] UKHL 47 (28 October 2004), [17] (Lord Steyn; Lords Bingham, Nicholls, Hoffmann and Carswell concurring); *Rugby Football Union v Consolidated Information Services Ltd* [2012] 1 WLR 3333, 3346–7, [2012] UKSC 55 (21 November 2012), [44]–[45] (Lord Kerr; Lord Phillips, Lady Hale, Lord Clarke and Lord Reed concurring); *Khuja (formerly PNM) v Times Newspapers* [2017] UKSC 49 (19 July 2017), [33] (Lord Sumption; Lord Neuberger, Lady Hale, Lord Clarke and Lord Reed concurring).

256 *Re Article 26 and the Health (Amendment) (No 2) Bill 2004* [2005] 1 IR 105, 198, [2005] IESC 7 [115] (Murray CJ, for the court) (striking down retrospective health charges). *White v Dublin City Council* [2004] 1 IR 545, 568–9, [2004] 2 ILRM 509, 531, [2004] IESC 35 (10 June 2004), [80] (Denham J; Murray, McGuinness, Fennelly and McCracken JJ concurring), striking down an absolute two-month limitation period in s 82(3B)(a)(i) of the Local Government (Planning and Development) Act 1963, as inserted by s 19(3) of the Local Government (Planning and Development) Act 1992.

257 In the *Health Bill* Reference (n 256) and in *Rock v Ireland* [1997] 3 IR 484, [1998] 2 ILRM 35, both tests are referred to, *semble* as equivalent. In *BUPA Ireland v Health Insurance Authority* [2006] IEHC 431 (23 November 2006), [238], [248], [297] McKechnie J set out both proportionality and *Touhy v Courtney*, and seemed to treated them as equivalent, but expressed his conclusion exclusively in proportionality terms. In *Shirley v O'Gorman* [2006] IEHC 27 (31 January 2006) Peart J perceived an 'overlap' between *Tuohy v Courtney* and proportionality.

258 *In re Article 26 and the Employment Equality Bill, 1996* [1997] 2 IR 321, 343 (Hamilton CJ, for the court); *An Blascaod Mor Teo v Commissioners of Public Works (No 4)* [2000] 3 IR 565, 590 (Budd J); *Shirley v O'Gorman* (n 257) (Peart J); *BUPA Ireland v Health Insurance Authority (No 2)* [2013] IEHC 103 (7 March 2013), [96] (Cooke J).

259 See, generally, part 4 above.

contrary to reason and fairness' as to constitute an unjust attack on the tobacco companies' speech rights.

5.8 Absence of review

It is now clear that legislation restricting rights will be subjected to a standard of review or scrutiny. It was not always so clear. In *State (Lynch) v Cooney*,[260] it was enough for O'Higgins CJ that the legislation restricting the plaintiff's speech rights was designed to protect the constitutionally sanctioned legitimate aim of 'the authority of the State'. This judgment predates the development of the proportionality and rationality standards of review or scrutiny discussed above. To the extent that it could preclude further review or scrutiny once a pressing and substantial reason to justify the legislation has been established, then it can no longer be right.[261] It is unthinkable that the packaging legislation would not be subject to some standard of review or scrutiny. The only question is which one: a tractable rationality test, or a more stringent three-step proportionality test, or some other test. And, in answer to that question, it is clear that the packaging legislation would satisfy any applicable test.

6 Conclusion

Restrictions upon rights can be justified by reasons that survive review. The Public Health (Standardised Packaging of Tobacco) Act 2015 and part 5 of the Health (Miscellaneous Provisions) Act 2017 together provide for comprehensive standardised packaging of tobacco products. Some elements of packaging are prohibited, others are regulated, and still others are required; and there are strict regulations upon, perhaps even prohibitions of, the use of trade marks and other branding.

These restrictions potentially engage or burden the speech rights contained in the Irish Constitution. There are two relevant two relevant Articles of the Constitution. The right 'to express freely . . . convictions and opinions' contained in Article 40.6.1(i) of the Constitution is a freedom of political expression. The unenumerated right to communicate, implied in Article 40.3.1, is a freedom of autonomous communication. Despite unpropitious beginnings, this bifurcation now provides a largely stable and relatively coherent basis for analysis and development. While the political and autonomous cores of the freedoms are now reasonably well established, it is not yet clear how far, if at all, beyond such core concerns these freedoms extend. Given that it is the tobacco companies' commercial speech that would be affected by the restrictions, it is not clear whether the freedom of political expression would be engaged or burdened, but it is clear, at least as a matter of authority, that their freedom of autonomous communication would be, albeit commercial speech is not at the core of that freedom.

260 [1982] 1 IR 337 (SC); contrast the approach of O'Hanlon J in the court below: [1982] 1 IR 337, 355 (considering how far the state may go to restrict freedom of speech).

261 This is not to say that, if an appropriate standard of review or scrutiny were applied, the result in the case would be different, so it might still be rightly decided on its facts; it is only to say that it cannot be right that no standard of review or scrutiny would be applied.

As to whether s 31 would survive review or scrutiny, so that *State (Lynch) v Cooney* (n 71) would be rightly decided on its facts, see *Purcell v Ireland* 15404/89 [1991] ECHR 77 (16 April 1991) (challenge to s 31 as contrary to Article 10 ECHR rejected as manifestly ill-founded); see also *R v Secretary of State for the Home Department, ex parte Brind* [1991] 1 AC 696, [1991] UKHL 4 (7 February 1991) (upholding similar UK powers); *Brind v UK* 18714/91 (1994) 18 EHRR CD76, [1994] ECHR 57 (9 May 1994) (challenge to UK powers as contrary to Article 10 European Convention on Human Rights rejected as manifestly ill-founded).

In public health and the protection of children, the state has pressing substantial reasons for the restrictions; and it may even be said that it is vindicating its citizens' right to health, and children's rights.

In reviewing the impact of the restrictions in the packaging legislation on the tobacco companies' speech rights against the backdrop of the state's protection of public health and children, the legislation must satisfy a three-step proportionality test of rational connection, minimal impairment and proportional effects. Because commercial speech is not at the core of the freedom of autonomous communication, it is easier to restrict it proportionally. In other jurisdictions, commercial speech rights are subject to such a light application of the proportionality test that restrictions for public health reasons routinely survive review or scrutiny; and it is no different here.

It is unlikely that Irish law will develop a stricter test of review of scrutiny without significant modifications to the presumption of constitutionality. However, if the court considers that the packaging legislation seeks to balance the tobacco companies' speech rights against citizens' right to health, and children's rights, then the legislation would have to satisfy only a rationality test, which it easily would.

Ireland has been in the vanguard of tobacco control worldwide. With the Public Health (Standardised Packaging of Tobacco) Act 2015 and part 5 of the Health (Miscellaneous Provisions) Act 2017, it continues to set a very important example. The constitutional validity of these packaging restrictions would underpin a crucial element of the Department of Health's moves towards a tobacco-free Ireland by 2025. And the pack of cigarettes, with large warning photos dominating standardised packaging, would be Cohen's little Parthenon no longer.

Appendix

Relevant provisions of the Irish Constitution:

Article 40

. . .

3 1 The State guarantees in its laws to respect, and, as far as practicable, by its laws to defend and vindicate the personal rights of the citizen.

2 The State shall, in particular, by its laws protect as best it may from unjust attack and, in the case of injustice done, vindicate the life, person, good name, and property rights of every citizen.

. . .

6 1 The State guarantees liberty for the exercise of the following rights, subject to public order and morality:

(i) The right of the citizens to express freely their convictions and opinions.

The education of public opinion being, however, a matter of such grave import to the common good, the State shall endeavour to ensure that organs of public opinion, such as the radio, the press, the cinema, while preserving their rightful liberty of expression, including criticism of Government policy, shall not be used to undermine public order or morality or the authority of the State.

The publication or utterance of blasphemous, seditious, or indecent matter is an offence which shall be punishable in accordance with law.

LEGISLATION, TRENDS AND CASES

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Trends

Regulatory revolution and new competition in the European Union payments industry

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Smartphone technology has increased the speed at which consumers send and receive information. However, advances in smartphone technology applications (apps) had not altered the way in which money was transferred until recent regulatory changes were introduced. The legal complexity in the traditional banking system has made it difficult for consumers to control their money or make quick transfers into and out of their bank accounts. In the European Union (EU), the solution to this problem has taken the form of a regulatory revolution designed to promote competition from alternative technologies. Traditional banks are already competing with 'e-money' providers and, following the implementation of Directive (EU) 2015/2366[1] (generally known as PSD2) on 13 January 2018, will soon also be competing with new entities called payment initiation service providers (PISPs). This article explains, with reference to the UK banking industry, the core problems that exist in the traditional banking system and charts the increasing adoption by consumers of alternative technologies employing e-money and PISPs, which can compete with traditional banks because of PSD2. It outlines how these alternative technologies have avoided the problems experienced by traditional banks and, informed by the effects of similar regulatory changes in the USA and China, anticipates how the consumer experience will change with increased competition for a share of the payments industry. Finally, based on evidence from the Chinese market, it argues that innovative financial technology start-ups and competitors entering the market from other data-heavy, consumer-orientated industries will be ideally placed to take advantage of the EU regulatory changes and challenge the dominance of traditional banks in the payments industry.

The problem with the traditional banking system

A bank account is a contract of agency[2] in which the account holder deposits money with a bank in return for a debt falling due on demand.[3] Where one party – the payer – transfers money to another party – the payee – both using the services of the same bank, the bank reduces its debt to the payer by the same amount that it increases its debt to the

1 Directive (EU) 2015/2366 of the European Parliament and of the Council of 25 November 2015 on payment services in the internal market [2015] OJ L337/35.

2 *Owen v Tate* [1976] QB 402.

3 *Foley v Hill* (1848) HLC 28; *N Joachimson v Swiss Bank Corporation* [1921] 3KB 110; see David Fox, *Property Rights in Money* (Oxford University Press 2008) 43 for an explanation of the fundamental principles of banking.

payee. If the payee holds an account with a different bank, the payer's bank reduces its debt to the payer and increases its debt to the payee's bank. The payee's bank then increases its debt to the payee. All UK banks hold an account with the Bank of England, which they use to make interbank payments such as the one just described. The Bank of England in turn holds an account with the European Central Bank to facilitate cross-border transactions.[4] A pyramid structure is formed, the complexity of which increases as more levels are required to be created within it.

Bank payments are either slow or, if an express service such as the Clearing House Automated Payment System is used, expensive.[5] Some banks are eligible to use the Faster Payments system within the UK.[6] Whilst this system allows certain payments to be made within two hours at no direct cost to retail account holders, the fees charged to business users for sending or receiving each Faster Payment may be passed on to the consumer. It costs the payer and payee additional time and effort to initiate, verify and confirm a payment.

In response to this, consumers have begun using alternative technologies, which transfer debts in different ways. Revolut, for example, amassed 1.5 million users between July 2015 and February 2017 and claims to be signing up between 6000 and 8000 new customers per day.[7] Transferwise, which focuses on international money transfers, and Monzo, a mobile-only bank, boast similar rapid growth and customer bases.[8]

E-money

The first alternative technology is e-money,[9] as employed by apps such as Revolut. Using the app, the payer buys credit from Revolut and then instructs Revolut to transfer some of that credit to another app user.[10] In effect, the app operator incurs a debt to the payer, and the payer assigns the debt to the other user. The other user can either transfer the value into their bank account or keep it as a debt and assign it to another user at a later stage.[11] The assignment of debt is instantaneous within the app, and all information required to initiate the assignment is held by the app operator. Compared to traditional banking, e-money has the advantage that users take money out of the traditional banking system and operate a separate, closed and much quicker payments system within the app.

There are currently two downsides to the e-money model. The first is that the user must remain in sufficient credit with the app operator to make any upcoming payments. The account in which the money must sit cannot, under electronic money regulation 45, bear any interest.[12] The second disadvantage is that e-money is not protected by the

4 Colin Bamford, *Principles of International Financial Law* (2nd edn, Oxford University Press 2015) 61.

5 Bank of England, 'CHAPS' (Bank of England, 29 May 2018) <www.bankofengland.co.uk/payment-and-settlement/chaps>; see *Tayeb v HSBC Bank plc* [2004] 4 ALL ER 1024 per Colman J for an explanation of CHAPS that is also largely applicable to Faster Payments.

6 Faster Payments, 'Eligibility Criteria' (*Faster Payments*, 11 July 2017) <www.fasterpayments.org.uk/participation/access-options/direct-participation/eligibility-criteria>.

7 Oscar Williams-Grut, 'Revolut Hits 1.5 Million Customers as Break-neck Growth Continues' *Evening Standard* (London, 26 February 2018) <www.standard.co.uk/tech/revolut-fintech-startup-customers-growth-a3775626.html>.

8 Steve O'Hear, 'Digital Banking Startup Revolut Raises $250M at a Valuation of $1.7B' (TechCrunch, 26 April 2018) <https://techcrunch.com/2018/04/25/revolunicorn>.

9 Grace T Y Cheng, 'E-money: Evolution or Revolution?' [2018] 33 Journal of International Banking Law and Regulation 57, 60.

10 Revolut, 'General Terms of Service' (Revolut, 27 February 2018) clause 11 <www.revolut.com/terms>.

11 Ibid clause 12.

12 Electronic Money Regulations 2011, SI 2011/99, reg 45.

Financial Services Compensation Scheme (FSCS).[13] E-money providers must either ring-fence or insure their users' funds,[14] but, unlike deposits in traditional banks, the risk of deposit dissipation by app operators is not covered by government insurance. These, however, are regulatory burdens which could be lifted in the future.

Directive (EU) 2015/2366

The second alternative to traditional banking focuses on the role of the payer and payee in initiating, verifying and confirming payments. PSD2 was implemented in the UK by the Payment Services Regulations 2017,[15] which came into force on 13 January 2018. It succeeded a 2007 directive on payment services which standardised the regulation of payment services across Europe and set capital maintenance requirements for any institutions which execute payment transactions.[16] Whilst the directive allowed for the existence of non-bank payment institutions, it did nothing to affect the domination of the industry by traditional banks, and it set significant financial barriers to market access by new competitors. The objective of the new Directive is to increase competition and integration in the payments industry by requiring banks to share data with service providers who can offer better, more innovative services. PSD2 creates two additional categories of banking entity, each of which will allow consumers to control and move their money in new and exciting ways. The first new category of entity is the account information service provider (AISP).[17] An AISP can, with the user's permission, access data associated with the user's bank account or accounts to provide a service. AISPs may soon offer everything from savings advice tailored to several accounts held with different banks, to spending tips informed by transaction data.[18] The second new category of entity is the PISP.[19] PISPs can act as agents for the user and access relevant account data to initiate payments from the user's account. Companies in this category will have the biggest impact on the EU payments industry.

Whenever a PISP receives a payment instruction, it uses an application programming interface[20] to build a software 'bridge' between the payer's and payee's bank accounts.[21] The payer's bank must execute the payment within one business day.[22] Although the balance in the payee's account will not be credited immediately when the PISP initiates a payment, the PISP will inform the payee that the payment has been executed.[23] PISP users can, in effect, instantly transfer money to anyone whose account details the PISP holds, or to any online or even physical retailer. Most significantly, the PSD2 text stresses that the PISP never holds the money to be transferred.[24] All traditional banks and e-money providers are required to comply with extensive regulations concerning capital

13 Financial Services Compensation Scheme, 'Q&As about Deposits' (Financial Security Compensation Scheme, 27 February 2018) <www.fscs.org.uk/what-we-cover/questions-and-answers/qas-about-deposits>.

14 Electronic Money Regulations (n 12) regs 20–22.

15 Payment Services Regulations 2017, SI 2017/752.

16 Directive 2007/64/EC of the European Parliament and of the Council of 13 November 2007 on payment services in the internal market [2007] OJ L319/1.

17 Payment Services Regulations (n 15) reg 17.

18 Directive (EU) 2015/2366, recital 28.

19 Payment Services Regulations (n 15) reg 69.

20 See Open Banking, 'Glossary' (Open Banking Ltd 2018) <www.openbanking.org.uk/about-us/glossary>.

21 European Commission Press Release, 'Payment Services Directive: Frequently Asked Questions' (2018) <www.europa.eu/rapid/press-release_MEMO-15-5793_en.htm>.

22 Payment Services Regulations (n 15) reg 86.

23 Ibid reg 46.

24 Ibid recital 35.

maintenance and liquidity.[25] PISPs will not be subject to the same rules, so it will be easier for entrepreneurs without significant investment backing to compete in the PISP market.

Impact

The results of this payments revolution will be, firstly, an expansion in the choice of services available to consumers keen to use alternatives to traditional banking. Secondly, consumers will soon have more control over their money and financial data. Thirdly, traditional providers of payment services will face competition for a share of the payments market.

These predictions are informed by evidence of the effect of similar regulatory reforms in other jurisdictions. In the USA, the Dodd-Frank Wall Street Reform and Consumer Protection Act 2010 created the Consumer Financial Protection Bureau (CFPB) to engage with and regulate consumer financial services.[26] Apps similar to Revolut, regulated by CFPB through updates in 2016 to regulations E and Z of the Electronic Funds Transfer Act 1978,[27] have become extremely popular among young people looking for an alternative to cash and cheques. Venmo, for example, was originally only a service for splitting bills and making payments between friends, but it is now also being accepted as a payment method by millions of retailers.[28] Services such as Apple Pay and Samsung Pay combine e-money and near-field communication in mobile phones to facilitate contactless payments at shop check-outs.[29] A recent *China Daily* survey found that 14 per cent of people in China carry no cash and that 74 per cent of people could spend fewer than 100 yuan (approximately £11) in cash per month.[30] A special regime, similar to PSD2, has applied to 'non-financial institutions', including e-money providers, in China since 2010.[31] The Chinese model for instant payments uses printed quick response codes because of their low cost and low infrastructure requirements.[32] It appears that today's consumers enjoy a choice of payment options afforded by recent regulatory liberalisation.

The governor of the Bank of England, Mark Carney, shared his prediction about the increased control that consumers are likely to gain over their money and financial data in the near future: 'FinTech will change the nature of money, shake the foundations of central banking and deliver nothing less than a democratic revolution for all who use

25 See Bank of England, 'Capital Requirements Directive IV' (Bank of England, 22 May 2018) <www.bankofengland.co.uk/prudential-regulation/key-initiatives/capital-requirements-directive-iv>.

26 *Financial Report of the Consumer Financial Protection Bureau, Fiscal Year 2017* (Consumer Financial Protection Bureau, 15 November 2017) 7 <https://s3.amazonaws.com/files.consumerfinance.gov/f/documents/cfpb_financial-report_fy17.pdf>.

27 Ibid 16.

28 Anna Irrera, 'PayPal rolls out Venmo Payments to its US Retailers' (Reuters, 17 October 2017) <uk.reuters.com/article/us-paypal-hldg-venmo/paypal-rolls-out-venmo-payments-to-its-u-s-retailers-idUKKBN1CM1GH>.

29 Apple, 'Near Field Communication' (Apple, 27 February 2018) <https://developer.apple.com/ios/human-interface-guidelines/user-interaction/near-field-communication/>.

30 Chinadaily.com.cn, 'About 14% People Carry No Cash in China' (Chinadaily.com.cn, 6 September 2017) <www.chinadaily.com.cn/bizchina/tech/2017-09/06/content_31633683.htm>.

31 Decree of the People´s Bank of China No 2 (2010), 'Administrative Measures on Payment Services Provided by Non-Financial Institutions' (People's Republic of China, 14 June 2010); Jing Bian and Frank Marchione, 'The New Battle Field: An Analysis of the Payment Systems in China' [2014] 29 33 Journal of International Banking Law and Regulation 641.

32 Lerong Lu, 'Decoding Alipay: Mobile Payments, a Cashless Society and Regulatory Challenges' [2018] 33 Butterworths Journal of International Banking and Financial Law 40, 40.

financial services.'[33] As a result of compulsory data sharing, consumers will be able to use new and accessible payment apps without having to change their current account or give up the financial security of an FSCS-insured bank. Traditional banks will therefore face competition from start-ups, which would not previously have been able to access the payments industry. This competition will increase both the quality of banking services and the ease with which consumers can switch from one service to another.

It follows from the predictions above that the EU regulatory reforms will bring unequal benefits to the different competitors in the payments industry. For example, whilst traditional banks retain the advantage of consumer trust, their legacy computer systems cannot deliver the user experience offered by newer competitors.[34] As a result, some banks are already partnering with payment apps to provide the full range of retail banking services.[35] Competition from e-money providers and PISPs will be significant in general, but the evolution of the payments industry in other jurisdictions suggests that payment service providers who enter the market from another data-heavy or user-orientated industry will be put at a particular advantage by regulations such as PSD2. The result of such an advantage is already evident in China, where the market is dominated by AliPay and WeChat Pay.[36] AliPay is owned by Alibaba, an online retailer similar to Amazon in size, and WeChat Pay is part of the multifunction WeChat app, owned by the Tencent conglomerate. Companies with hundreds of millions of existing users, market capitalisation equal to the world's biggest lenders and whose business models are centred around the collection and control of data appear to be ideally placed to integrate personal banking into their user interfaces. Google, Apple, Facebook and Amazon look poised to enter the market in the near future, and would perhaps present the biggest competition to traditional banks.[37]

Conclusion

The analysis of e-money and PSD2 demonstrates how regulation is facilitating alternatives to traditional banking in the EU payments industry. It is predicted that fierce competition among payment service providers will result and that consumers will benefit from increased control over their money and financial data as well as an expanded choice of payment service providers. Insights from the US and Chinese markets indicate the range of services from which EU consumers may benefit. Additionally, such observations suggest that payment service providers entering the market from other data-heavy or user-orientated industries will be ideally placed to take advantage of the regulatory changes in Europe. Some banks have responded by improving their services, but, given the inherent complexity of the traditional banking system and associated costs, their dominance within the payments industry to date will be difficult to sustain. Arguably, this will be the democratic revolution that Mr Carney predicted.

33 Mark Carney, 'Enabling the FinTech transformation: Revolution, Restoration, or Reformation? (Bank of England, 16 June 2016) <www.bankofengland.co.uk/-/media/boe/files/speech/2016/enabling-the-fintech-transformation-revolution-restoration-or-reformation.pdf?la=en&hash=93734A70D1475F5438CBC9E8BF8C3733BDA4CF36>.

34 Lerong Lu, 'Financial Technology and Challenger Banks in the UK: Gap Fillers or Real Challengers?' [2017] 32 Journal of International Banking Law and Regulation 273, 274.

35 Leo King, 'First Direct Makes It Personal with Open Banking' *The Times* (London, 28 November 2017) <www.thetimes.co.uk/raconteur/finance/first-direct-makes-personal-open-banking/>.

36 Lu (n 32).

37 Martin Moeller, 'Ready or Not, the New Banks Are Here' (LinkedIn, 5 January 2018) <www.linkedin.com/pulse/ready-new-banks-here-martin-moeller/?trackingId=xLQmPhiQWsenDkgSpZ%2FyFw%3D%3D>.