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EDITORIAL

I am very pleased to introduce the latest edition of the *Nottingham Law Journal* and to have the opportunity of taking over the role of editor. My predecessor, Tom Lewis carried out his duties with aplomb in often challenging circumstances, and ensured that the *Journal* continued to offer the highest quality of academic analysis and contemporary legal commentary. I hope that, with the help of a strengthened editorial team, we can continue in the same vein.

This volume continues to offer a range of stimulating articles on topical themes. The current economic landscape reflects our contributions with articles on insolvency, mortgages and equitable interests in property law. These are indeed challenging times and I am very pleased that the *Nottingham Law Journal* can provide relevant critical perspective.

As advised in the previous editorial, we are planning some changes to the format of the *Journal* which are currently in the consultation process. We hope to move towards a yearbook edition from 2012 which will include both a special feature with several linked articles in addition to our usual high quality submissions on a range of current legal issues. As in the present edition, we are intending to include a regular short feature on current developments in the legal profession. For this particular edition I am most grateful to the submission from my colleague, Jane Jarman.

Our website is soon to be developed and will feature links to both Nottingham Law School's conference and seminar events in addition to links enabling access to Nottingham Trent University's distinguished lecture series. We intend to update the online archive and to include instructions for potential contributors with a simplified style-sheet.

In 2011, Nottingham Trent University has hosted two distinguished lectures of particular interest to those involved in the study and practice of law. In February, Sami Chakrabarti, Director of Liberty, presented a particularly timely lecture on current human rights challenges which addressed many topical issues including the right to vote for prisoners, the use of undercover policing in the environmental movement and the decision of the European Court of Human Rights in *Gillan and Quinton v UK* 2010. In March, the eminent jurist Lord Saville presented an illuminating lecture entitled 'The conduct of a public inquiry' in which he reflected on his role presiding over the Bloody Sunday inquiry, the longest running inquiry in British legal history. We are very pleased to enable free access to these presentations on the NTU website: www.ntu.ac.uk/pastdistinguishedlectures.

Nottingham Law School has also hosted a diverse collection of academic seminars in recent months, from Professor Mathew Forster's presentation on "International law of the sea and Somalian pirates" to Judith Rowbottom's seminar entitled "Historicising the Criminal Justice Process – Creating Unnecessary Methodological Angst". Additionally we have hosted a half day conference on Partnership and LLP law and been entertained by the inaugural readership lecture of Graham Ferris entitled "Property law: What is it good for? Absolutely everything". Information on our forthcoming seminars and lectures will be included on the new, improved *Journal* website.

To conclude, I would like to express my gratitude to those unsung heroes who help make the *Journal* a reality. In particular Carole Vaughan whose encyclopaedic knowledge of journal protocol is integral in getting the proofs to copy and I would like to thank all those who have assisted in reviewing our, not insignificant number, of high-quality submissions. Finally, I wish to thank all those who have submitted engaging contributions and my associate editor, Andrea Nicholson, who has been proof-reading tirelessly during her vacation to meet our revised deadline.

HELEN O'NIONS

ARTICLES

WHEN IS PRE-PACKAGED ADMINISTRATION APPROPRIATE? – A THEORETICAL CONSIDERATION

DR PETER WALTON*

INTRODUCTION

Pre-packaged administration (“pre-pack”) has been described as:

An arrangement under which the sale of all or part of a company’s business or assets is negotiated with a purchaser prior to the appointment of an administrator, and the administrator effects the sale immediately on, or shortly after, his appointment.¹

Different policy justifications have been advanced to support pre-packs, including maximising returns, the saving of jobs and the rescue of viable businesses. The disenfranchisement of unsecured creditors does not sit comfortably with some of the policy considerations highlighted by the Cork Committee.² We have the benefit of: Professor Frisby’s empirical research in the area;³ existing black letter law including the recent rules on the payment of pre-pack fees;⁴ the profession’s adoption of Statement of Insolvency Practice 16 (“SIP 16”)⁵ which requires pre-pack administrators to give full disclosure of the reasons for, and the terms of, the pre-pack deal; judicial recognition of perceived problems with pre-packs;⁶ and the views of a large number of academics and practitioners.⁷ We also have some political input from the House of

* Reader in Law, University of Wolverhampton. This article is based upon a paper with the same title given at the International Insolvency Conference held at Nottingham Trent University on 15 September 2010.

¹ Statement of Insolvency Practice 16 available at: <https://www.r3.org.uk/uploads/sip/Statement%20of%20Insolvency%20Practice%20-%202016%20.pdf> (last accessed 1 September 2010).

² *Report of the Review Committee on Insolvency Law and Practice* Cmnd 8558 (1982), at 232, 914, 917 and 919.

³ See, eg, S Frisby, *A preliminary analysis of pre-packaged administrations – Report to The Association of Business Recovery Professionals* August 2007; S Frisby, “The pre-pack progression: latest empirical findings” [2008] *Insolvency Intelligence* 154; and S Frisby, “The Second Chance Culture and Beyond: Some Observations on the Pre-Pack Contribution” [2009] *Law and Financial Markets Review* 242.

⁴ See Insolvency (Amendment) Rules 2010 (SI 2010/686), Schedule 1.

⁵ See SIP 16 *op cit*, and the Insolvency Service’s respective reports on the first and second six months’ operation of SIP 16 available at: <http://www.insolvency.gov.uk/insolvencyprofessionandlegislation/policychange/sip16-final.pdf> and <http://www.insolvency.gov.uk/insolvencyprofessionandlegislation/sip16/Report%20on%20the%20Operation%20of%20Statement%20of%20Insolvency%20Practice%2016,%20July%20-%20December%202009.pdf> respectively and the response to these monitoring reports made by R3 (the Association of Business Recovery Professionals March 2010 available at: https://www.r3.org.uk/uploads/press/Pre%20packs%20and%20SIP%2016_FINAL.pdf (all last accessed 1 September 2010).

⁶ See, eg, His Honour Cooke J’s comments in *Re Kayley Vending Limited* [2009] EWHC 904 (Ch), [2009] BCC 578, at 583.

⁷ See, eg, S Harris, “The Decision to Pre-Pack” Winter 2004 *Recovery* 26; J Moulton, “The Uncomfortable Edge of Propriety – Pre-Packs or Just Stitch-Ups?” Autumn 2005 *Recovery* 2; M Ellis, “The Thin Line in the Sand – Pre-Packs and Phoenixes” Spring 2006 *Recovery* 3; S Davies, “Pre-pack – he who pays the piper calls the tune” Summer 2006 *Recovery* 16; P Walton, “Pre-Packaged Administrations – Trick or Treat?” (2006) 19 *Insolvency Intelligence* 113; A Bloom and S Harris, “Pre-Packaged Administrations – what should be done given the current disquiet?” (2006) 19 *Insolvency Intelligence* 122; V Finch, “Pre-Packaged Administrations: bargains in the shadow of insolvency or shadowy bargains?” [2006] *Journal of Business Law* 568; S Frisby, “A preponderance of pre-packs?” (2008) 23 *Butterworths Journal of*

Commons Select Committee on Business and Enterprise,⁸ criticisms highlighted by the Office of Fair Trading,⁹ some mostly critical media commentary¹⁰ and the recent consultation carried out by the Insolvency Service on the future regulation of pre-packs (“the Consultation”)¹¹ (as well as the earlier limited Insolvency Service consultation on payment of pre-pack administrators’ fees¹²). Still there is no obvious answer as to when a pre-pack is appropriate (if ever).

Although black letter lawyers and practitioners in the UK do not always see the practical use or relevance of legal theory, this is usually because any legal framework being analysed is already in place, and arguing for or against it from a theoretical point of view may be of limited, if any, practical use. In the case of pre-packs, there is, in effect, a blank canvas with which to work. There is little substantive law governing pre-packs *per se*. It is therefore a unique opportunity for policy makers to consider relevant legal theories in assisting the design of an appropriate legal framework.

This article will examine pre-packs from a theoretical point of view in order to consider how some of the possible theories underpinning insolvency law might apply to pre-packs. It will consider in particular how theories such as those put forward by contractarians (emphasising wealth maximisation and the hypothetical creditors’ bargain), communitarians, forum theorists and adherents to a multiple values approach could be applied to a pre-pack scenario and how such application might be used to inform policy in light of the recent Consultation.

PERCEIVED PROBLEMS WITH PRE-PACKS

Although a pre-pack “may offer the best chance for a business rescue, preserve goodwill and employment, maximise realisations and generally speed up the insolvency process”,¹³ it tends to create discontent within the ranks of a company’s unsecured creditors. There is a general concern that the pre-pack administrator, in agreeing to the pre-pack in consultation with the company’s management team (and usually its secured creditors), favours the interests of the managers and secured creditors ahead of the

International Banking and Financial Law 23; P Walton, “Pre-packin’ in the UK” (2009) 18 *International Insolvency Review* 85; R Insall, “Pre-packaged administrations: misguided or misunderstood?” (2010) *Corporate Rescue and Insolvency* 99; Bo Xie, “Protecting the interests of general unsecured creditors in pre-packs: the implication and implementation of SIP 16” (2010) 31 *Company Lawyer* 189; V Finch, “Corporate rescue processes: the search for quality and the capacity to resolve” [2010] *Journal of Business Law* 502.

⁸ See the Committee’s sixth report of Session 2008–09 available at: <http://www.publications.parliament.uk/pa/cm200809/cmselect/cmberr/198/198.pdf> (last accessed 1 September 2010).

⁹ “The market for corporate insolvency practitioners: A market study” June 2010 (OFT1245) available at: http://www.oft.gov.uk/shared_ofi/reports/Insolvency/oft1245 (last accessed 1 September 2010).

¹⁰ See, eg, M Herman, “Abuse of pre-pack deals ‘could turn Britain into an insolvency brothel’” *Times* 18 January 2010, at 36 where Lord Kirkham the chairman of DFS is quoted as saying: “These shameful devices give badly managed businesses a huge cost advantage . . . I cannot get my head around why such incompetence should be rewarded at the expense of successful companies.” Bertrand des Pallieres in the context of the Hellas Telecommunications transfer of its centre of main interest to the UK and subsequent pre-pack administration is quoted as saying: “If nothing is done, London will become a bankruptcy brothel for low-life businesses to come from all over and take advantage of the British system to dump some of their debts and move on.” The insolvency practitioner profession countered such criticisms with Peter Sargent, then president of R3 (Association of Business Recovery Professionals), quoted as saying: “Pre-packs are a very misunderstood insolvency tool, and the benefits – for example, the numbers of jobs saved – are often lost in concerns over the impact on unsecured creditors.”

¹¹ Consultation/Call for Evidence: improving the transparency of, and confidence in, pre-packaged sales in administrations March 2010 available at: http://www.insolvency.gov.uk/insolvencyprofessionandlegislation/con_doc_register/Pre-pack%20consultation%2031%20march%202010.pdf (last accessed 2 September 2010).

¹² This consultation was carried out in June 2007. Amendments introducing a mechanism for creditor approval of a pre-pack administrator’s pre-appointment fees were subsequently made to rules 2-33 and 2-67 and new rules 2-33A and 2-67A were added to the Insolvency Rules 1986 (SI 1986/1925). These changes were made by the Insolvency (Amendment) Rules 2010 (SI 2010/686) and came into force on 6 April 2010.

¹³ Insolvency Service’s “Enterprise Act 2002 – Corporate Insolvency Provisions: Evaluation Report” January 2008, 147 available at: <http://www.insolvency.gov.uk/insolvencyprofessionandlegislation/legislation/EA02CorporateInsolvencyReport.pdf> (last accessed 2 September 2010).

company's general creditors. The speed and secrecy of the operation often lead to a deal being executed about which the unsecured creditors know nothing, have no say in and which leaves them empty handed. There is often a suspicion that the consideration paid for the business may not have been maximised due to the absence of open marketing. Credit may have been incurred inappropriately prior to the pre-pack and this may not be fully investigated. SIP 16 requires that unsecured creditors receive better information than before, about why and how the pre-pack was executed, but they only receive this information after the pre-pack has been completed. At that point there is unlikely to be any office holder in place looking out for their interests. Leaving unsecured trade creditors unpaid may have knock-on effects to the broader community and where the business is sold to a "phoenix" company, there is often a feeling that the market is distorted by providing that company an unfair advantage over its competitors who continue to paid their debts.

THE INSOLVENCY SERVICE'S CONSULTATION

In outline terms the Consultation identifies a number of possible solutions to the perceived problems with pre-packs. The options may be summarised as follows:

1. No change;
2. Give statutory force to the disclosure requirements required by SIP 16;
3. Following a pre-pack administration, restrict exit from administration to compulsory liquidation, so as to achieve automatic scrutiny by the official receiver of directors' and administrators' actions;
4. Require different insolvency practitioners to undertake pre and post administration appointment work so that the terms of a pre-pack need to be approved by an independent insolvency practitioner prior to execution;
5. Require the approval of the court or creditors, or both, for the approval for all pre-pack business sales to connected parties.

Can a consideration of legal theory help to find an answer to concerns about pre-packs and inform a policy to ensure that pre-packs only operate in appropriate circumstances?

SOME COMPETING THEORIES

Theoretical bases put forward to underpin or justify insolvency law policy abound. There are almost as many theories as there are writers in the area. In order to bring some structure to the discussion, it is proposed to consider in general terms the dominant theories in the area.¹⁴

Contractarianism

This theory, as it applies to insolvency law, has its roots in the Law and Economics movement.¹⁵ It has as its basis the idea of wealth maximisation: the idea that the law

¹⁴ The headings adopted in the text below are borrowed from V Finch, *Corporate Insolvency Law Perspectives and Principles* (Cambridge University Press, 2002).

¹⁵ See, eg, D Baird, "The Future of Law and Economics: Looking Forward" 64 *University of Chicago Law Review* 1129 where there is an account of a "roundtable discussion" of leading law and economics scholars of the time including Judge Richard Posner, Richard Epstein, Gary Becker, Ronald Coase, Merton Miller and Douglas Baird; T Jackson, *The Logic and Limits of Bankruptcy Law* (Cambridge Massachusetts and London, England, Harvard University Press, 1986); T Jackson and R Scott, "On the Nature of Bankruptcy: an Essay on Bankruptcy Sharing and the Creditors' Bargain"

should maximise the collective return to creditors. It is not concerned with either the debtor or the public interest. Whilst an individual is able to pay all of its debts, its creditors are safe. Once the individual debtor is insolvent, not all the creditors will be paid. Rather than permit individual creditors each to enforce their rights against individual debtors, insolvency law needs to replace these individual enforcement rights with a right to take part in a collective process. Otherwise the creditors will have to expend time and money in monitoring each of their debtors and once insolvency is suspected, to take action to win the race to enforce their debt more quickly than the other creditors. This is seen as inefficient administratively and may lead to a nil return to the creditor if other creditors get there first. The solution is to view the debtor's assets as a common pool which should be used to satisfy the debtor's pre-insolvency liabilities largely in accordance with the creditors' pre-insolvency priority rights.¹⁶ The compulsory and collective nature of insolvency proceedings is likely to lead to less wasted costs in pursuing individual actions, to fewer administrative costs in realising the assets and to a larger aggregate realisation of the debtor's assets.

The wealth maximisation model rests on the notion that with any given set of entitlements, creditors would prefer a system that kept the size of the pool of assets as large as possible. This would include the use of transaction avoidance provisions.¹⁷ It is a criticism of the way pre-packs operate that potential actions for transaction avoidance or wrongful trading are not always fully considered by the pre-pack administrator.

Whether to liquidate or reorganise the company should be decided upon by which provides the greater aggregate financial return from the assets.¹⁸ The justification for reorganisation, including it seems a pre-pack deal in favour of the incumbent management team, must be that the assets are worth more to the incumbents themselves than they would be to third parties.¹⁹ It is a common criticism of pre-packs that, without openly testing the market, the full value for assets is not always achieved.²⁰

Law and Economics contractarians make the assumption that their form of wealth maximisation approximates to "the contractual terms to which at the time credit is extended, a creditor and debtor would agree should govern in the event of the debtor's insolvency."²¹ This is the hypothetical creditors' bargain. The hypothetical creditors sit behind a Rawlsian "veil of ignorance".²² They have no knowledge as to their own individual characteristics, whether, for example, they are secured or unsecured, supplier, lender or employee. Such creditors would agree to the wealth maximisation model of collective and compulsory insolvency procedures.

(1989) 75 *Virginia Law Review* 155; and J Bhandari and L Weiss (eds), *Corporate Bankruptcy: Economic and Legal Perspectives* (Cambridge University Press, 1996).

¹⁶ There are obvious exceptions to this rule such as the limited rights of preferential creditors under Insolvency Act 1986, Schedule 6. Criticisms have been made of contractarian theory for not dealing adequately with distributional issues: see, eg, E Warren, "Bankruptcy Policy" (1987) 54 *University of Chicago Law Review* 775, at 799–800.

¹⁷ T Jackson, "Avoiding Powers in Bankruptcy" 36 *Stanford Law Review* 725, at 728.

¹⁸ See, eg, T Jackson, *The Logic and Limits of Bankruptcy* (Cambridge Massachusetts and London, England, Harvard University Press, 1986), at 212–3.

¹⁹ *Ibid.*, at 214.

²⁰ See *Clydesdale Financial Services Ltd v Smailes* [2009] EWHC 1745 (Ch), [2009] BCC 810.

²¹ R Rasmussen, "An Essay on Optimal Bankruptcy Rules and Social Justice" [1994] 1 *University of Illinois Law Review* 1.

²² See T Jackson, *The Logic and Limits of Bankruptcy* (Cambridge Massachusetts and London, England, Harvard University Press, 1986), at 17 referring to the work of J Rawls in *A Theory of Justice* (revised edition) (Oxford University Press 1999) which first appeared in 1971. Both R Mokal, *Corporate Insolvency Law: Theory and Application* (Oxford University Press, 2005) at 61–62 and D Korobkin, "Contractarianism and the Normative Foundations of Bankruptcy Law" (1993) 71 *Texas Law Review* 541, have doubted that the creditors' bargain theory is an application of Rawls' methodology.

Many learned writers have criticised this theory not least because it only considers hypothetical *contract* creditors. Some have suggested variations on this theme to take account of other hypothetical creditors who are not voluntarily contracting with the debtor such as tort victims or tax authorities.²³ Other critics have pointed out that an economic analysis cannot by definition consider non-economic matters such as social, moral, political and personal consequences and that the creditors' bargain theory also ignores distributional issues.²⁴ Such criticisms have not stopped Germany being influenced by it in the promulgation of the German Bankruptcy Code 1994.²⁵

There is some evidence to suggest that in the past, the Insolvency Service, when it consulted on how the fees of pre-pack administrators should be paid, was influenced by the wealth maximisation part of contractarian theory. The Insolvency Service carried out a limited consultation exercise in the summer of 2007²⁶ on draft amendments to the Insolvency Rules²⁷ to allow pre-pack administrators to claim the costs of their pre-appointment work as administration expenses subject to the approval of the company's creditors. According to the Insolvency Service's consultation letter the proposed changes recognised the policy imperative of pre-packs is to maximise the return to creditors. In doing so there is a need to strike a balance between the "informational interests of creditors" whilst leaving the administrator free "to act expeditiously and without undue hindrance" in maximising asset realisations and returns to creditors. This is a recognition that the most important aspect of pre-packs is their apparent ability to maximise realisations. No other interests warrant particular consideration beyond informing creditors subsequently that the pre-pack has occurred.

There remain real doubts as to whether pre-packs lead to wealth maximisation due to the lack of transparent and open marketing of the business. This is particularly a concern where the incumbent management team buys the business. How many independent valuations are needed to provide an accurate appraisal of how much the business would actually be worth? The requirement in SIP 16 to detail how the valuation of the business has been arrived at has led to more transparency.²⁸ There are certain situations where the evidence has convinced a court that only a pre-pack can lead to wealth maximisation²⁹ but there is no convincing evidence that this is always the case. In *Clydesdale Financial Services Ltd v Smailes*,³⁰ the court ordered the replacement of the pre-pack administrator to carry out an independent assessment of the valuation of the business.

If any or all the potential amendments suggested by the Consultation are introduced, a judgment could be made as to whether or not wealth maximisation has been achieved, by the court, a subsequent liquidator or by the appointment of an independent administrator. Under contractarian theory there remains the potential stumbling block that even with such safeguards, the pre-pack mechanism would still not be one which hypothetical creditors would agree to *ex ante*.

Contractarian theory assumes that insolvency procedures will be collective in nature. This requires that all creditors get a say in the process or at least have their interests

²³ See, eg, D Korobkin, "Rehabilitating Values: a Jurisprudence of Bankruptcy" (1991) 91 *Columbia Law Review* 717 and R Mokal *ibid*.

²⁴ See E Warren, "Bankruptcy Policy" (1987) 54 *University of Chicago Law Review* 775, at 800–804.

²⁵ See Finch *op cit* at 29.

²⁶ The consultation period ran from June 2007 to the end of August 2007 and appears to have been directed principally at insolvency professionals. The consultation documentation is no longer available on the Insolvency Service's website.

²⁷ SI 1986/1925.

²⁸ See the Insolvency Service's respective reports on the first and second six months' operation of SIP 16, *op cit*.

²⁹ See, eg, *Re Kayley Vending Ltd* [2009] EWHC 904 (Ch), [2009] BCC 578.

³⁰ [2009] EWHC 1745 (Ch), [2009] BCC 810.

fairly protected. Real concerns in this regard have been expressed by real creditors. A view expressed by the Association of British Insurers suggests that creditors perceive a lack of independence in management buy-out pre-packs:

We do not believe that insolvency practitioners can fully and properly discharge their duty to act independently in the interests of creditors, when they have already been engaged by the distressed company to achieve a pre-agreed outcome (particularly where that outcome is a sale of parts of the business to the existing owners).³¹

This criticism is echoed by the judgment in *Re Johnson Machine and Tool Co Ltd*³² where the court refused to allow the administrator's pre-appointment costs as administration expenses, as the balance of benefit arising from the incurring of pre-appointment costs was in favour of the management as potential purchasers of the business rather than the creditors.

Would hypothetical creditors agree to a process where the insolvency practitioners involved freely admit that a pre-pack "offers the secured creditors a high level of control and certainty" even though it "must be exercised with careful planning and with an abiding sense of fair play for all stakeholders"?³³ Without more, it seems unlikely. The pre-pack process appears to have more in common with receivership where the receiver owes a primary duty to the appointing creditor rather than administration where the administrator owes a duty to all creditors. If the pre-pack were a receivership, the receiver would be prevented from acting subsequently as liquidator³⁴ or from moving the company immediately from receivership into dissolution.³⁵ It would therefore seem sensible, as the Consultation proposes, to require an independent insolvency practitioner to be appointed to assess the pre-pack where it is in the more common form of an administration. This would go some way to persuade the hypothetical creditor that its interests will be considered independently.

The Cork Committee³⁶ stated back in 1982 that the basic objective of insolvency law is "to support the maintenance of commercial morality and encourage the fulfilment of financial obligations".³⁷ If such a basic objective is to be achieved "it is essential that proper investigation will be made in every case in which it is warranted".³⁸ The Committee also made the point that:

Insolvency proceedings are inherently collective in nature . . . If each . . . creditor is denied by law the right to pursue separate remedies against the insolvent and is obliged to rely on the outcome of collective proceedings, then his interest in those proceedings ought to be, so far as consistent with the claims of his fellow creditors, as fair and reasonable as circumstances will permit.³⁹

Even if the subsequent appointment of an independent office holder would satisfy these concerns, it is difficult to conclude that hypothetical creditors, contracting *ex ante* from their original position, would agree to an insolvency process whereby two or

³¹ See [http://www.insolvency.gov.uk/insolvencyprofessionandlegislation/con_doc_register/responses/2%20ABI%20\(Association%20of%20British%20Insurers\).pdf](http://www.insolvency.gov.uk/insolvencyprofessionandlegislation/con_doc_register/responses/2%20ABI%20(Association%20of%20British%20Insurers).pdf) (last accessed 27 August 2010). Similar sentiments have been expressed by the Road Haulage Association: see <http://www.rha.uk.net/docs/internet/policy/Pre-packs%20consultation%20RHA%20response.pdf> (last accessed 27 August 2010).

³² [2010] EWHC 582 (Ch), [2010] BCC 382.

³³ S Harris, "The Decision to Pre-Pack" Winter 2004 *Recovery* 26, at 27.

³⁴ *Karamelli v Barnett* [1917] 1 Ch 203.

³⁵ Both possibilities are, of course, possible for a company in administration under Insolvency Act 1986, Schedule B1, paragraphs 83 and 84.

³⁶ *Insolvency Law and Practice: Report of the Review Committee* (1982) Cmnd 8558.

³⁷ *Ibid*, at paragraph 191.

³⁸ *Ibid*, at paragraph 194.

³⁹ *Ibid*, at paragraph 232.

possibly three practitioners are paid fees for dealing with one insolvent company (two administrators may be appointed, one to prepare the terms of the pre-pack, the other to approve and execute it and then a subsequent liquidator may be appointed if the company is wound up at the conclusion of the administration). One of the concerns that contractarians express in relation to reorganisations is that they “invite dissipation of the common pool by specialists, lawyers, accountants, and economists, who are similarly motivated to secure individual advantage at group expense”.⁴⁰ If all the Consultation’s proposals were put into effect, pre-packs would certainly be criticised along these lines.

Communitarianism

Rather than concentrating solely on the private rights of creditors under the creditors’ bargain theory, communitarians look to balance a wide range of different stakeholders in the insolvency of the debtor and to consider the welfare of the community at large.⁴¹ They still take account of financial matters but argue that such matters need to be balanced with the welfare of the community at large. Communitarianism considers limiting the rights of high ranking creditors to give way to some extent to others including the community at large. It is at its core looking at a system of distribution of the debtor’s estate in a way which may require altering creditors’ pre-insolvency rights to give priority to community concerns. An example of this would be where the debtor’s failure leads to environmental clean up costs which would need to be met by the taxpayer if it did not fall on the existing creditors.⁴² Redistribution aspects of communitarian theory could be used to justify, for example, an increase in the funds which would otherwise be available to unsecured creditors under the prescribed part set aside under section 176A of the Insolvency Act 1986.⁴³ The likely knock-on effects of the uncertainty of having different rules of distribution post insolvency to those pre-insolvency, would seem to include increased costs of borrowing or other unfavourable trading terms.⁴⁴

In order that insolvency law acts to benefit society at large, communitarians would favour the survival of businesses where feasible as well as orderly windings up where survival is not possible. The economic life of a region or the nation should be considered as significant. The ripple effects of a business failure and its long term consequences should be factored into insolvency law. The main criticism levelled at communitarians is that the interests of the community at large are not easily defined and may stretch to include very tenuous links to individuals or groups who claim an interest. If insolvency law were to be drafted to take account of unlimited community interests it seems that the courts or some other independent arbiter would need to be called upon to adjudicate each time a potential community interest was raised as relevant (the mechanism for such independent assessment is suggested by the Consultation’s latter three proposals).

Communitarians have much in common with some of the basic principles recommended by the Cork Committee and would favour a proper rescue culture as originally

⁴⁰ T Jackson and R Scott, “On the Nature of Bankruptcy: An Essay on Bankruptcy Sharing and the Creditors’ Bargain” (1989) 75(2) *Virginia Law Review* 155, at 204. The learned authors also comment at 192 that “reorganisation is necessarily a more complex and attenuated process and inevitably presents many more opportunities for abuse”.

⁴¹ K Gross, “Taking Community Interests into Account: an Essay” (1994) 72 *Washington University Law Quarterly* 1031.

⁴² K Heidt, “The Automatic Stay in Environmental Bankruptcies” (1993) 67 *American Bankruptcy Law Journal* 69.

⁴³ This would be one way of taking account of the comment made by the House of Commons Select Committee on Business and Enterprise, *op cit*, at 25: “The interests of unsecured trade creditors must take a higher priority, especially in ‘phoenix’ pre-pack administrations”.

⁴⁴ A point made by Finch *op cit*, at 37.

proposed by the Enterprise Act⁴⁵ rather than the salvage culture of the pre-pack. Turning around a financially distressed business may have many community benefits in terms of continued business for suppliers, continued employment for workers⁴⁶ and in the context of three pre-pack cases,⁴⁷ continuity of legal services for clients where the failed business is a solicitors' firm. These are not relevant factors currently written expressly into the Insolvency Act 1986. Communitarians would also argue that it is in the interest of the community at large not to have an insolvency procedure which brings the law into disrepute.⁴⁸ Pre-packs have certainly been the subject of such criticism.⁴⁹

Some light is shed on the effect of pre-packs on the community at large by comments received by the Insolvency Service from the Road Haulage Association (the "RHA") in response to the Consultation. The RHA points out that the transport sector is highly competitive and essential to the economy. It goes on to state:

[O]ur members are sometimes outraged that a pre-pack sale allows the failed management team to resurrect a rival business. In the road transport sector businesses often get into trouble by undercutting the rates of other more sound operators to unsustainably levels. We understand that the Government wishes to support the business community in the recession and also to protect jobs. However in the road haulage sector the collapse of an ailing business is unlikely to have a significant impact on jobs, because employment in the sector is related to the total number of goods that need to be transported by road. If a carrier fails then one of the other businesses in the sector will hire vehicles or recruit drivers to transport any additional loads.

Little if any significance appears to be attached to the impact of a pre-pack company on its competitors. It is our view that, within the road haulage sector, far from protecting jobs pre-packs undermine quality and sustainable jobs within the industry and that far more importance should be attached to the damaging impact that a pre-pack company has on its responsible competitor firms and their employees within the sector.

In our view the current position leads to significant market distortions within the road haulage sector.⁵⁰

Another problem with seeing pre-packs as good news for job retention is that a high proportion of pre-packed businesses subsequently fails quite swiftly. Writing off a business's liabilities using a pre-pack is, as often as not, a short term solution. This is particularly true of pre-packs where the business is sold to connected persons.⁵¹ A more

⁴⁵ During the Parliamentary passage of the Enterprise Act, in giving evidence at Standing Committee stage, Mr Douglas Alexander, Minister for E-Commerce and Competitiveness stated that: "[t]he purpose 'to rescue the company' evidently means to rescue the company as a going concern, with the whole or much of its business intact. We are confident that the courts would interpret the purpose in exactly that way ... If the objective of administration were to rescue the company's businesses rather than the company itself, frankly there would be little incentive for directors of the company to enter into administration, which is one of the intentions of the Bill" (HC 9 May 2002 House of Commons Standing Committee B (pt 3) at Columns 548–9).

⁴⁶ A survey carried out on behalf of R3 (the Association of Business Recovery Professionals) in February 2010 covering 169 pre-packs showed that in 116 cases all the jobs were saved and that overall of the 17,762 people employed prior to the pre-pack 15,980 were retained (approximately 90%): "Pre-packs and SIP 16" March 2010 available at: https://www.r3.org.uk/uploads/press/Pre%20packs%20and%20SIP%2016_FINAL.pdf (last accessed 2 September 2010). See also S Frisby, "A preponderance of pre-packs?" (2008) 1 *Journal of International Banking and Financial Law* 23 and S Frisby, "The pre-pack progression: latest empirical findings" [2008] *Insolvency Intelligence* 154.

⁴⁷ *DKLL Solicitors v HMRC* [2007] EWHC 2067 (Ch), [2007] BCC 908, *Clydesdale Financial Services Ltd v Smailes* [2009] EWHC 1745 (Ch), [2009] BCC 810 and *Re Halliwells LLP* [2010] EWHC 2036 (Ch).

⁴⁸ A criticism made by the House of Commons Select Committee on Business and Enterprise *op cit*, at 25.

⁴⁹ See, eg, Jon Moulton, formerly of Alchemy Partners who is quoted by Daily Mail Online on 5 January 2009 as saying: "Pre-packs could be very easily abused. Bad management can plan for a pre-pack months in advance, line up an administrator — and then be back running the business immediately."

⁵⁰ Preamble to Road Haulage Association response to the Insolvency Service Consultation/Call for Evidence – Improving the transparency of, and confidence in, pre-packaged sales in administrations *op cit*.

⁵¹ See S Frisby, "The pre-pack progression: latest empirical findings" [2008] *Insolvency Intelligence* 154, although it must be said that the same point could be made of all business sales by administrators.

root-and-branch reorganisation of such businesses, not using a pre-pack, may lead to a greater survival rate.

The previous Labour government showed itself to be open to adopting communitarian principles in the context of its codification of the law on directors' duties. The duty of a director to act in good faith to promote the success of the company under section 172 of the Companies Act 2006, must be carried out having regard, *inter alia*, to its long terms consequences; the interests of employees; the need to foster business relationships with suppliers, customers and others; and the impact of the company's operations on the community and the environment. According to the then Minister of State for Industry and the Regions the new duty "marks a radical departure in articulating the connection between what is good for a company and what is good for society at large."⁵²

Although an attractive ideal, communitarianism does not have a ready-made solution to the problem of how to ensure pre-packs operate consistently with its principles. It does consider society's needs in general but articulating those needs in a legislative form may prove problematic. Such considerations could be taken into account in assessing whether or not a pre-pack was appropriate in given circumstances but such a judgment would be potentially problematical for a court (and/or an independent insolvency practitioner or the official receiver) and could lead to a lack of certainty. It would be necessary to weigh each relevant consideration in the context of each case and if, for example, secured creditors' rights were reduced in an insolvency to allow for redistribution to other community aims, this would probably lead to an increase in the cost and availability of borrowing.

Forum Theory

Procedurally there should be a forum available where all interests affected by a business failure can be heard. This would apply to those with a direct financial interest in the failure and those with non financial claims but still an interest in the ongoing business (such as employees, suppliers and customers).⁵³ Even if those with non financial claims have no decisive say ultimately in the future of the failed enterprise, there should be some mechanism whereby those about to lose their money such as unsecured creditors have some effective say in the future of the enterprise. This theory is consistent with the Cork Committee recommendations on creditor involvement and is inconsistent with the way pre-packs currently operate. The secrecy in which a pre-pack is planned and executed and the lack of a forum for creditors to consider its terms make it inconsistent with the Forum Theory.

In the Foreword to the White Paper "Insolvency – A Second Chance"⁵⁴ in 2001, the then Secretary of State for Trade and Industry (the Rt Hon Patricia Hewitt MP) proposed that the Enterprise Act 2002 (as it became) would "create a streamlined administration procedure which will ensure that all interest groups get a fair say and have an opportunity to influence the outcome".⁵⁵ This policy would, if it applied in practice to pre-packs, be consistent with Forum theory.

⁵² These comments were made by the Rt Hon Margaret Hodge MP in her introduction to *Duties of Company Directors Ministerial Statements* DTI, June 2007 available at: <http://www.dti.gov.uk/files/file40139.pdf> (last accessed 1 September 2010). For a consideration of the difficulties created by this new formulation of the duty of good faith see: A. Keay, "The Duty to Promote the Success of the Company: Is it Fit for Purpose?" at: <http://www.law.leeds.ac.uk/assets/files/research/events/directors-duties/keay-the-duty-to-promote-the-success.pdf> (last accessed 27 September 2010).

⁵³ A Flessner, "Philosophies of Business Bankruptcy Law: an International Overview" in J Ziegel (ed) *Current Developments in International and Comparative Corporate Insolvency Law* (Oxford, Clarendon Press, 1994), at 27.

⁵⁴ CM 5234.

⁵⁵ See also the ministerial answers given during the passage of the Enterprise Act 2002 (HC 9 May 2002 House of Commons Standing Committee B (pt 3) at Columns 548–9).

In order to satisfy Forum theorists, some form of representation of creditors, if not other interested parties, would need to be introduced. This could be achieved, at least to some extent, by the Consultation's suggestion of a subsequent liquidation with a concomitant creditors' meeting and an independent liquidator. The Consultation's proposal, that where a pre-pack involves a management buy-out, the creditors should get to vote on it prior to its execution, would be favoured by Forum theorists but would rather defeat the whole point of the pre-pack, as it will usually require to be completed in secret and speedily.

Multiple Values/ Eclectic Approach

As the name suggests this approach is, in effect, an amalgamation of others with some additional characteristics of its own. Although subject to criticism, the creditors' bargain theory does have the beauty of being self contained in a single economic vision. Professor Warren, the principal advocate of the multiple values approach, takes issue with the creditors' bargain theory for being too narrowly focused.⁵⁶ Warren accepts the need for collectivism as one of the significant features of insolvency law but argues that it cannot be used to justify the whole system.⁵⁷ She makes the point that in insolvency someone has to bear the costs of default and provides a non-exhaustive list of distributional priorities. These include the relative ability to bear the costs of default, transaction avoidance, treating creditors with similar characteristics equally, impairment of some creditors' pre-insolvency rights to ensure fairness and the "almost axiomatic principle of business law . . . that, because equity owners stand to gain the most when a business succeeds, they should absorb the costs of the business's collapse – up to the full amount of their investment".⁵⁸

In the context of the revival of a failing business, the multiple values approach requires recognition of the interests of those who are not directly "creditors" such as older employees who would struggle to retrain for other jobs, customers who would have to resort to less attractive suppliers of goods and services, suppliers who would lose current customers, nearby property owners who suffer declining property values and tax authorities suffering a reduction in taxation revenue. In any proposed reorganisation of a failing business, this approach acknowledges the losses of those who have depended upon it. Where winding up is unavoidable the process allows for delay, which in turn gives time for all those relying on the business to accommodate the change.⁵⁹ This theory has much in common with the communitarians and those holding to the Forum theory but goes further.

A policy focussing on such disparate values assists the decision making process "even if it does not dictate specific answers".⁶⁰ The critical questions under this approach include asking a number of questions about the business failure. Who may be hurt by it? How might they be hurt? Can the hurt be avoided? At what cost can it be avoided? Who is helped by the business failure? Who can efficiently evaluate the risks of business failure? Who contributed to the failure? Who can best bear the costs? Who is expected to bear the costs?

It is frequently observed that the people who benefit from pre-packs tend to be the company's managers, the pre-pack administrator and (usually) any secured creditor. Any benefit to unsecured creditors is either non-existent or coincidental. If the above

⁵⁶ E Warren, "Bankruptcy Policy" (1987) 54 *University of Chicago Law Review* 775.

⁵⁷ *Ibid*, at 800.

⁵⁸ *Ibid*, at 790–791.

⁵⁹ *Ibid*, at 788.

⁶⁰ *Ibid*, at 796.

values are considered in this context, it would seem that those who have contributed to the failure often benefit from it. The gain that secured lenders and company managers stand to receive from the company whilst it is profitable does not really disappear if, when insolvency descends upon the company, the business is pre-packed back to those same parties free from unsecured debt. The majority of the costs frequently fall on the unsecured creditors who may be worst placed to bear the costs. Some balancing of the costs of the business failure in such circumstances may be seen to be just.

The multiple values approach is as Warren admits: “a dirty, complex, elastic, interconnected view of bankruptcy from which I can neither predict outcomes nor even necessarily fully articulate all the factors relevant to a policy decision . . . [but] likely to yield useful analysis”.⁶¹

The main criticism of the multiple values approach is, not surprisingly, that it is too widely expressed to be much specific assistance in developing a policy.⁶² There is little guidance provided as to how much emphasis needs to be given to each of the priorities identified. It is not clear which principles are to be seen as core and which are of peripheral relevance.

It is arguable that insolvency law needs to balance the rights of all the different stakeholders. Once a company enters an insolvency regime, the creditors will take a hit. If the company’s participants, the company insolvency advisers and the company’s secured lenders take no significant hit, the balance of the law cannot be right. The need to redress the balance in a pre-pack situation has been highlighted by the House of Commons Select Committee on Business and Enterprise.⁶³ The obvious difficulty is assessing how to strike such a balance.⁶⁴

The answer to this conundrum may lie in the origins of pre-packs in the UK. In 2004, when the debate on pre-packs first entered the public domain they were considered as useful in certain specific types of situation where a drawn-out public restructuring or insolvency would destroy value. If the business was regulated (eg by the Solicitors’ Regulation Authority),⁶⁵ was a “people” business with few physical assets or where a brand, intellectual property or lease portfolios would be irrevocably damaged,⁶⁶ the speed at which a pre-pack could be executed was seen as essential.⁶⁷ It may not be essential in other circumstances and the interests of all stakeholders may be better considered in more conventional and less controversial insolvency procedures. The Consultation does not consider such a possible solution.

CONCLUSION

Although the above theories differ in many important respects, aspects of each or some of them could be used to inform future policy following the Consultation process. The Insolvency Service has previously shown itself to favour contractarian principles. Its parent, the Department of Business, Innovation and Skills, has previously legislated

⁶¹ *Ibid.*, at 811.

⁶² See, eg, Finch *op cit*, at 42.

⁶³ House of Commons Select Committee on Business and Enterprise *op cit*, at 25 and 26.

⁶⁴ For a consideration of factors to take into account in establishing the correct balance in individual bankruptcy law see A Keay, “Balancing Interests in Bankruptcy Law” (2001) 30 *Common Law World Review* 206.

⁶⁵ As in *DKLL Solicitors v HMRC* [2007] EWHC 2067 (Ch), [2007] BCC 908, *Clydesdale Financial Services Ltd v Smailes* [2009] EWHC 1745 (Ch), [2009] BCC 810 and *Re Halliwells LLP* [2010] EWHC 2036 (Ch).

⁶⁶ Conceptually not dissimilar to the facts in *Re Kayley Vending Ltd* [2009] EWHC 904 (Ch), [2009] BCC 578.

⁶⁷ S Harris, “The Decision to Pre-Pack” Winter 2004 *Recovery* 26, at 27.

upon the basis of communitarian ideals. It might be possible in drafting legislative provisions identifying when pre-packs are appropriate, to include both contractarian and communitarian factors which would need to be taken into account in assessing individual pre-packs.

Few people would argue against pre-packs if they were clearly operating to maximise wealth and providing all interested stakeholders with a say in how the process was carried out. The collective nature of most insolvency procedures appears to be largely absent from pre-packs. It would seem that no theory would encourage wealth maximisation in a process which was not collective. The secrecy of the process leads to distrust and can be seen as evidence that the pre-pack is not being prepared for the collective benefit of the creditors. The secrecy is a contributing factor in potentially bringing the law into disrepute. SIP 16 may dilute this effect but it is still only information being provided after the fact. A limit to the circumstances in which a pre-pack is deemed appropriate combined with the subsequent assessment of an independent liquidator (whether a private sector insolvency practitioner or the official receiver) with the power to attack the pre-pack if it has already been executed, would go some way to allay these concerns.

In order to assess wealth maximisation, it is necessary to introduce some mechanism for independent assessment. The proposed requirement for a compulsory liquidation following on from a pre-pack may fit the bill. It is not apparent that all pre-packs are necessary in that they truly lead to a more beneficial result for the creditors than a winding up would do. The courts have identified some cases where this is clearly the case and the original justification put forward for them would suggest that they are only truly needed in very specific circumstances where there is a true benefit to the creditors as a whole and do not just lead to a result where the ostensible benefit is in favour of the directors, the administrator and/or the secured lender.

It is frequently suggested that pre-packs save jobs. Although this in itself may not be the case in all industries, it is a reasonable point in support of pre-packs that if a business can be saved as a going concern that this is likely to be a positive development from the point of view of the employees and other businesses or organisations which rely upon the business. This is therefore arguably one factor, albeit not an overriding one, which communitarians and adherents to multiple values methodology might favour, which perhaps should be considered in assessing the appropriateness or not of a proposed pre-pack. A similar factor to be taken into account could be the effect on the local or national economy of approving or not the pre-pack. The flipside to this is that it is equally arguable that a pre-pack which is likely to lead to market distortions is not in the best interests of the community and should not be permitted. These factors again could be listed as relevant considerations in assessing the appropriateness of a pre-pack. The costs of a court hearing requiring expert evidence from economists and accountants in assessing these factors is not likely to be consistent with wealth maximisation for the general body of creditors. If such action is only commenced once the pre-pack has passed through the filter of an independent liquidator, litigation is unlikely to be commonplace. The potential for independent investigation and action should have a deterrent effect on the execution of pre-packs which do not satisfy the relevant criteria.

The perceived lack of independence of pre-pack administrators is a genuine concern from the creditors' point of view. Insolvency practitioners are subject to professional conduct rules generally and the requirements of SIP 16 in particular. There remains the perception that they are not acting truly independently on behalf of all the creditors in achieving the best deal available. This concern is given support by the Insolvency Service's suggestions in its Consultation that two administrators (one to plan the

pre-pack and the other to approve and execute it) may be needed or the proposal for a subsequent compulsory liquidation or the proposed requirement for court or creditor approval prior to pre-packs involving a purchase by the management team. All will be expensive options but someone needs to be in a position to assess the appropriateness of the pre-pack.

An option which might lead to more wealth maximisation would be to require the appointment of an independent insolvency practitioner in a creditors' voluntary liquidation after the pre-pack (a solution proposed but not on the facts adopted in *Smailes* where valuations were brought into question). A voluntary liquidation would be less expensive than the Consultation's proposed compulsory liquidation. Is there now not enough confidence in the profession to allow for such a solution? If the accepted view is that a pre-pack administrator is too conflicted to be seen to be acting in the interests of the creditors as a whole, it is necessary to treat the administrator as in a position akin to that of a receiver. If that is the case, the precedent of *Karamelli v Barnett*⁶⁸ provides the solution that such an insolvency practitioner cannot thereafter act as liquidator. The pre-pack would be seen as not truly a collective procedure and such a solution would recognise that point without incurring unnecessary costs (although a mechanism would need to be found to ensure the payment of the liquidator's fees and expenses). The independent liquidator could assess the appropriateness of the pre-pack, according to any criteria laid down, and act to protect the interests of creditors as a collective body. The liquidation would give creditors some say in how the pre-pack is examined retrospectively but might still fall short of what advocates of the Forum theory might prefer and that is a say in approving the pre-pack before it happens.

Any solution to the ongoing furore around pre-packs would need to emphasise honesty and fair dealing. At present, disenfranchised creditors may see the system as one which is reminiscent of the famous quotation from Groucho Marx: "The secret of life is honesty and fair dealing. If you can fake that, you've got it made."

⁶⁸ [1917] 1 Ch 203.

ABOLISHING OBSOLETE CROWN PREROGATIVES RELATING TO THE MILITARY

GRAHAM McBAIN*

INTRODUCTION

In Britain today, there is concern at the loss of authority of Parliament. There is also the problem of how well Parliament and the Crown inter-relate in modern times. A vast number of decisions are taken in the name of that mysterious, and amorphous, entity: 'the Crown.'¹ Legal rights specific to the Crown are denominated its 'prerogatives'² and they are said to derive from the common law.³ They used to be intimately connected with the sovereign in person since, in medieval times, the sovereign and the Crown were, in the eyes of the law, virtually one and the same. Today, however, the role of the sovereign is almost wholly ceremonial. Her rights remain, but they have drained away into the wider concept of the Crown: the apparatus of government and bureaucracy that operates in her name but over which she has little (or no) control.⁴ Thus, there is legal fiction and reality: something prevalent with regard to the British constitution.⁵

Crown prerogatives have been described as residual rights.⁶ That is, legal rights⁷ not otherwise transferred (usually by legislation) to other institutions and individuals.

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¹ *Bank voor Handel v Slatford* [1952] 1 All ER 314, 319 *per* Devlin J 'As Maitland says, the Crown is a convenient term, but one which is often used to save the asking of difficult questions. It is a description of the powers that formerly at common law were exercised by the king in person, and that latterly have been bestowed by statute on the king in council or on various ministers. There is, I think, uncertainty about what is meant by the 'Crown.' F W Maitland, *The Constitutional History of England* (Cambridge University Press, 1963), at 418 'the crown does nothing but lie in the Tower of London to be gazed at by sight seers . . . the crown is a convenient cover for ignorance: it saves us from asking difficult questions.'

² W Blackstone, *Commentaries on the Laws of England* (Oxford, Clarendon Press, 1st ed, 1765–9, University of Chicago Press rep 1979), vol 1 at 232, "By the word prerogative, we usually understand that special pre-eminence, which the king hath, over and above all other persons, and out of the ordinary course of the common law, in right of his regal dignity. It signifies in its etymology (from *prae* and *rogo*) something that is required or demanded before, or in preference to, all others. And hence it follows, that it must be in its nature singular and eccentrically: that it can only be applied to those rights and capacities which the king alone enjoys." Exactly what 'prerogative' and 'crown' mean are open to debate (eg discussions in Sunkin & Payne, *The Nature of the Crown* (Oxford University Press, 1999)). However, an analysis is unnecessary for the purposes of this article, since few would challenge the assertion that the Crown prerogatives discussed herein are such.

³ E Coke, *Institutes of the Laws of England* (W Clarke & Sons, London, last ed, 1824), vol 1, at 90b, The king's prerogative "extends to all powers, pre-eminences, and privileges which the law giveth to the crown" (spelling modernised). *Case of Proclamations* (1611) 12 Co Rep 74, 76 (77 ER 1352) "the king hath no prerogative, but that which the law of the land allows him." (spelling modernised). W Staunford, *An Exposition of the King's Prerogative* (Company of Stationers, 2nd ed, 1607), at 2, "parliament maketh no part of the king's prerogative, but long time before it had his [its] being by order of the common law." EW Ridges, *Constitutional Law of England* (Stevens & Sons, 5th ed, 1934, ed AB Keith), at 184, "the prerogative forms part of the common law, and the courts have frequently adjudicated upon its extent." *Halsbury's, Laws of England*, 4th ed, vol 8(2), para 368 "The prerogative is . . . derived from and limited by the common law."

⁴ Sunkin & Payne, *op cit*, n 2, at 58 "notwithstanding the formal position, in the exercise of these prerogatives, the Queen is advised, directed and controlled by others." C R Munro, *Studies in Constitutional Law* (Oxford University Press, 2nd ed, 1999) at 256 "For practical purposes, power has passed from the monarch to the politicians."

⁵ Around the concepts both of the crown and the constitution there are many legal fictions. Sunkin & Payne, *op cit*, n 2, at 3, "the course of constitutional history has left us coping with concepts which are more or less fictional in nature and which have left gaps between form and reality." R F V Heuston, *Essays in Constitutional Law* (2nd ed, 1964) at 64, "The traditional lawyer's view of the constitution . . . is a somewhat unreal one."

⁶ AV Dicey, *Introduction to the Study of the Law of the Constitution* (Macmillan, London, 9th ed, 1948) at 424 "The prerogative appears to be both historically and as a matter of actual fact nothing else than the residue of discretionary and arbitrary authority, which at any given time is legally left in the hands of the crown."

⁷ Whether the prerogatives can be categorized as 'rights' (privileges) or 'powers' (authorities) is an interesting issue, but one which need not be addressed in this article.

Historically, the Crown asserted such rights when the sovereign was more powerful than Parliament. Today, these Crown prerogatives tend not only to detract from individual human rights; they also detract from the authority of Parliament. Crown prerogatives are often categorised into a number of discrete areas, *viz.* the rights of the Crown in relation to the: military; justice; Parliament; Church of England; commerce; revenue; land, honours and dignities; and miscellaneous.⁸

This article considers certain Crown subsidiary prerogatives relating to military matters. These prerogatives are 'executive' as opposed to 'personal' prerogatives. That is, they would be exercised today (if at all) by ministers and not by the Queen in person. It asserts that they are obsolete. If they were abolished, this would enable a clearer analysis of whether the sovereign (and the Crown in the wider sphere) should retain any responsibility over the military at all or whether it would be better for Parliament to have control over the same. In considering this topic, it may be noted there were few early legal treatises dedicated to the Crown prerogative.⁹ The principal ones comprise:

- (a) Staunford, *Exposition of the King's Prerogative* (1607);¹⁰
- (b) Hale, *The Prerogatives of the King* (written c 1640's)¹¹ and
- (c) Chitty, *Prerogatives of the Crown* (1820).¹²

Although the Abridgments (major and minor)¹³ contain some material on the Crown prerogatives, of greater use are Coke,¹⁴ Blackstone¹⁵ and Halsbury.¹⁶ There are also modern texts on constitutional law¹⁷ and history¹⁸ albeit these make scant reference to the prerogatives considered in this article.

⁸ J Chitty Jun, *A Treatise of the Law of the Prerogatives of the Crown* (Butterworths, London, 1820) is the standard Victorian text. It categorized Crown prerogatives under specific headings, which has proved useful. 'Miscellaneous' Crown prerogatives comprise a hodge podge of rights that include the appointment of ambassadors, rights to certain animals (whales, sturgeon, swans), royal mines, coinage *etc.* Cf. Halsbury, *op cit*, n 3, vol 8(2), para 371.

⁹ Blackstone (writing in 1765), *op cit*, n 2, vol 1, at 230, explained that it was, "a topic, that in some former ages was thought too delicate and sacred to be profaned by the pen of a subject. It was ranked among the *arcana imperii*; and, like the mysteries of the *bona dea*, was not suffered to be pried into by any but such as were initiated in it's service; because perhaps the exertion of the one, like the solemnities of the other, would not bear the inspection of a rational and sober enquiry." For the reference to *arcana imperii* see James I [1603–25] in answer to a petition of the House of Commons in 1621 "You usurp upon our prerogative royal and meddle with things far above your reach." See WS Holdsworth, *A History of English Law* (London, Methuen, 3rd ed, 1945), vol 6, at 15 n 1.

¹⁰ See n 3.

¹¹ *Sir Matthew Hale's Prerogatives of the King* (ed. D E C Yale) Selden Society, vol 92 (London, 1976). See also T Brecknock, *Droit Le Roy* (London, 1764). For other early texts (of variable worth) see Sweet and Maxwell, *A Legal Bibliography of the British Commonwealth of Nations* (2nd ed, 1955, 2 vols).

¹² See n 8.

¹³ N Statham, *Abridgment of the Law* (Pynson, London, c 1490); A Fitzherbert, *La Graunde Abridgment* (Tottell, London, 3rd ed 1577); R Brooke, *La Graunde Abridgment* (Tottell, London, 1586); H Rolle, *Abridgment des plusieurs Cases et Resolutions del Common Ley* (A Croke *et al*, 1668). See also W Hughes, *Grand Abridgment of the Law* (Henry Twyford *et al*, London, 1660–3); W Sheppard, *Grand Abridgment of the Common and Statute Law of England* (George Sawbridge *et al*, London 1759); W Nelson, *Abridgment of the Common Law* (E & R Gosling, London, 1725–6); M Bacon, *New Abridgment of the Law* (ed H Gwillim, London, 5th ed, 1798); E Viner, *A General Abridgment of the Law and Equity* (GCJ & J Robinson, London, 1st ed, 1741–57); J Comyns, *Digest of the Laws of England* (A Hammond, last ed, 1822); J Lilley, *Practical Register* (2nd ed, 1765).

¹⁴ See n 3.

¹⁵ See n 2.

¹⁶ See n 3.

¹⁷ W R Anson, *The Law and Custom of the Constitution* (Oxford, Clarendon Press, 1935); Barendt, *An Introduction to Constitutional Law* (Oxford University Press, 1998); A W Bradley & K D Ewing, *Constitutional and Administrative Law* (Longman, 14th ed, 2006); S A De Smith & R Brazier, *Constitutional and Administrative Law* (Penguin, 8th ed, 1998); O H Phillips & P Jackson, *Constitutional and Administrative Law* (Sweet & Maxwell, 8th ed, 2001); A Le Sueur & M Sunkin, *Public Law* (Longman, 1997); I Jennings, *The Law and the Constitution* (University of London Press, 5th ed, 1959); G Marshall, *Constitutional Theory* (Oxford, Clarendon Press, 1971).

¹⁸ H Brougham, *The British Constitution* (Griffin, Bohn & Co, London, 1861); H Hallam, *Constitutional History of England* (J Murray, London, 1897); J E A Jolliffe, *Constitutional History of Medieval England* (A & C Black, 2nd rep, 1948); D L Keir & F H Lawson, *Cases in Constitutional Law* (Oxford, Clarendon Press, 6th ed, 1979), ch 2 (intro); C G

PREROGATIVE TO DECLARE WAR AND PEACE

Crown prerogatives in respect of military matters stem from the legal proposition that the sovereign has the legal right (prerogative) to declare war and peace, both within, and outside, the realm. This has long been held.¹⁹ Sir Thomas Smith, in his *De Republica Anglorum*, written c 1562–5, stated the position firmly²⁰ and, in 1765, Blackstone observed:

[T]he king has . . . the sole prerogative of making war and peace. For it is held by all the writers on the law of nature and nations, that the right of making war, which by nature subsisted in every individual, is given up by all private persons that enter into society, and is vested in the sovereign power:²¹ and this right is given up not only by individuals, but even by the entire body of people, that are under the dominion of a sovereign. It would indeed be extremely improper, that any number of subjects should have the power of binding the supreme magistrate, and putting him against his will in a state of war.²²

Halsbury, citing Blackstone, states: “War can be commenced or terminated only by the authority of the crown.”²³

This remains true as a legal proposition. However, in reality, the sovereign’s role in this has become purely formal. The sovereign no longer declares (*ie* determines on, as well as actually pronounces) war or peace.²⁴ After all, she no longer leads her troops into battle.²⁵ Nor does she issue any orders to the military, nor sit in cabinet (or Parliament) to authorise war and peace. Thus, while the ability of the sovereign to

Robertson, *Select Statutes Cases and Documents* (7th ed, 1935); W Stubbs, *Constitutional History of England* (Oxford, Clarendon Press, 1st ed, 1874); P Taswell-Langmead, *English Constitutional History* (Sweet & Maxwell, 11th ed, 1960); M A Thomson, *Constitutional History of England* (Methuen, London, 1938), vol 4 (1642–1801); B Wilkinson, *Constitutional History of Medieval England* (Longmans, 1958). Also, J Allen, *Inquiry into the Rise and Growth of The Royal Prerogative in England* (Longmans, London, 1849).

¹⁹ F C T Tudsbery, *Prerogative in Time of War* (1916) 32 LQR 384, “The defence of the realm has by our constitution been entrusted to the crown, and from the time of the Norman Conquest onwards the military forces in the United Kingdom have always been maintained by the crown as the authority responsible for the defence of the kingdom.”

²⁰ T Smith, *De Republica Anglorum*, (ed Dewar, CUP, 2009) at 85 “the monarch . . . has absolutely in his power the authority of war and peace, to defy what prince it shall please him, and to bid him war, and again to reconcile himself and enter into league or truce with him at his pleasure or the advice only of his privy council.” (spelling modernized). See also Coke, *op cit*, n 3, vol 3 at 9 “no subject can levy war within the realm without authority from the king, for to him it only belongeth.” and *Calvin’s Case* (1608) 7 Co Rep 1 at 25ba (77 ER 377) “*bellum indicere* belongeth only and wholly to the king, and not to the subject.” A Fitzherbert, *New Natura Brevium* (1st ed, 1534, last ed 1793, from which I cite) at 113a, “the king of right ought to keep and defend his kingdom . . . against enemies, that it be not . . . wasted, and to provide a remedy for the same.”

²¹ Blackstone, *op cit*, n 2, vol 1, at 249. He quoted S Pufendorf, *The Whole Duty of Man According to the Law of Nature* (trans A Tooke 1691, rep Liberty Fund, 2003), at 200 “But that those, who by mutual agreement have constituted a civil society, may be safe against the insults of strangers, the supreme magistrate has the power to assemble, to unite into a body, and to arm, or, instead of that, to list as many mercenaries as may seem necessary, considering the uncertain number and strength of the enemy, for the maintaining the public security: and it is likewise entirely left to the discretion of the same magistrate, to make peace whenever he shall think convenient.”

²² *Ibid.* Also, p 245, “What is done by royal authority, with regard to foreign powers, is the act of the whole nation: what is done without the king’s concurrence is the act only of private men. And so far is this point carried by our law, that it hath been held, that should all the subjects of England make war with a king in league with the king of England, without the royal assent, such war is no breach of the league”. He quoted Coke, *op cit*, n 3, vol 4, at 152. Chitty, *op cit*, n 8, at 50 “What is termed the war prerogative of the king is created by the perils and exigencies of war for the public safety.”

²³ Halsbury Laws, *op cit*, n 3, vol 8(2), para 810 citing the 14th edition of Blackstone (published in 1803), at 257–8. *Esposito v Bowden* (1855) 7 El & Bl 763 at 782 (119 ER 1430) *per* Willes J, “The force of a declaration of war is equal to that of an Act of Parliament, prohibiting intercourse with the enemy except by the Queen’s licence. As an Act of State, done by virtue of the prerogative exclusively belonging to the crown, such a declaration carries with it all the force of law.”

²⁴ Hale, *op cit*, n 11, at 127 (writing in the 1640’s) noted the former manner of declaring war and peace by the sovereign, “when the king by his writ styled *summonitio exercitus* hath prefixed the convening of his army, the usual badge whereof is . . . the setting up of his standard . . . And is regularly ended when the king by writ proclaimed his peace.” In modern times, the declaration of war has been made by the Prime Minister. *eg* in the Second World War, the declaration of war against Germany on 3 September 1939 was made by Neville Chamberlain and against Japan on 8 December 1941 by Winston Churchill. Peace was made by treaty; then announced by proclamation or statutory instrument. See also Halsbury, *op cit*, n 3, vol 8(2), para 810.

²⁵ The last time a sovereign led his troops into battle was George II (1727–60) in 1743 at the battle of Dettingen.

declare war and peace exists as a legal reality, it does not exist as a political reality; decisions are not made *by* (but *for*) her. And, in the making of these decisions, the Crown itself is but the cipher through which the political party in control of Parliament effects its will. From the prerogative to declare war and peace derives the prerogative of the sovereign to be commander-in-chief of the armed forces.²⁶ Chitty (writing in 1820) noted:

As the constitution of this country has vested in the king the right to make war or peace, it has necessarily and incidentally assigned to him on the same principles the management of the war; together with various prerogatives which may enable his majesty to carry it on with effect.²⁷

This prerogative has been accepted by the courts.²⁸ However, today – although the Queen is commander-in-chief of the armed forces – this role is also a formal one.²⁹ By legislation, and in practice, the power to command the armed forces is vested in the Defence Council.³⁰ From the prerogative to *command* the armed forces derives the prerogative of the sovereign to *regulate* the armed forces. Blackstone, writing in 1765, stated: “In this capacity therefore, of general of the kingdom, the king has the sole power of raising and regulating fleets and armies.”³¹

This prerogative to regulate the armed forces includes the power to build and maintain military fortifications³² (and to prevent subjects from so doing, without licence).³³ These major Crown prerogatives, *viz.* to: (a) declare war and peace; (b) command the armed forces; and (c) regulate the armed forces, remain extant today. This article does not seek to discuss them. Instead, it discusses various prerogatives of a subsidiary nature which flow from these. These comprise Crown prerogatives to:

- i. impress subjects for the navy;
- ii. issue letters of marque;
- iii. issue letters of safe conduct;

²⁶ The Militia Act 1661 (13 Car II c 6) (rep) declared that “the sole supreme government, command, and disposition of the militia and of all forces by sea and land, and of all forts and places of strength, is, and by the laws of England ever was the undoubted right of his majesty, and his royal predecessors . . . and that both, or either, of the houses of parliament cannot, nor ought to pretend to the same.”

²⁷ Chitty, *op cit*, n 8, p 44. Blackstone, *op cit*, n 2, vol 1, at 254 “The king is considered . . . as the generalissimo or the first in military command, within the kingdom. The great end of society is to protect the weakness of individuals by the united strength of the community: and the principal use of government is to direct that united strength in the best and most effectual manner, to answer the end proposed. Monarchical government is allowed to be the fittest of any for this purpose: it follows therefore, from the very end of its institution, that in a monarchy the military power must be trusted in the hands of a prince.”

²⁸ *eg China Navigation Co Ltd v AG* [1932] 2 KB 197. Also, *Chandler v The DPP* [1964] AC 763, 791 *per* Lord Reid, “the deposition and armament of the armed forces are and for centuries have been within the exclusive discretion of the crown.” See also Bradley & Ewing, *op cit*, n 17, at 260.

²⁹ Halsbury, *op cit*, n 3, vol 8(2), para 886 “The monarch has . . . long since ceased to exercise the supreme command in person” noting that the king gave up personal command of the armed forces in 1793 when a commander-in-chief was appointed.

³⁰ The Defence (Transfer of Functions) Act 1964, s 1(1) (b) which empowers the Defence Council to have “powers of command and administration over her majesty’s armed forces”. By subsequent letters patent this is held jointly with the sovereign. Sunkin & Payne, n 2, at 267 (article by P Rowe, *The Crown and Accountability for the Armed Forces*). Rowe noted that, despite this joint command, “In reality, of course, the powers would be exercisable in all cases by the Defence Council.” See also Halsbury, *op cit*, n 3, vol 8 (2), para 883 *et seq.*

³¹ Blackstone, *op cit*, n 2, vol 1, at 254. Chitty, *op cit*, n 8, at 45 “The king as head of his army and navy, is alone entitled to order their movements, to regulate their internal arrangements, and to diminish, or during war, increase their numbers, as may seem to his majesty, most consistent with political propriety.” Sunkin & Payne, *op cit*, n 2, at 14 “the disposition of the armed forces is a matter of the royal prerogative exercisable by the crown.”

³² Chitty, *op cit*, n 8, at 45 (referring to the Militia Act 1661, see n 26). See also Blackstone, *op cit*, n 2, vol 1, at 255.

³³ Coke, *op cit*, n 3, vol 3, at 300, “the common law doth prohibit any subject to build any castle, or house of strength embattled, *etc.* without the king’s licence, for the danger that might ensue”. Also, Coke, *op cit*, n 3, vol 1, at 5a. Cf. in time of war. *Maleverer v Spinke* (1537) 1 Dyer 35 at 36b (73 ER 79) “in time of war a man may justify making fortifications on another’s land without licence . . . for these are cases of the common weal”. Also, *King’s Prerogative in Saltpetre* (1606) 12 Co Rep 12 at 13 (77 ER 1294).

- iv. prohibit subjects from leaving the realm;
- v. order subjects to return to the realm;
- vi. dig for saltpetre, to make gunpowder.

It is asserted these prerogatives are no longer needed and should be abolished. If ever required in future, they should be effected by legislation and, thus, be subject to Parliament.

PREROGATIVE TO IMPRESS SUBJECTS FOR THE NAVY

A Crown prerogative deriving from the control of the armed forces is the right to impress (that is, force) men to serve in the royal navy.³⁴ This was always highly unpopular³⁵ and it was never created, or expressly confirmed, by legislation. Blackstone, writing in 1765, noted that:

The power of impressing men for the sea service by the king's commission, has been a matter of some dispute, and submitted to with great reluctance; though it has very clearly and learnedly been shown, by Sir Michael Foster, that the practice of impressing, and granting powers to the admiralty for that purpose, is of very ancient date, and has been uniformly continued by a series of precedents to the present time: whence he concludes it to be part of the common law.³⁶

Foster considered the legal basis for impressment in depth in *Broadfoot* (1743).³⁷ He cited precedents, in terms of mandatory writs and commissions, dating from the reign of Edward III (1327–77). He also cited legislation (all now repealed).³⁸ However, he admitted that; “I know of no statute now in force, which directly and in express terms empowereth the crown to press mariners into the [naval] service . . .”³⁹

Foster grounded the prerogative to impress into the royal navy on ‘*immemorial usage*’ at common law,⁴⁰ one which was based on public policy and defence of the realm in wartime.⁴¹ Blackstone, in 1765, agreed with Foster, albeit he also noted (with

³⁴ Halsbury, *op cit*, n 3, vol 8(2), para 160.

³⁵ Unpopular because of the poor rates of pay and conditions on board ship – which meant that mariners much preferred to serve in the merchant marine or privateers. Being a mariner was never a popular occupation anyway. There are a number of works on naval impressment of a general nature, as well as many on its abolition (see British Library catalogue).

³⁶ Blackstone, *op cit*, n 2, vol 1, at 406. The citation to Sir Michael Foster was to *R v Broadfoot* (1743) Foster 154 (168 ER 76) (Mr Sarjeant Foster, sitting as recorder at the sessions of goal delivery in Bristol). See also *R v Tubbs* (1776) 2 Cowp 517 (98 ER 1215) *per* Mansfield CJ at 517, “The power of pressing is founded upon immemorial usage allowed for ages . . . the practice is deduced from that trite maxim of the constitutional law of England, ‘that private mischief had better be submitted to, than that public detriment and inconvenience should ensue.’”

³⁷ *Broadfoot*, *op cit*, n 36. The case held it was not murder, but manslaughter, to kill a sailor belonging to a press gang which did not have a legal warrant. Maitland, *op cit*, n 1, at 280 & 461–2 “there can be no doubt . . . to press sailors into his service is one of the king's prerogatives”.

³⁸ The Acts cited were: 2 Ric II c 4 (1378) (it spoke of mariners being arrested and retained for the king's service and provided a remedy against their running away); 2 & 3 Ph & M c 16, s 4 (1555) (Thames waterman who hid during the execution of any commission of impressment liable to heavy penalties); 5 Eliz c 5, s 26 (1563) no fisherman to be taken by the king's commission without certain steps being followed); 7 & 8 Will III c 21 s 15 (1696) (licences could be given to any land man willing to enter into the merchant service which would give them protection against being impressed for 2 years); 2 & 3 Ann c 6 ss 4 & 5 (1703) (apprentices under 18 not to be impressed. Also, parish officers could bind poor boys to the merchant service. If so, they shall not be impressed); 4 Ann c 19 s 17 (1705) (no apprentices to sea service of 18 exempt from impressment); 13 Geo II c 17 (1740) (raised age of impressment to 55); 11 Geo 3 c 38 (1771) (Greenland whale fishery), 19 Geo 3 c 75 (1779) (no person shall be detained in the royal navy for longer than 5 years against his consent, save in the case of emergencies); 5 & 6 Will IV c 24 s 1 (1835) (*ibid*).

³⁹ *Broadfoot*, *op cit*, n 36 at 168.

⁴⁰ *Ibid*, at 174, “upon a general immemorial usage, allowed, approved, and recognized by many Acts of Parliament”. Also, at 159, “the right of impressing mariners for the public service is a prerogative inherent in the crown, grounded upon common law, and recognized by many acts of parliament.” Also, p 167, “the Crown hath been always in possession of the prerogative of pressing mariners for the public service.”

⁴¹ *Ibid*, at 157, “I think the crown hath a right to command the service of these people [*ie* mariners], whenever the public safety calleth for it. The same right that it hath to require the personal service of every man able to bear arms in the

Foster) that: “[N]o statute has expressly declared this power to be in the crown, though many of them very strongly imply it.”⁴²

As it was:

- (a) Impressment for the navy was abandoned after 1814 and has never been re-assumed;⁴³
- (b) There were many statutory exceptions the effect of which was to limit impressment to *mariners* in the merchant marine⁴⁴ albeit the Crown prerogative to impress for the navy extended to *landsmen* as well. That said, the impressment of landsmen into the navy was rarely invoked pre-1740 (after that, legislation prevented it) because it would have caused even more public outcry;⁴⁵
- (c) The Crown prerogative to impress was not asserted to apply to the army.⁴⁶ In the few occasions where impressment for the army was made, this was effected pursuant to legislation. Impressment for the army ended by 1780;⁴⁷
- (d) Impressment for the navy was invariably undertaken only during wartime (or just prior to). However, the prerogative was never specifically limited to wartime.⁴⁸

The Crown prerogative to impress for the navy still exists. It is asserted it should be abolished for the following reasons:

case of a sudden invasion or formidable insurrection. The right in both cases is founded on one and same principle, the necessity of the case in order to [secure the] preservation of the whole.” Also, at 159 “War itself is a great evil, but it is chosen to avoid a greater. The practice of pressing is one of the mischiefs war bringeth with it.” Also, at 174 “This burden is plainly an impress in time of war.”

⁴² Blackstone, *op cit*, n 2, vol 1, at 407. He continued at 407, “All of which [statutes] do most evidently imply a power of impressing to reside somewhere; and, if any where, it must from the spirit of our constitution, as well as from the frequent mention of the king’s commission, reside in the crown alone.” Chitty, *op cit*, n 8, at 47, forcible impressments in the navy were “founded on immemorial usage, recognized, admitted, and sanctioned by various acts of Parliament.”

⁴³ Halsbury, *op cit*, n 3, vol 8(2), para 160 “The power of impressment has been in abeyance for a long time and this paragraph is retained for historical interest only.” It notes that impressment was carried out under a warrant from the admiralty grounded on an order by the sovereign in council and that since the office of lord high admiral was placed in abeyance, no power of impressments has been inserted in the patents of the board. The office of lord high admiral has been in abeyance since the 18th century, DM Walker, *The Oxford Companion to Law* (Oxford, 1980) (extract on the Lord High Admiral).

⁴⁴ These exceptions meant that impressments did not extend to: (a) landsmen (after 1740); (b) fishermen except in certain cases; (c) harpooners, line managers and boatsteerers employed in the Greenland fisheries; (d) seamen in the British sugar colonies in the West Indies or serving in privateers, or trading ships employed in such colonies – except in the case of invasion or other urgent necessity; (e) persons under 18 or over 55; (f) foreigners, whether mariners, seamen or landsmen for the first 2 years of their going to sea; (g) apprentices not used to the sea for the first 5 years from the time of their binding themselves to serve at sea. See Chitty, *op cit*, n 8, p 47. It has been asserted that London citizens (and their apprentices) cannot be impressed because of a charter of Edward III of 6 March 1327, A Pulling, *The Laws, Customs, Usages and Regulations of the City and Port of London* (WH Bond, London, 2nd ed, 1842), at 68. Also, Comyns, *op cit*, n 13, vol 5, at 20.

⁴⁵ Broadfoot, *op cit*, n 36. D Barrington, *Observations on the Statutes* (3rd ed, Dublin, 1767), at 302 noted that a writ of Henry VI (1422–71) provided even for the impressment of singing boys. See also Halsbury, *op cit*, n 3, vol 2(2), para 160.

⁴⁶ Chitty, *op cit*, n 8, at 47 noted that, apart from legislation, “his majesty has no legal power to force anyone to enlist in his armies.” Broadfoot, n 36 at 157 *per* Foster, “We are not at present concerned to inquire, whether persons may be legally pressed into the land service.” Also, at 175, “One reason of the difference, among others, may be that the land service was thought to be sufficiently provided for in ordinary courts by military tenures; and extraordinary cases, cases of necessity, such as that of a foreign invasion, were expressly excepted.” Cf. Taswell-Langmead, *op cit*, n 18, at 399 who assumed men were impressed for the army pre-1640 (*ie* prior to 16 Car 1 c 28, see n 47) by virtue of the Crown prerogative. See also P Hughes & JF Larkin, *Tudor Royal Proclamations* (Yale UP, 1969), vol 1, at 338, 483.

⁴⁷ See 1 Edw III st 2 c 5 (1328); 25 Edw III st 5 c 8 (1352) and 4 Hen IV c 13 (1402) (all now repealed). Also, Anson, *op cit*, n 17, vol 2, at 201–2. See also 35 Eliz c 4 s 1 (1593) (rep) (relief of soldiers who were pressed) and 16 Car 1 c 28 (1640) (rep) ‘by the laws of this realm none of his majesty’s subjects ought to be impressed or compelled to go out of his country to serve as a soldier in the wars, except in the case of necessity of the sudden coming in of strange enemies into the kingdom, or except they be otherwise bound by tenure of their lands and possessions’. For impressment during the Civil War, see Impressment Act 1642 (rep) and JR Tanner, *English Constitutional Conflicts of the Seventeenth Century 1603–1649* (CUP, 1962) at 115–6, 120. See also Recruiting Acts 1778 (18 Geo 3 c 53) & 1779 (19 Geo 3 c 10), repealed in 1780. See also Maitland, *op cit*, n 1, at 453 and CM Clode, *The Military Forces of the Crown* (W Clowes, London, 1869), at 26–7.

⁴⁸ Chitty, *op cit*, n 8, at 47 “With respect however to persons who come within the description of seamen and seafaring men, the king may *even in time of peace* compel them to re-enter the navy by forcibly impressing them.” (italics supplied)

- i. Joining the armed forces today is voluntary and impressment is not required. If impressment in the navy were ever needed again, this should be by way of legislation and not Crown prerogative;
- ii. There is no reason why this prerogative should continue to apply to the navy only, pay and conditions (the main reason necessitating impressment) having improved;
- iii. Lord Brougham, in his work on the British Constitution in 1861, said: “The only intelligible arguments in favour of impressments are confined to one point, – the necessity of suddenly obtaining a supply of seamen when a war unexpectedly breaks out. The fact, however, is, that no war ever can break out so suddenly as to have given no notice and no power of providing men by bounty [*ie* by paying them] . . . To maintain the barbarous, though lawful and very ancient practice of impressments, merely in order to save high bounties, is, of all injustices, the most oppressive.”⁴⁹ This statement remains true. In modern times, the chances of war unexpectedly breaking out requiring the impressment of persons for the navy is remote (and, should it occur, it should be effected by legislation);
- iv. To attempt to impress for the navy today (whether in peace or wartime) by relying on the Crown prerogative would be politically unacceptable;⁵⁰
- v. All the statutory exceptions to the prerogative⁵¹ have been repealed. Thus, today, the Crown prerogative could be used to impress men (and women) of whatever age into the navy, whether mariners or not. This is inappropriate;
- vi. A Royal Commission report in 1859 on Manning of the Navy stated that: “the evidence of the witnesses, with scarcely an exception, shows that the system of naval impressments, as practised in former wars could not now be successfully enforced.”⁵²

It is asserted that the Crown prerogative to impress (whether during peace or wartime), one which is no longer subject to any statutory exceptions, is unnecessary and should be abolished.

PREROGATIVE TO ISSUE LETTERS OF MARQUE⁵³

Letters of marque and reprisal (the words are synonyms) were a form of Crown licensed privateering as opposed to piracy.⁵⁴ The Oxford English Dictionary summarises the evolving position:

⁴⁹ Brougham, *op cit*, n 18, at 398–9.

⁵⁰ C Vincenzi, *Crown, Powers, Subjects and Citizens* (Pinter, London and Washington, 1998), at 115 (in 1998) “the navy still retains the power of recruitment by impressments – that is, by force – because this prerogative power, although its use has long since been abandoned, and would be politically wholly unacceptable, has never been abolished.” Anson (writing in 1935), *op cit*, n 17, vol 2, at 217, “the exercise of the prerogative would undoubtedly be called into question is brought into use in the present day.”

⁵¹ See *op cit*, n 44. Halsbury, n 3, vol 8(2), para 160 states “Statutory exemptions . . . are now almost wholly defunct.” In fact, all have now been repealed.

⁵² Report (c 1st series) p xi referred to in Halsbury, *op cit*, n 3, vol 8(2) para 160.

⁵³ See generally, F R Stark, *The Abolition of Privateering and the Declaration of Paris*. Studies in History, Economics and Public Law (University of Colombia, 1897); DJ Staub, *Letters of Marque: A Short Term Solution to an Age Old Problem* Journal of Maritime Law and Commerce (2009) vol 40(2), at 261–70; T M Cooperstein, *Letters of Marque and Reprisal: The Constitutional Law and Practice of Privateering* (2009) JMLC vol 40(2), at 221–60. There is also a volume of general literature on privateering including: W Gomer, *History of Liverpool Privateering and Letters of Marque with an Account of the Slave Trade 1744–1812* (Liverpool University Press, 2005); D Petrie, *The Prize Game* (Annapolis Md, Naval Institute Press 1999), p 143; Lord Russell, *The French Corsairs* (London, Robert Hale, 2001); Upton, *Maritime Warfare and Prize* (New York, John Voohies, 1863). Letters of marque are also often referred to in the Parliament Rolls (1272–1504), now on CD (Scholarly Digital Editions, 2005, www.sd-editions.com). See also C Molloy, *De Jure Maritimo et Navali* (T Waller, London, 1769), vol 1, chs 2 & 3.

Originally, a licence granted by a sovereign to a subject, authorizing him to make reprisals on the subjects of a hostile state for injuries alleged to have been done to him by the enemy's army. In later times this became practically a licence to fit out an armed vessel and employ it in the capture of the merchant shipping belonging to the enemy's, the holder of letters of marque being called a privateer or corsair, and entitled by international law to commit against the hostile nation acts which would otherwise have been condemned as piracy.⁵⁵

The basic premise was that, if a foreign sovereign seized or spoiled (*ie* destroyed) the goods of English subjects, the king could take reprisal on the former's subjects in England, and, by extension, if foreign subjects seized or spoiled the goods of English subjects, the king could issue letters of marque to the latter for them to take reprisal against the subjects of that other country.⁵⁶ Letters of marque, the first of which was said to have been issued on the authority of Edward I (1272–1307) in 1295,⁵⁷ tended to be given in respect of shipping. However, they did not have to be, they could also apply to reprisals on land. Stroud summarises letters of marque as follows:

Letters of marque or reprisal, are commissions (recognised by the law of nations) issued by a sovereign state to the commanders of merchant ships for reprisals, in order to make reparation for the damages they have sustained, or the goods they have been despoiled of, by strangers at sea, or to cruise against and make prize of an enemy's ships or vessels *etc*, either at sea or in their harbours.⁵⁸

The Crown prerogative to issue letters of marque derives from the prerogative to make war – a point noted by Blackstone who stated in 1765:

But, as the delay of making war may sometimes be detrimental to individuals who have suffered by depredations from sovereign potentates, our laws have in some respect armed the subject with powers to impel the prerogative; by directing the ministers of the crown to issue letters of marque and reprisal upon due demand: the prerogative of granting which is nearly related to, and plainly derived from, that other of making war; this being indeed only an incomplete state of hostilities, and generally ending in a formal declaration of war. These letters are grantable by the law of nations,⁵⁹ whenever the subjects of one state are oppressed and injured by those of another; and justice is denied by that state to which the oppressor belongs. In this case letters of marque and reprisal (words in themselves

⁵⁴ The first recorded mention of a letter of marque in legislation appears to be 27 Edw III s 2 c 17 (1354), 'If our liege people, merchants or other, be indamaged by any lords of strange lands or their subjects, and the said lords, duly required, fail of right to our said subjects we shall have the law of marque, and of [taking them again] as hath been used in times past, without fraud or deceit.' See also 14 Hen VI c 7 (1435) (rep) (forged letters of marque).

⁵⁵ Oxford English Dictionary (OED) (letter of marque).

⁵⁶ *R v Cusacke* (1620) 2 Rolle 113 (81 ER 694). Also, Comyns, *op cit*, n 13, vol 7, at 43–4. Cf. A writ could also be brought against despoiling foreign merchants if they later came to England. See Coke, *op cit*, n 3, vol 4, at 137; Hale, n 11, at 317–21 and Fitzherbert, *op cit*, n 20, at 114.

⁵⁷ Stark, *op cit*, n 53, at 52. A British subject had his ship and cargo confiscated by Portuguese sailors, the king of Portugal sharing in the spoil. In 1295, the subject was granted a letter of marque (confirmed by Edward I) valid for 5 years to 'mark, retain and appropriate' the people of Portugal and their goods until he had recovered £700 in damages claimed by him. Any excess was to be accounted for to Edward I. For other instances, see Hale, *op cit*, n 11, at 317–21 and Rolle, *op cit*, n 13, vol 2, at 175–6.

⁵⁸ Stroud, *Judicial Dictionary of Words and Phrases* (Sweet & Maxwell, 6th ed, 2000 ed D Greenburg). Cf. Walker, *op cit*, n 43 (definition of letter of marque), 'The authority formerly given by a belligerent state to a private shipowner authorising him to use his ship as a ship of war or privateer, and to wage sea-warfare on enemy shipping. They might be special, authorising hostile acts as a means of securing reparation for individuals; or general, when issued as a means of waging warfare. Both are now obsolete.' However, these definitions fail to distinguish adequately between letters of marque issued by virtue of Crown prerogative and those issued by the lord high admiral pursuant to legislation.

⁵⁹ Blackstone referred to H Grotius, *De Jure Praedae* (Commentary on the Law of Prize and Booty) (1604, rep Liberty Fund, 2006), at 421 'the fact that the law of all nations permits the use of force to resist force.' Grotius defended Dutch licensed privateering against Spanish and Portuguese vessels. Cf. Hale, *op cit*, n 11, p 319 'Upon what these reprisals are grounded. And it seems it is upon the right of necessity, and thereupon a custom introduced and allowed by the law of nations.' Brecknock, *op cit*, n 11, at 80 'if an English merchant happen to be injuriously deprived of his goods by foreigners, and cannot obtain justice abroad, the king can grant letters of marque or reprisal to the party thus wronged, to redress himself out of the merchandizes of any subject of that country, to which the despoilers do belong.'

synonymous and signifying a taking in return) may be obtained, in order to seize the bodies or goods of the subjects of the offending state, until satisfaction be made, wherever they happen to be found . . .

But here the necessity is obvious of calling in the sovereign power, to determine what reprisals may be made; else every private sufferer would be a judge in his own cause. And, in pursuance of this principle, it is with us declared by the statute 4 Hen V c 7 [1416, rep]⁶⁰ that, if any subjects of the realm are oppressed in time of truce [peace] by any foreigners, the king will grant marque in due form, to all that feel themselves grieved. Which form is thus directed to be observed: the sufferer must first apply to the lord privy seal, and he shall make out letters of request under the privy seal: and, if, after such request of satisfaction made, the party required do not within convenient time make due satisfaction or restitution to the party grieved, the lord chancellor shall make him out letters of marque under the great seal; and by virtue of these he may attack and seize the property of the aggressor nation, without hazard of being condemned as a robber or pirate.⁶¹ (Wording divided for ease of reading).

Letters of marque were not restricted to wartime – they were often issued prior to the commencement of war.⁶² Chitty noted in 1820 that letters of marque issued by the lord chancellor under the great seal pursuant to the Crown prerogative, should not be confused with letters of marque which legislation empowered the lord high admiral to issue during wartime.⁶³ He stated:

By various statutes enacted during every war, the Lord High Admiral, or the Commissioners of the Admiralty, are empowered to grant commissions or, as they are also called, letters of marque and reprisals, to the owners of ships, enabling them to attack and take the property of his majesties' enemies; which statutes also contain various provisions as to the prizes captured. These statutes do not, it should seem, affect the royal prerogative in question in the slightest degree.⁶⁴

It is asserted the Crown prerogative to issue letters of marque should be abolished for the following reasons:

⁶⁰ 4 Hen V st 2 c 7 (1416) (rep). This Act only applied in time of peace (truce). Its repeal did not affect the prerogative of the Crown to issue letters of marque. See also Hale, *op cit*, n 11, at 320–1.

⁶¹ Blackstone, *op cit*, n 2, vol 1, at 250. Chitty, *op cit*, n 8, at 40 “The law of nature and of nations, vest in every power a right to make reprisals, and adopt a system of fair retaliation, for the aggressions of another community. Where a nation manifests a general spirit of hostility towards another, by a series of unauthorized attacks, and satisfaction is denied and explanations are evaded, though it be the king's duty as protector of the rights and honour of his dominions, to enable his subjects to retaliate on their oppressors, yet his majesty being the only constitutional judge of the policy and expediency of commencing hostilities, his subjects cannot legally adopt the *lex talionis* without the royal authority . . . The law has therefore wisely ranged the right to grant letters of marque and reprisals, either during war or peace, among the *jura regalia*, and has vested it solely in the king: so that by the law of the admiralty, the property in a ship taken from the aggressors, without letters of marque and reprisals, vests in the king as a *droit* to the crown, not in the suffering or other subject who captured it.”

⁶² Stark, *op cit*, n 53, at 54, notes that the purpose of the letter of marque was to secure compensation in peace time which, in theory, it did not break. However, it soon became a form of licensed piracy during hostilities, for private vessels (privateers) to harry the enemy's fleet and recover spoils. See Hughes & Larkin, *op cit*, n 46, vol 1, at 345 (letters of marque against the Scots and French in 1544).

⁶³ Originally, the empowerment of the Lord High Admiral to issue letters of marque was under the Crown prerogative. *eg* Royal Declaration of June 1702 (London Gazette no 3815/3) “Her Majesty's having empowered the Lord High Admiral of England to grant letters of marque or commissions for privateers.” Later, letters were issued pursuant to legislation. See also Stark, *op cit*, n 53, at 57 *et seq*.

⁶⁴ Chitty, *op cit*, n 8, at 42. He referred to 29 Geo 2 c 34 (1756); 19 Geo 3 c 67 (1779); 43 Geo 3 c 160 (1803) and 45 Geo 3 c 72 (1805) (all repealed). HJ Stephen, *New Commentaries on the Laws of England* (Butterworth, London, 1842), vol 2, at 516, “this manner of granting letters of marque has long been disused, and the term itself is now somewhat differently applied. If during war a subject should take an enemy's ship without commission from the king, the prize would, by the effect of the prerogative, become a *droit* of admiralty, and would belong not to the captor but the crown. Therefore, to encourage merchants and others to fit out privateers or armed ships in time of war, the lords of the admiralty have been empowered by various acts of parliament, and sometimes by proclamation of the king in council, to grant commissions to the owners of such ships, and the prizes captured by them have been directed to be divided between such owners and the captains and crews. These commissions are ordinarily denominated letters of marque; and it is in that sense alone that the term usually occurs.”

- (a) Chitty writing in 1820 (citing an edition of Blackstone published in 1803) regarded them as obsolete.⁶⁵ It is uncertain when the last letters of marque were issued in England under the Crown prerogative. However, the practice ended, in any case, after the Napoleonic War in 1815;⁶⁶
- (b) The Declaration of Paris respecting Maritime Law of 16 April 1856, to which Britain was a signatory, renounced privateering,⁶⁷ an essential aspect of which was the issuing of letters of marque. Therefore, the Declaration impliedly abolished letters of marque;
- (c) Letters of marque are different from the law of prize, which relates to the seizure of enemy property (mainly ships) by military personnel after a declaration of war.⁶⁸ However, it may be noted that the right to grant prize money to officers and crew (the military equivalent to issuing letters of marque to privateers) has been abolished;⁶⁹
- (d) Letters of marque, being a form of reprisal, in any case are contrary to the UN Charter (unless they occur in self defence).⁷⁰

Abolition of the right of the Crown to issue letters of marque would not prevent future legislation on the same, albeit this is highly unlikely today.

In conclusion, letters of marque should be abolished as a Crown prerogative.

PREROGATIVE TO ISSUE LETTERS OF SAFE CONDUCT

Letters of safe conduct⁷¹ are of ancient date.⁷² They were issued by the sovereign both to subjects and to aliens. In the case of the latter in particular, in early times, aliens

⁶⁵ *Ibid*, at 42 referring to the Act of 1416 and to Blackstone (14th ed, 1803), vol 1, at 259. Stephen, *op cit*, n 64, vol 2, at 516 (writing in 1842) “this manner of granting letters of marque has been long disused.”

⁶⁶ Chitty, *op cit*, n 8, at 42 refers to *Walton v Hanbury* 2 Vern 592 (1707) (23 ER 985) (letter of marque from Duke of Savoy); *Nightingale et al v Bridges* (1689) Shower 137 (89 ER 497) (letter of marque given by Royal African Company, a company established by royal charter); *Sacra Familia* 5 Rob R 360 (1805) (165 ER 805) (English privateer took Spanish ship but did not have letter of marque); *R v Carew* (1682) 1 Vern 55 (23 ER 306) (letters of reprisal may be repealed in chancery after a peace). It is important to distinguish cases where letters were issued to naval personnel. Also, where legislation provided for the situation such as 4 & 5 Will and Mar c 25 (1693) (rep) and 6 Anne c 13 (1693) (rep). See also Stark, *op cit*, n 53, at 68–9 and Molloy, *op cit*, n 53, vol 1, at 46 (citing letter of marque of 1663).

⁶⁷ 46 BFSP 26, “privateering is and remains abolished.” Also, Stark, *op cit*, n 53, at 139 *et seq*. In 1854, at the onset of the Crimean War, the British announced their intention not to issue letters of marque. British and Foreign State Papers, vol 46, at 36 and Stark, *op cit*, n 53, at 139.

⁶⁸ Halsbury, *op cit*, n 3, vol 36(2), para 801 “Prize is the term applied to a ship or goods captured by the maritime forces of a belligerent at sea or seized in port.” Para 809 “capture is lawful from the outbreak of war.”

⁶⁹ *Ibid*, para 814 & vol 36(2), para 846.

⁷⁰ *Ibid*, vol 49(1), para 402 who note that “reprisals are a method of retaliation for a breach of international law by means of action which would in other circumstances be itself an unjustifiable breach of international law.”

⁷¹ OED, *op cit*, n 55, “The privilege granted by a sovereign or other competent authority, of being protected from arrest or molestation while making a particular journey or travelling within a certain region.” Also “a document by which this privilege is conveyed.” Walker, n 43 (definition of letter of safe conduct). “A protection granted under the great seal and enrolled in chancery which might be granted to an enemy alien to travel on the high seas, enter the realm, or have his goods transported free from liability to seizure.” This is incorrect in that it was also granted to subjects, and to aliens who were not enemies. See generally, D Turack, *Early Restrictions on Travel* in C H Alexandrowicz (ed), *Studies in the History of the Law of Nations*. Grotian Society Papers 1968, p 142; D Williams, *British Passports and the Right to Travel* (1974) 23 ICLQ at 642–56 and K Kim, *Aliens in Medieval Law: The Origins of Modern Citizenship* (Cambridge University Press, 2000).

⁷² W Blackstone, *Law Tracts* (Oxford, Clarendon, 1762) vol 2, at xxiii mentions King John [1199–1216] giving letters of safe conduct to his barons in 1215 as well as, p lii, letters of protection and safe conduct to Prince Louis of France in 1217. TH Riley, *Chronicles of Mayors and Sheriffs of London* (London, Trubner, 1863), at 83 mentions Henry III (1216–72) giving letters of safe conduct to the mayor and citizens of London in 1265. For a reference in the time of Elizabeth I [1558–1603], see *Reports from the Lost Notebooks of Sir James Dyer*, Selden Society, vol 109, at 256–7 (concerning a foreign Queen, Mary of Scots, coming into England by safe conduct and protection). The Parliament Rolls (*op cit*, n 53) also make frequent mention of letters of safe conduct.

(especially alien merchants) had no status in the eye of the law and they held their privileges from the sovereign.⁷³ Magna Carta 1215 mentions protection being given to foreign merchants, chapter (section) 41 providing:

All merchants shall have safe and secure exit from England, and entry to England, with the right to tarry there and to move about as well by land as by water, for buying and selling by the ancient and right customs, quit from all evil tolls, except (in time of war) such merchants as are of the land at war with us. And if such be found in our land at the beginning of war, they shall be detained, without injury to their bodies or goods, until information be received by us, or by our chief justiciar, how the merchants of our land found in the land at war with us are treated; and if our men are safe there, the others shall be safe in our land.⁷⁴

During wartime, enemy aliens were particularly at risk of losing their lives and goods and letters of safe conduct were given to enable them to enter the realm and to travel within.⁷⁵ Only the sovereign could issue letters of safe conduct.⁷⁶ Writing in 1765, Blackstone stated:

Upon exactly the same reason stands the prerogative of granting safe conducts [*ie* it is derived from the prerogative of making war], without which by the law of nations no member of one society has a right to intrude into another . . . no subject of a nation at war with us can, by the law of nations, come into this realm, nor can travel himself upon the high seas, or send his goods and merchandize from one place to another, without danger of being seized by our subjects, unless he has letters of safe conduct; which by divers ancient statutes⁷⁷ must be granted under the king's great seal and enrolled in chancery, or else are of no effect: the king being supposed the best judge of such emergencies, as may deserve exception from the general law of arms.⁷⁸

In Victorian times, passports superseded letters of safe conduct. Chitty noted in 1820 that:

As conductor of a war, the king is also entitled to adopt measures to prevent the egress or ingress of his enemies out of or into his majesty's dominion . . . his majesty may . . . permit an enemy to come into the country without molestation by granting him letters of safe conduct. These letters ought to be under the great seal and enrolled in chancery. But passports under the king's sign manual or licences from his ambassadors abroad are now more usually obtained, and are allowed to be of equal validity.⁷⁹

⁷³ McKechnie, *Magna Carta* (Glasgow, J Maclehose, 1914), at 399 (speaking of the reign of King John [1199–1216] “The control of commerce was reserved for the king's personal supervision: no binding rule of law or traditional usage trammelled him in his dealings with foreign merchants, who are dependent on royal favour, not on the law of land, for the privilege of trading and even for personal safety. No alien could enter England or leave it, nor take up his abode in any town, nor move from place to place, nor buy and sell, without paying heavy tolls to the king. This royal prerogative proved a profitable one.” *Ibid.*, at 398–407. Also, F Pollock & F W Maitland, *The History of English Law before the Time of Edward I* (Cambridge University Press, 1968), vol 1, at 458–67.

⁷⁴ Magna Carta 1215, c 41 (rep).

⁷⁵ *Calvin's Case* (1608) 7 Co 1a at 21b (77 ER 377). The subject of a king in amity with the king of England did not need a letter of safe conduct or licence. However, a sovereign in amity did (Coke cited the safe conduct given to the King of Man by Henry III in 1350). So too, in ancient times, did ambassadors.

⁷⁶ *Ibid.*, at 25b “The king only . . . may make . . . letters of safe conduct.” Breaching a letter of safe conduct was treason, 2 Hen V c 6 (1414) (rep). Further, letters of marque could be granted, 4 Hen V st 2 c 6 (1416) (rep).

⁷⁷ He cited 15 Hen VI c 3 (1436) (rep) (letters of safe conduct had to express the name of the ship, master, number of mariners and the portage of the ship); 18 Hen VI c 8 (1439) (rep) (merchants may take ships of enemies not having letters patent of safe conduct on board or enrolled in chancery); 20 Hen VI c 1 (1441–2) (rep) (letters of safe conduct had to be enrolled upon record in chancery or else they were void, and the goods were lawful prize); 31 Hen 6 c 4 (1452) (rep) (if a subject attaches the person or goods of anyone who has a letter of safe conduct, the lord chancellor calling to him any justice of the one bench or of the other on a bill of complaint, may make process against the defender and may award delivery and restitution of the person, ship or goods); 14 Edw 4 c 4 (1474) (rep) (confirms previous Acts). See also Viner (1735), *op cit*, n 13, vol 16, at 599 and Comyns (1822), *op cit*, n 13, vol 7, at 45.

⁷⁸ Blackstone, *op cit*, n 2, vol 1, at 251–2. See also Brecknock, *op cit*, n 11, at 74–5.

⁷⁹ Chitty, *op cit*, n 8, at 48–9. Repeated by Stephen (in 1842), *op cit*, n 64, vol 2, at 517.

Over the centuries, letters of safe conduct were no longer issued to subjects but only to aliens and in wartime. When such letters were last issued by the Crown, under the great seal, is uncertain.⁸⁰ However, it is likely before the Aliens Registration Act 1836 (see below). It is asserted the Crown prerogative to issue letters of safe conduct is no longer required, for the following reasons:

- (a) Since 1793, aliens arriving in England were required to obtain from the mayor, chief magistrate or justice of the peace of the county *etc* a 'passport' containing their name and description.⁸¹ And, since 1798, no alien could depart from the realm without a 'passport' from one of his principle secretaries of state.⁸² In 1836, the Aliens Registration Act of that year required aliens entering the country, to present at British ports, any 'passport' which might be in their possession (or to make a declaration as their nationality and country of departure).⁸³ The First World War produced regulations prohibited aliens from landing, or embarking, from the UK, without a passport.⁸⁴ This continued after the War.⁸⁵ Thus, letters of conduct have been superseded by the passport *vis-a-vis* permitting an alien to enter the country – whether during wartime or peacetime. It should be noted that a letter of safe conduct is not the same as a passport⁸⁶ – although they were similar in nature until about 1826;⁸⁷
- (b) The purpose of letters of safe conduct was mainly to enable foreign merchants to enter the realm without risk of their goods being seized (especially when the law of marque and reprisal also prevailed). Today, there is no need for this, since there is no legal distinction drawn between a subject and an alien in respect of property rights (whether in peace or wartime) in the absence of legislation;
- (c) Provision for the terms of entry into the UK by aliens (including enemy aliens) has long been a matter of legislation, not Crown prerogative. There is no need for the latter in this area of law.

⁸⁰ Coke, *op cit*, n 3, vol 4, at 152 mentions James I (1603–25) issuing a letter of safe conduct to Samuel Palache (ambassador to Morocco) on 25 October 1613.

⁸¹ 33 Geo III c 4 (1793) (rep). See also K Diplock, *Passports and Protection in International Law* (1947) The Grotius Society, vol 32, at 46–7.

⁸² 38 Geo III c 50 (1798) (rep). See also Diplock, *op cit*, n 81, at 47. For the legal position until 1826, see at 48–9 (passports were issued to aliens during time of war and certificates of entry by Customs during peace time).

⁸³ 6 & 7 Will IV c 11 (rep by Aliens Act 1905, s 10 (2)). Between 1836–1914, it seems, there was no legal requirement on a British subject to have a passport – although a visa system operated between Britain and some European countries.

⁸⁴ Defence of the Realm (Consolidated Regulations) of 28 November 1914 (passed under the Defence of the Realm Consolidation Act 1914), reg 14C (prohibited aliens from landing, or embarking, without a passport). See also C Cook, *Defence of the Realm Manual* (Stationary Office, 6th ed, 1918), p 107. Prior to this, on the outbreak of war, the Aliens Registration Order 1914 reg 3, prohibited aliens from landing in the UK 'unless provided with a permit issued by the Secretary of State for Foreign Affairs.' Thus, the permit and passport replaced the letter of safe conduct. Further, the authority was Parliament and not the Crown prerogative (the Aliens Restriction Act 1914 expressly giving power to his majesty in time of war, imminent national danger or great emergency by order in council to impose restrictions on aliens – including in relation to their landing and departure).

⁸⁵ The Aliens Order 1920 no 488 required aliens entering, or leaving, the UK to present to customs a passport (or other identity document). They were then issued with a certificate by Customs, which they surrendered on leaving the UK.

⁸⁶ Noted by E de Vattel in his *Droit des Gens* (1856, rep by the Liberty Fund), book 3, ch 17, s 265 'Safe conducts and passports are a kind of privilege ensuring safety to persons in passing and repassing, or to certain things during their conveyance from one place to another . . . the term 'passport' is used, on ordinary occasions, when speaking of persons who lie under no particular exception as to passing and repassing in safety, and to whom it is only granted for greater security, and in order to prevent all debate, or to exempt them from some general prohibition. A safe conduct is given to those who otherwise could not safely pass through the places where he who grants it is master; as, for instance, to a person charged with some misdemeanor, or to an enemy.' See also Diplock, *op cit*, n 81, at 46 (citing 1758 ed).

⁸⁷ Diplock, *op cit*, n 81, at 48 "At the beginning of the 19th century a 'passport' meant 'a written permission given by a belligerent to enemy subjects or others allowing them to travel in his territory or enemy territory occupied by him.'"

In conclusion, letters of safe conduct should be abolished as a Crown prerogative, being replaced by the passport.

PREROGATIVE TO PROHIBIT SUBJECTS FROM GOING ABROAD⁸⁸

It is remarkable that, in modern times, the Crown can still prohibit subjects from leaving the UK, and that it need give no reason. Further, that it is a crime – contempt of the sovereign – for a subject to disobey.

Prerogative to Prohibit: Pre-1290

Blackstone, writing in 1765, stated that:

By the common law,⁸⁹ every man may go out of the realm for whatever cause he pleaseth, without obtaining the king's leave; provided he is under no injunction of staying at home; (which liberty was expressly declared in King John's [1199–1216] great charter,⁹⁰ though left out in that of Henry III [1216–72]) but, because that every man ought of right to defend the king and his realm, therefore the king at his pleasure may command him by his writ that he go not beyond the seas, or out of the realm without licence; and if he do the contrary, he shall be punished for disobeying the king's command.⁹¹

The position on the freedom of English citizens to travel abroad in early times is complex. It is unclear whether the common law allowed subjects to travel abroad without any licence from the sovereign.⁹² Turack maintains that clerics needed the licence of the sovereign from the time of William I (1066–87) onwards, and asserts that this also applied to subjects generally.⁹³ However, this appears to conflict with the Constitutions of Clarendon 1166 which provided:

It is not permitted the archbishops, bishops and priests of the kingdom to leave the kingdom without the lord king's permission. And if they do leave they are to give security, if the lord king please, that they will seek no evil or damage to king or kingdom in going, in making their stay, or in returning.⁹⁴

As Beames notes, *if* it had been unlawful for any subject to go abroad without the sovereign's licence, the Constitutions would not have needed to make specific provision

⁸⁸ See generally, J Beames, *The Writ of Ne Exeat Regno* (New York, 1821; Diplock, n 81; N W Sibley, *The Passport System* 7 Journal of the Society of Comparative Legislation NS (1906), at 32; Turack, *op cit*, n 71; C M Whelan, *Passports and Freedom of Travel: The Conflict of a Right and a Privilege* (1952) 41 Georgetown Law Journal 63 and Williams, *op cit*, n 71. All the material in these articles is dated and none contains a detailed analysis of the Crown prerogative. See also J Torpey, *The Invention of the Passport* (Cambridge University Press, 2000).

⁸⁹ He cited Fitzherbert's *New Natura Brevium* 1534 (see n 107) as authority.

⁹⁰ Magna Carta 1215, c 42 (rep) 'It shall be lawful in future for any one (excepting always those imprisoned or outlawed in accordance with the law of the kingdom, and natives of any country at war with us, and merchants, who shall be treated as is above provided)[see Magna Carta c 27, n 72] to leave our kingdom and to return, safe and secure by land and water, except for a short period in time of war, on grounds of public policy – reserving always the allegiance due to us'. See also McKechnie, *op cit*, n 73, at 407–11.

⁹¹ Blackstone, *op cit*, n 71. However, he mainly concentrates on clerics and the position on subjects in general (particularly unimportant ones) is less clear.

⁹² Turack, *op cit*, n 71, at 157–8 cites early forms of the licence. *eg* one issued by King John (1199–1216) "John, by the grace of God, king & etc, to all his faithful subjects. Know ye, that we have given licence to Sampson, the bearer of these presents, to go to Nantes and there to purchase lampreys for the use of the countess of Blois. These letters are to be valid for one journey only and no more. Witness ourself at Bauge, on [12 January, 1202]."

⁹³ See Turack, *op cit*, n 71. However, he mainly concentrates on clerics and the position on subjects in general (particularly unimportant ones) is less clear.

⁹⁴ Constitutions of Clarendon 1166, art 4. See also McKechnie, *op cit*, n 73, at 408 and Turack, *op cit*, n 71, at 151–2. Glanvill, *Treatise on the Laws and Customs of the Realm* (c 1189, trans GDG Hall, Nelson, 1965), at 14 mentions an essoin for being overseas (including on pilgrimage, at 16) without any mention of the need for a licence. Cf. at 16 (if with abroad the sovereign, must show writ to claim essoin).

for clerics.⁹⁵ Further, even in respect of clergy, the prohibition was temporarily lifted by Magna Carta, chapter (section) 42.⁹⁶ That said, this chapter was omitted in the re-issue of Magna Carta in 1216 and it seems clear that Henry III (1216–72) fined laity and clergy who left the country without his licence.⁹⁷ Britton (writing c 1290) mentions a Crown prohibition on great men going abroad without licence.⁹⁸ In conclusion, up to 1290, clerics and important people needed the sovereign's licence to go abroad. As for ordinary subjects, the position is less certain, it seems, being dependent on the whim of a particular sovereign.

Prerogative to Prohibit: 1290–1765

The reigns of Edward II (1307–27) and Edward III (1327–77) indicate the use of mandates and proclamations to prevent particular subjects and, at times, subjects in general for leaving the realm without licence.⁹⁹ This is not especially surprising, since both sovereigns faced situations of emergency: the first civil war, the second the Black Death (1347–50) where there was concern about a shortage of labour and of people taking their skills, and money, out of the realm.¹⁰⁰ In particular, in 1352, Edward III proclaimed that no earl, baron, knight, man of religion, archer or labourer should leave the realm on pain of arrest or imprisonment.¹⁰¹ An Act of 1382 (repealed in 1606) stated the position legislatively. It prohibited subjects from going abroad (including clerics) without licence from the sovereign on pain of forfeiture of all their goods “*except only the lords and other great men of the realm, and true and notable merchants, and the king's soldiers.*”¹⁰² (italics supplied)

There arose uncertainty as to what this legislation actually meant. However, by 1570, the courts seem to have resolved that this Act of 1382 did not actually prohibit all subjects from going abroad without a licence – despite its wording.¹⁰³ As to the

⁹⁵ Beames, *op cit*, n 88, at 2.

⁹⁶ See *op cit*, n 90.

⁹⁷ McKechnie, *op cit*, n 73, at 408 and Turack, *op cit*, n 71, at 159–61. See also Coke, *op cit*, n 3, vol 3, at 178 who cites the case of William Marmion in 1222–3 (a cleric fined for going to France without the licence of Henry III (1216–72)).

⁹⁸ Britton, (c 1290, trans F M Nichols, John Byrne & Co, 1901), at 605 “For no great lord or knight of our realm ought to travel forth of it without our licence, since by that means the kingdom might be left destitute of able persons.” See also Blackstone, *op cit*, n 2, vol 1, at 256 and Coke, *op cit*, n 3, vol 3, at 179. *Fleta* (c 1290), Selden Society, vol 99, at 122 “If anyone wishes to cross over [the sea] at another time, [ie when the sovereign is not himself on pilgrimage] he will do this unwisely unless he sets forth by leave of the prince.”

⁹⁹ Turack, *op cit*, n 71, at 162, citing a mandate of Edward I (1272–1307) to the Warden of the Cinque Ports in 1304 to prevent the departure of knights and esquires who might leave the realm. Also, mandates and proclamations of Edward II in: 1309 (against nobles), 1317 (no subjects, without special licence), 1321 (knights or men at arms), 1325 (clerics), 1326 (no subjects save for merchants) from leaving the realm. Also, proclamations of Edward III (1327–77) in 1327 (no religious, if without licence and no merchants until they joined the staple), 1329 (no person without special licence), 1331 (no men at arms, horses and armour without special licence), 1336 (no religious), 1341 (no earl, baron, soldier or other man at arms without leave). See also Hale, n 11, at 296. An Act of 1335 (9 Ed 3 st 2 c 8) prohibited pilgrims from going abroad save ‘only at Dover’, on pain of a year's imprisonment.

¹⁰⁰ Turack, *op cit*, n 71, at 164 citing proclamations of Edward III in 1348 (no subjects), 1349 (no subjects except merchants, notaries or the king's envoys), 1350 (no subjects). An Act of 34 Edw 3 c 12 (1360) (rep) prohibited subjects from carrying corn into a foreign country.

¹⁰¹ See Coke, *op cit*, n 3, vol 3, at 179, citing Close Roll of 25 Edward III (1352). See also McKechnie, *op cit*, n 73, at 409. Coke cited the case of Matthew Gournay (also spelt Gournay and Gourney). A freebooter (mercenary), he went abroad in 1366 contrary to a writ of Edward III prohibiting him from doing so and from serving in foreign wars. See Oxford Dictionary of National Biography (ODNB). See also Hale, *op cit*, n 11, at 270.

¹⁰² 5 Ric 2 st 1 c 2 (rep, 1606). R Crompton, *Star Chamber Cases*, FF Heard (ed) (Soule & Bugbee, Boston MA 1881) refers to Philip Howard, 13th Earl of Arundel (1557–95). In May 1586, he was fined £10,000 by the Star Chamber for going abroad without the licence of Elizabeth I (1558–1603), contrary to this Act (also for claiming the title to the Dukedom of Norfolk and intriguing with the those who had been declared the Queen's enemy). He was later executed as a traitor. See also ODNB, *op cit*, n 101. For William Barlow, see *op cit*, n 103.

¹⁰³ The Act of 1382 appears to reverse the position in respect of great men and soldiers from that stated by Britton and the proclamation of 1352. McKechnie, *op cit*, n 73, at 409, was dubious this was the actual position. In Selden Society, *Reports from the Lost Notebooks of Sir James Dyer* (ed J H Baker), vol 109, at lxxv it appears the Act of 1382 was construed in the early years of Mary (1553–8) to prohibit citizens in general from going abroad without a licence. For example, Dr William Barlow (later bishop of Chichester) was committed to the Tower of London in 1553 for going

sanction for disobeying a royal prohibition on going abroad, at a meeting of judges (probably in Sargeant's Inn) in 1556, it was clarified that:

if anyone goes across the sea without the king's leave, or goes with the king's leave but the king afterwards by his letter commands him for certain causes to return to [this] realm, and he does not return upon this command, but is in contempt of the said command, the king may for this contempt seize his goods and lands into his hands and retain them until the party thus in contempt returns and [submits to justice], and submits to the king's grace for his contempt, and sues the lands out of the king's hands by livery or ousterlemain without issues: as appears by various precedents in the lord king's exchequer; which were shown to the said justices, such as the case [in 1326] of Lord Woodstock, earl of Kent,¹⁰⁴ and that was without any office previously found thereof, but only upon the contempt returned and appearing of record.¹⁰⁵

The right of the Crown to prohibit a subject from leaving the realm was supported by Fitzherbert in his *New Natura Brevium* (1534). He declared:

By the common law every man may go out of the realm to merchandise, or on pilgrimage, or for what other cause he pleaseth, without the king's leave; and he shall not be punished for so doing: but because that every man is of right for to defend the king and his realm, therefore the king at his pleasure by his writ may command a man that he go not beyond the seas, or out of the realm, without licence; and if he do the contrary, he shall be punished for disobeying the king's command.

And it seemeth that this command may be made by the king's writ¹⁰⁶ under the great seal, and also under the privy seal, or his signet; for by the law the subject is bounden to take notice of every of the king's seals in such case, as well as of the great seal.¹⁰⁷ (wording divided for ease of reference).

The Act of 1382 was repealed in 1606.¹⁰⁸ There were also a number of Acts in the period 1382–1627 which restricted the right of subjects to travel abroad in respect of designated persons, all of which have been long repealed.¹⁰⁹ Coke (his work being

abroad without a licence from Mary I (1553–8). See ODNB, *op cit*, n 101. See also 2 Dyer 165(b) (1559) (73 ER 360). However, by 1570, it seems the Act of 1382 was interpreted to allow all subjects to go abroad *unless* prohibited, see *Anon* (1570) 3 Dyer 296a (73 ER 664). The early precedents as to whether a subject needed a licence – or not – to go abroad were rehearsed in *R v Earl of Nottingham & Oths* (1610) Lane 43 (145 ER 284).

¹⁰⁴ See *op cit*, n 139.

¹⁰⁵ *Reports of William Dalison*, Selden Society, vol 124, at 101 (1556). Also reported in 2 Dyer 176 (1556) (73 ER 280) "it was moved, that if the queen send a special mandate under the privy or great seal to any of those who are now in parts beyond sea, and who departed out of the kingdom without licence so that they shall return into the kingdom at a certain day upon pain *etc* and they refuse to come, their lands and chattels shall be seised to the use of the queen for the contempt. And a notable precedent was shown of such a matter in 12 Edw 2 in the exchequer against the earl of Richmond called William of Brittany, who was sent for into Gascony by the king, and refused to return into the kingdom at the king's command, whereupon his goods and chattels, lands and tenements were commanded to be seized into the hand of the king *etc*." For the reference to William of Brittany (likely a mis-reference to John of Brittany) see *op cit*, n 140.

¹⁰⁶ The writ in the time of Fitzherbert was *Breve de securitate in veniendi quod se non divertet ad partes externas sine licencia regis*. See also Turack, *op cit*, n 71, at 154. This writ was already obsolete in Coke's time (as McKechnie notes, *op cit*, n 73, at 410). It was replaced by the writ *ne exeat regnum*, the origin of which writ is obscure. Beames, *op cit*, n 88, at 9,15 thought it was derived from the writ *Breve etc* in so far as it related to clergyman (for the form of that writ see Fitzherbert, *op cit*, n 20, 85). In support of this he cited W Brown, *Praxis Almae Curiae Cancellariae* (4th ed, 1725), at 135. Cf. Hale, *op cit*, n 11, at 270 who thought the writ *ne exeat regno* originally rested on an information. See also Stephen, *op cit*, n 64, vol 2, at 439–40. T. Gurdon, *The History of the High Court of Parliament* (London, R Knaplock, 1731), vol 1, at 134 stated 'The writ *ne exeas regnum* is grounded upon [the] Statutes of Clarendon.' (see, *op cit*, n 94).

¹⁰⁷ Fitzherbert, *op cit*, n 20 at 85. He referred to 2 Dyer 165b (1559) ((73 ER 360), see *op cit*, n 103).

¹⁰⁸ 4 Jac 1 c 1. For the reason, see McKechnie, *op cit*, n 73, at 409.

¹⁰⁹ eg 12 Ric 2 c 15 (1388) (no one to go abroad to provide or purchase a benefice of the holy church without special leave of the sovereign); 13 Eliz c 3 s 5 (1571) (any subject leaving the realm without licence under the great seal, privy seal or privy signet forfeited his personal estate and the profits of his land); 14 Eliz c 6 (1572) (explains Act of 1571); 1 Jac 1 c 4 s 5 (1603) & 3 Jac 1 c 5 s 11 (1606) (made provision against the going, or sending, of children to any seminary beyond the sea, and against the departure out of the realm, without licence, of any children not being soldiers, mariners, merchants, or other apprentices or factors for any cause whatsoever); 3 Jac 1 c 4 s 12 (1606) (a felony for a subject to

published in 1641) thought it clear that, with the repeal of the Act of 1382, this still left intact the Crown prerogative to prohibit citizens from going abroad, and to punish them if they did.¹¹⁰ Blackstone (writing in 1765) agreed with Coke (and Fitzherbert) concluding:

undoubtedly if the king, by writ of *ne exeat regnum*,¹¹¹ under his great seal or privy seal,¹¹² thinks proper to prohibit him from so doing . . . and . . . the subject disobeys; it is a high contempt of the king's prerogative, for which the offender's lands shall be seized till he return; and then he is liable to a fine and imprisonment.¹¹³

Thus, by 1570 at least, it seems that the English courts recognised the right of subjects to freely travel abroad *unless* they were prohibited by legislation or royal command.¹¹⁴

Prerogative to Prohibit – Post 1765

After Blackstone wrote, there was little commentary on this prerogative (although it was repeated in subsequent editions of his work). The reason for this is not difficult to determine. The last time a sovereign prohibited a subject from leaving the realm (whether by writ, letter under the great seal, privy seal or privy signet or by way of proclamation) is uncertain. A case mentions James I (1603–25) giving a licence to a subject to leave the realm in 1607 and a refusal to return.¹¹⁵ The last edition of Hawkins in his *Treatise of the Pleas of the Crown* in 1824 does not cite any new cases of persons being prohibited or ignoring the same.¹¹⁶ Nor do subsequent editions of Blackstone (the last edition of which was in 1876). Further, the last case generally for the crime of contempt of the sovereign seems to have been in 1703.¹¹⁷ In 1842, although Stephen quoted Blackstone's words of 1765¹¹⁸ he also noted that the writ of *ne exeat*

leave the realm to serve any prince, state or potentate *etc* not having taken an oath mentioned in the Act) and 3 Car 1 c 2 (1627) (restrained the passing, or sending, of any to be popishly bred beyond the seas).

¹¹⁰ Coke, *op cit*, n 3, vol 3, at 178 “the inferior laity may go without licence, if they travel not to the aforesaid prohibited ends” (prohibited ends being contrary to legislation or the sovereign's command). Coke cited Fitzherbert's *New Natura Brevium* (see *op cit*, n 107). Hale (writing in the 1640's), *op cit*, n 11, at 270 “At common law any person might pass the seas without licence till prohibited.” F Bacon, *Cases of Treason* (pub 1641 by the assigns of J Moore), at 180 “The king may constrain the person of any of his subjects not to go out of the realm at all. See also *Boyle v Scarborough* (1655) Style 442 (82 ER 846) and Brecknock, *op cit*, n 11, at 81.

¹¹¹ Also referred to as *ne exeas regnum* and *ne exeat regno*. It could be issued against clerics and laity, see Coke, *op cit*, n 3, vol 3, at 53.

¹¹² The privy seal has been abolished. Noted by Halsbury, *op cit*, n 3, vol 8(2), para 815.

¹¹³ Blackstone, *op cit*, n 2, vol 1, at 256–7. See also vol 1, at 133 “The king indeed, by his royal prerogative, may issue out of his writ *ne exeat regnum*, and prohibit any of his subjects from going into foreign parts without a licence. This may be necessary for the public service, and safeguard of the commonwealth.” Also, vol 4, at 122 “by letters from the king to a subject commanding him to return from beyond the seas (for disobedience to which his lands shall be seized till he does return, and himself afterwards punished) or by his writ of *ne exeat regnum*, or proclamation, commanding the subject to stay at home.” See also Bacon, *op cit*, n 13, at 522–4.

¹¹⁴ Williams, *op cit*, n 71, at 654 stated that “The earlier position in law was that the subject needed a royal licence to leave the realm”. However, this statement is too general in purport. Further, his article failed to analyze relevant legal texts, case law and legislation.

¹¹⁵ *R v Nottingham & Others* (1610) 43 Lane (145 ER 284) discussing the case of Sir Robert Dudley (1574–1649). He was given a licence by James I (1603–25) to go abroad. It was revoked on 2 February 1607 and he was ordered to return by privy seal on 10 April 1608 on pain of forfeiture of his lands and fortunes. It seems Dudley refused to accept the revocation on the basis it did not style him the Earl of Warwick. This angered James I who ordered a sequestration of his house at Kenilworth. See ODNB, *op cit*, n 101. Also, Bacon, *op cit*, n 13, at 525. A charter for Maryland in 1632 allowed persons to voyage there, subject to a proviso that none of the travellers be specially restrained by the king. Williams, *op cit*, n 71, at 645.

¹¹⁶ Hawkins (last ed, 1824), vol 1, at 65, it was a contempt of the sovereign if a person “[goes] beyond sea against the king's will expressly signified, either by the writ *ne exeat regnum* (which may be directed as well to a layman as to a clergyman, and on the suggestion of a private as well of a public matter) or under the great or privy seal or signet or by proclamation.” This was the same wording as in the first edition of Hawkins in 1716.

¹¹⁷ GS McBain, *Abolishing Some Obsolete Common Law Crimes* (2009) *King's Law Journal* 89 at n 110 citing *R v Taylor* (1703) 2 Ld Raym 879 (92 ER 88).

¹¹⁸ Stephen, *op cit*, n 64, at 525.

regno was no longer used as a Crown (State) writ but between private parties only.¹¹⁹ Similarly, McKechnie, in 1914, said this writ was still in use in his time but it had ceased to be an engine of royal tyranny and that it was:

never issued except as part of the process of a litigation pending in the court of chancery. Regarded with suspicion by the courts of common law, it was for centuries the special instrument which prevented parties to a suit in equity from withdrawing to foreign lands. Some uncertainty exists as to the proper province of these writs since the Judicature Acts have merged the court of Chancery in the High Court of Justice.¹²⁰

Holdsworth considered that the writ of *ne exeat regno* ceased to be used after 1688 as a State writ.¹²¹ In respect of the current position as to the ability of the sovereign to prohibit a subject from going abroad, Halsbury states:

There is authority for the use of proclamations in wartime¹²² to restrain any persons or classes of persons from leaving the country. The common law writ of *ne exeat regno* might possibly also still be used as a state writ to prevent departure from the country in time of war¹²³ . . . In anticipation of the outbreak of war in 1939 the Crown's prerogative powers were augmented by wide powers to make defence regulations by Order in Council, and those powers were used to control the departure of . . . British subjects from the country.¹²⁴

Halsbury is not very accurate, since the sovereign could, by virtue of the Crown prerogative, prohibit a subject from leaving the country both in wartime and in *peacetime*. Further, as noted below, the writ generally has been abolished.

¹¹⁹ *Ibid*, at 525, n (d) "This writ is not now used for state purposes, but has become a mere process between private parties in an equity suit, and is used where one party wishes to prevent the other from withdrawing his person or property from the jurisdiction of the court, by going abroad." When this happened is uncertain, see *Flack v Holm* (1820) 1 Jac & W 405 (37 ER 430), p 414 per Lord Eldon; *Ex p Brunner* (1734) 3 P Wms 312 (24 ER 1079) (citing Lord Bacon's Ordinances, No 89); *Mead's Case* (1633-4) cited in *Read v Read* (1668) 1 Chan Cas 114 (22 ER 720); *Sands v Child* (1693) 4 Mod 177 (87 ER 332) and *Goodman v Sayers* (1821) 5 Mod 471 (56 ER 975). Lord Bacon's Ordinances (issued 1642) no 89 stated "Writs of *ne exeat regno* are properly to be granted according to the suggestion of the writ, in respect of attempts prejudicial to the king and state in which case the Lord Chancellor will grant them upon prayer of any of the principal secretaries, without showing cause, or upon such information as his lordship shall think of weight. But otherwise they also may be granted according as of long time used, in the case of interlopers in trade, great bankrupts in whose estates many subjects are interested, or other cases that concern multitudes if the king's subjects, also in case of duels, and divers others." See also Halsbury, *op cit*, n 3, vol 8 (2), para 815, fn 2 and J Story, *Equity Jurisprudence* (2nd ed, 1839), vol 2, at 685-93. For the resuscitation of this writ between private parties, see L Anderson, *Antiquity in Action: Ne Exeat Regno* (1987) 104 LQR 246.

¹²⁰ McKechnie, *op cit*, n 73, at 410.

¹²¹ Holdsworth, *op cit*, n 9, vol 10, at 391-2. Diplock, *op cit*, n 81, at 44 (writing in 1946) stated that the prerogative power to issue a writ of *ne exeat regnum* had lapsed 'through desuetude.' See also S Theloall, *Registrum Brevium* (London, 4th ed 1687), Appendix, at 54-5.

¹²² Halsbury, *op cit*, n 3, vol 8(2), para 815. Halsbury fails to identify the proclamations; and which applied just to subjects. In early times proclamations prohibited subjects from going abroad on the basis of the Crown prerogative. In Tudor times, it seems proclamations were rarely used, cf. Hughes & Larkin, *op cit*, n 122, at 52-4 (1499 proclamation forbidding ships to carry unlicensed passengers, excepting merchants). Instead, legislation (the Act of 1382) or writ was used. In more recent times, in World War I, the Defence of the Realm (Consolidated Regulations), reg 14 G prohibited subjects (save for military and other authorised personnel) from embarking from any UK port to go abroad without the permission of an aliens officer – provided that, in granting or refusing permission, the same "shall act in accordance with the general or special instructions of the Secretary of State and any refusal of permission may be revoked by a secretary of state". See also C Cook, *op cit*, n 84, p 109. Reg 14C prohibited British subjects from embarking without a passport (see n 84) and restricted subjects on entering enemy territory (14F) as well as leaving as a member of the crew of a neutral ship (14D). These powers were all statutory, the regulations being passed under the Defence of the Realm Consolidation Act 1914. For World War II, see Emergency Powers (Defence) Act 1939; it gave powers to His Majesty to make orders in council for the defence of the realm, and regulations thereunder.

¹²³ The writ *ne exeat regno* was not just limited to wartime. See Bridge, *The Case of the Rugby Football Team as the High Prerogative Writ* (1972) 88 LQR 83. Sunkin & Payne (article by R Brazier, *Constitutional Reform and the Crown*), *op cit*, n 2, at 347 "It is legally possible . . . that the Crown (or a Home Secretary) might try to use the prerogative writ *ne exeat regno* to stop a citizen leaving the United Kingdom, at least in time of emergency." Cf. Phillips & Jackson, *op cit*, n 17, at 316 "The prerogative to issue the writ *ne exeat regno* . . . at the instance of a secretary of state is obsolescent."

¹²⁴ Halsbury, *op cit*, n 3, vol 8(2), para 815. See also *op cit*, n 122.

Existence of Prerogative Today

Does such a prerogative exist today at common law? One would argue that it does not, and that this Crown prerogative is obsolete. The following may be noted:

- i. The privy seal has been abolished. So too, the writ (it is now the claim form). Therefore, the writ *ne exeat regno* also appears to have been abolished. As a result, the ability of the sovereign to prohibit a subject from leaving the realm, in modern times, would have to be by way of: (a) a letter issued under the great seal¹²⁵ or; (b) proclamation.¹²⁶ Today, the sovereign would not order the issue of either without the advice of the executive. This being a matter of state control of the free movement of the individual, any limitation should be effected by way of legislation (such as that any restrictions imposed by legislation relating to customs, criminal activity, terrorism *etc*) and not by way of Crown prerogative;
- ii. The Act of 1382, and other legislation, prohibiting a subject from quitting the realm¹²⁷ having long been abolished, there are few (if any) cases where individuals were prohibited post-Tudor times by the sovereign from leaving the realm by exercise of the Crown prerogative;
- iii. The purpose of preventing subjects leaving the realm was the safety of the sovereign (or the country).¹²⁸ The cases were intimately linked to allegiance to the sovereign and, hence, treason.¹²⁹ They also tended to be against specific individuals (when not by way of proclamation or legislation). In particular, those who were perceived as being a direct threat to the safety of the sovereign (in the time of Edward II or in Tudor times).¹³⁰ Today, the prospect of persons leaving the realm in order to plot against the life of the sovereign is most unlikely;
- iv. As Beames (in 1821) noted, the grant by the sovereign of licences to leave the realm was a fruitful source of revenue (*ie* a tax).¹³¹ Thus, the protection of the country (or the sovereign) was not the only motive. Tax raising should only be undertaken by Parliament today;
- v. Disobedience to the command of the sovereign resulted in the crime of ‘contempt of the sovereign’ involving confiscation of lands and/or a fine or imprisonment. It is contended this crime is obsolete – the last case of which

¹²⁵ The Lord Chancellor acts as keeper of the great seal together with the Clerk of Crown in Chancery (who holds the additional office of Permanent Secretary to the Lord Chancellor).

¹²⁶ Fitzherbert, *op cit*, n 20 at 85, “And also the king by his proclamation may inhibit his subjects, that they go not beyond the seas, or out of the realm, without licence, and that without sending any writ or commandment unto his subjects; for perhaps he cannot find his subject, or know where he is, and therefore the king’s proclamation is sufficient in itself”. He cited *Anon* (1570) 3 Dyer 296a (73 ER 664), see *op cit*, n 103. See also proclamation of Edward III in 1352, *op cit*, n 101.

¹²⁷ See *op cit*, ns 102 & 109.

¹²⁸ See citations by Bridge, *op cit*, n 123, at 87–8 including *Anon* (1748) 1 Atk at p 521 (26 ER 329) *per* Lord Hardwicke “to prevent any person from going beyond the sea, to transact anything to the prejudice of the king or his government”. Also, *Flack v Holm* (1820) 1 Jac & W (37 ER 430) *per* Lord Eldon, at 414 ‘intended by the laws for great political purposes and the safety of the country.’

¹²⁹ See, *eg*, *Barlow* (*op cit*, n 103, in 1553), *Bartue* (*op cit*, n 142, in 1555), *Duchess of Suffolk* (*op cit*, n 141, in 1555) – protestants fleeing Mary. Also, *Earl of Arundel* (*op cit*, n 102, in 1588) and *Englefield* (*op cit*, n 145, in 1563) – catholics fleeing Elizabeth I. See also, *Lord Woodstock* (*op cit*, n 139, in 1326) and *John of Brittany* (*op cit*, n 140, in 1326) who opposed Edward II. Cf. *Dudley* (*op cit*, n 115, in 1607) with James II.

¹³⁰ *Bate’s Case* (1606) Lane 22 (145 ER 267) seems to make it clear that the power to prohibit could be extended to any subject, and that it could be with conditions, at 29 “the king may inhibit any man . . . and the reason wherefore any man may be restrained, is for defence of the realm . . . and that appears by the writ *licencia transportandi* in the register which containeth licence for one to travail, and limits him to what place he shall go, and when he shall return, and with what goods;”.

¹³¹ Beames, *op cit*, n 88, at 9 “The granting of these licences was no doubt a fruitful source of revenue.”

appears to have been as long ago as 1703.¹³² Further, this crime is uncertain in scope since the amount of fine (or length of imprisonment) is not stipulated; it is subject to the determination of the judge in the instant case. Such a crime is fundamentally undemocratic in nature and inappropriate to modern times. If really required, legislation should provide for the same;

- vi. The licence (permission) of the sovereign to permit a subject to leave the realm was the forerunner of the passport. In modern times, the entry and egress of individuals is controlled by this method – supplemented by emergency legislation in time of war or terrorism;¹³³
- vii. As Maitland observed in 1908, if the Crown were to try and assert this ancient prerogative, it would likely result in an outcry.¹³⁴ In 1972, Bridge stated much the same;¹³⁵
- viii. The European Convention on Human Rights (ECHR) has been incorporated into English law by the Human Rights Act 1998. Although Protocol 4 to the ECHR has been signed by the UK it has not yet been ratified by the UK. Thus, this Protocol is not part of English law. However, it may be noted that, Article 2(2) provides: ‘Everyone shall be free to leave any country including his own.’ Article 2 (2) is subject to exceptions.¹³⁶ Having regard to those exceptions, it is asserted that a blanket Crown prerogative to prohibit a subject from leaving the country is not necessary for the: (a) protection of the rights and freedoms of others; (b) national security or public safety; (c) maintenance of *ordre public*; (d) prevention of crime.¹³⁷ Nor is it justified by the ‘public interest in a democratic society.’¹³⁸ Thus, if the UK ratifies Protocol 4, then this Crown prerogative likely conflicts with it;
- ix. Today, any prohibition on a subject from freely leaving the country (and making disobedience to it, a crime) should be by way of Parliamentary legislation, if really required, with the imposition of any such prohibition being much more limited in scope than the present Crown prerogative.

¹³² See *op cit*, n 117.

¹³³ *eg* Prevention of Terrorism (Temporary Provisions) Act 1989, s 7(1) “If the Secretary of State is satisfied that any person (a) is or has been concerned in the commission, preparation or instigation of acts of terrorism to which this Part of this Act applies; or (b) is attempting to or may attempt to enter Great Britain or Northern Ireland with a view to be concerned in the commission, preparation or instigation of such acts of terrorism, the Secretary of State may make an exclusion order against him.” Cited in Halsbury, *op cit*, n 3, vol 8(2), para 815. See also Phillips & Jackson, *op cit*, n 17, p 326. For World War I and II, regulations were made under legislation, see 122. Bridge, *op cit*, n 123, at 644 “the Crown possesses adequate and simpler means of controlling the exit of individuals from the country through passport control.”

¹³⁴ Maitland, *op cit*, n 1, at 421 “We find it laid down that if the king, under his great or privy seal, prohibits a man from leaving the realm, or enjoys him to come back from foreign parts, and this command is disobeyed, the disobedience may be punished by fine and imprisonment. I believe that we must say that this is the law, though for a long time past it has not been used, and though any use of it except in very extraordinary circumstances would surprise the nation and create a great outcry.”

¹³⁵ Bridge, *op cit*, n 123, at 92, “It may be concluded that the writ of *ne exeat regno* survives, in so far as its original political use is concerned, more as a historical relic than as a legal tool of any utility. In effect only the Crown may apply for it and the Crown possesses an adequate and simpler means of controlling the exit of individuals from the country through passport control. Not only is there no need in practice for this application of *ne exeat regno* but it is also unlikely to be revived because failure to obey it may be punished by fine and imprisonment and, as Maitland commented over sixty years ago, public opinion would not tolerate the use of such draconic measures.”

¹³⁶ Art 2 (3) “No restrictions shall be placed on the exercise of these rights other than such as are in accordance with law and are necessary in a democratic society in the interests of national security or public safety, for the maintenance of *ordre public*, for the prevention of crime, for the protection of health and morals, or for the protection of the rights and freedoms of others”.

¹³⁷ *Ibid*.

¹³⁸ Art 2 (4) “The rights set forth in paragraph 1 may also be subject, in particular areas, to restrictions imposed in accordance with law and justified by the public interest in a democratic society.”

It is asserted this Crown prerogative is obsolete. If needed in the future (for example, in time of war or emergency) Parliament should legislate for the same.

PREROGATIVE TO ORDER SUBJECTS TO RETURN TO THE REALM

A corollary to the Crown prerogative of prohibiting subjects from going abroad is a Crown prerogative to order a subject to return to the realm. It seems that, from early times, the Crown exercised this prerogative. This is not especially surprising since the feudal concept of allegiance required obedience by the subject to the will of the sovereign and the right to protection by the same in return. As previously noted the judges in 1556 also held that the sovereign had the prerogative to command a subject to return from abroad.

- (a) Two early cases were cited by the judges by way of precedent. Lord Woodstock, Edmund Plantagenet (1301–30)¹³⁹ refused to return from France in 1325 on the command of Edward II being an ally of the wife of Edward II (Isabella) and her lover Roger Mortimer, Earl of March who later deposed Edward II. Woodstock's lands in England were seized in March 1326. However, they were later restored to him, on Edward II being deposed;
- (b) John (not William) of Brittany in 1326 also sided with Isabella and Mortimer.¹⁴⁰ On 2 January 1326, Edward II ordered the seizure of his lands and, on 13 March 1326, his arrest. His lands were restored on Christmas Day 1326, on Edward II being deposed. Both these individuals opposed Edward II. Therefore, their refusal to return to England should be viewed in the context of treason. On the deposition of the sovereign, their lands were restored to them.

Other cases of a refusal to return, when commanded by the sovereign may be noted.

- (c) The decision of the judges in 1556 may have been to with *Bartue and the Duchess of Suffolk's Case* (1560).¹⁴¹ Richard Bartue (Bertie) was the husband of the duchess.¹⁴² In 1553, he had been given a license by Mary I (1553–8) to go abroad to settle debts. The licence contained a condition that – if he conversed with (protestant) fugitives – the licence would cease. In 1555, Mary sent a messenger to him when he was in Germany with his wife (who had secretly joined him). In a letter sent under her privy seal, she commanded them, on their allegiance, to return to England. The messenger was prevented from meeting them in Germany and the messenger returned to England, certifying that this had occurred and that they had been conversing with fugitives. Their lands were seized in punishment in September 1555.¹⁴³ However, they were restored¹⁴⁴ when they returned to England after Elizabeth I (1558–1603) came to the throne;

¹³⁹ He was the youngest son of King Edward I (1272–1307). See ODNB, n 101. See also Bacon, *op cit*, n 13, vol 5, at 524–5.

¹⁴⁰ John of Brittany, 1st Earl of Richmond (1266?–1334). See ODNB, n 101 and S Phillips, *Edward II* (Yale, 2010), at 492.

¹⁴¹ 2 Dyer 176b (73 ER 388). See also Bacon, *op cit*, n 13, at 525.

¹⁴² Katherine Bertie, duchess of Suffolk (1519–80). A protestant patron, she left England to escape religious persecution under Mary I. For Bertie and her husband Richard (1517–82), see ODNB, *op cit*, n 101.

¹⁴³ JR Dasent (ed) *Acts of the Privy Council*, vol 5 (1892), at 180 (for the duchess of Suffolk).

¹⁴⁴ Calendar of State Papers (Domestic) 1547–1580, at 135. This was not without problems in the case of the duchess of Suffolk, see 93 LQR 34.

- (d) In 1558, Sir Francis Englefield¹⁴⁵ was given a licence by Elizabeth I (1558–1603) to go abroad (on the grounds of ill health) on condition that he avoided the Queen's enemies and returned when summoned. In 1563, by letter under her privy seal, Elizabeth commanded him to return. He did not do so, being a catholic and fearing persecution. His properties under lease from the Crown were seized. In 1587, he was attainted.

In 1641, Coke summarised the position on the Crown prerogative to command subjects to return from abroad:

those of the laity and men of the church also being beyond sea may be commanded by the king's writ, either under the great seal or privy seal,¹⁴⁶ *in fide et ligeantia etc* to return into the kingdom (though he be not there to any of the above said prohibited ends)¹⁴⁷ and if he return not, for his contempt his lands and goods shall be seized . . . the letters under the great seal, or privy seal to recall any from beyond sea, ought to be served by some messenger, who upon his oath is to make a certificate thereof in the chancery, and from thence a *mittimus* to be sent into the exchequer, and thereupon a commission to be granted to seize the lands and goods of the delinquent.¹⁴⁸

Following him, Blackstone (in 1765) stated:

at present every body has, or at least assumes, the liberty of going abroad when he pleases. Yet undoubtedly, if the king . . . sends a writ to any man, when abroad, commanding his return; and in either case the subject disobeys; it is a high contempt of the king's prerogative for which the offender's lands shall be seized till he return; and he is liable to fine and imprisonment.¹⁴⁹

On this authority, Halsbury states that:

The Crown enjoys the right of recalling subjects from abroad by letters under the great seal served by the Queen's messenger, disobedience to which formerly rendered the person's property in the realm liable to seizure under a commission issued by the exchequer until the recall was complied with.¹⁵⁰ This prerogative, so far as it is not obsolete, applies; it seems, either in time of war or in time of peace.¹⁵¹

It is asserted this Crown prerogative is obsolete for the following reasons:

- i. It is uncertain when was the last instance a sovereign commanded a subject to return from abroad (whether by way of proclamation, writ, letter under the privy or great seal). It was likely in Tudor times;¹⁵²

¹⁴⁵ See *Sir Francis Knole's Case* (1581) Dyer 375b (73 ER 841). Also, *Knowles v Luce* (1580) Moore (KB) 110 (72 ER 473) in which Manwood CB referred to *Bartue* (n 141). See also the *Case of Sturton & Mordant* Moore (KB) (1607) 779 (72 ER 901) (in 1576, Englefield had signed a conveyance before witnesses conveying his estates in England to his nephew for life which would revert to their original owner after the presentation of a gold ring to the nephew). An Act of 1593 (35 Eliz c 5) was directed at this 'gold ring' conveyance. See also Hale, *op cit*, n 11, at 271 and Bacon, n 13, at 525–6

¹⁴⁶ The privy seal has been abolished, *op cit*, n 112.

¹⁴⁷ *ie* when there was no restriction on him (or her) going abroad.

¹⁴⁸ Coke, *op cit*, n 3, vol 3, at 179.

¹⁴⁹ Blackstone, *op cit*, n 2, vol 1, at 256. He referred to Hawkins, *Pleas of the Crown* (3rd ed, 1739) ch 22 s 4 "It is also a high crime to disobey the king's lawful commands or prohibitions [by] not returning from beyond sea upon the king's letters to that purpose; for which the offender's lands shall be seized till he return, and when he does return he shall be fined . . .". This was the same wording as in the first edition of Hawkins in 1716 and the last in 1824. See also Bacon, *op cit*, n 13, at 524–6.

¹⁵⁰ Halsbury fails to note that disobedience was also a crime – contempt of the sovereign. See *op cit*, n 117.

¹⁵¹ Halsbury Laws, vol 8(2), para 816. In *HRH Prince Augustus of Hanover v AG* [1955] Ch 440, 447 (at first instance) Vaisey J referred to a previous edition of Halsbury (2nd ed, vol 6, at 530) which contained similar wording. However, he did not discuss it.

¹⁵² Perhaps, *Englefield* (*op cit*, n 145) in 1563. It seems that proclamations were not use in Tudor times against specific individuals (see *op cit*, n 122). Rather, the command of the sovereign for a subject to return from abroad was done more secretly, usually under the privy seal.

- ii. Today, even if it were possible for the sovereign to issue a letter commanding the return of a subject:¹⁵³ (a) the exchequer no longer exists; (b) the privy seal has been abolished; (c) writs have been abolished; and (d) the crime of contempt of the sovereign, it is asserted, is obsolete.¹⁵⁴ If the sovereign were to command a subject to return today it would have to be by way of proclamation or letter under the great seal;
- iii. This Crown prerogative to command the return of a subject applies both during war and peace time and it could apply for whatever reason. It could also apply to any number of people. If such a requirement is necessary today, this should only be by way of Parliamentary legislation (such as it is in relation to the extradition of subjects from foreign countries) and it should be much more limited in scope than the current Crown prerogative. Reference to the ECHR, Protocol 4 may also be made.

It is asserted this Crown prerogative is obsolete. If needed in the future (for example in time of war or emergency) then Parliament should legislate for the same.

PREROGATIVE TO DIG FOR SALTPETRE

Gunpowder, which used saltpetre (potassium nitrate),¹⁵⁵ was an important weapon of war.¹⁵⁶ The crown still has the Crown prerogative to dig for saltpetre on other people's land. Halsbury states:

By prerogative right the crown is entitled to dig for saltpetre in the land of a subject; but this right, being allowed to the crown originally for the defence of the realm in connection with the making of gunpowder, cannot be granted away, demised or transferred. The right is also subject to certain rules for the protection of the owner of the soil. Thus, the Crown may not dig in a man's house, barn or outhouse, or so as to weaken the walls, and the soil must be left as commodious as it was before; nor can the crown restrain the owner of the soil from digging for saltpetre himself.¹⁵⁷

The authority for this is the case of the *King's Prerogative in Saltpetre* (1606).¹⁵⁸ It determined what prerogative the sovereign had in digging, and taking, saltpetre on the land of others, to make gunpowder. In the case, the judges' state:

Although the invention of gunpowder was devised within the time of memory *viz.* in the time of Richard 2 [1377–99], yet inasmuch as this concerns the necessary defence of the realm, he [the sovereign] shall not be driven to buy it in foreign parts; and foreign princes may restrain it at their pleasure, in their own dominions: and so the realm shall not have sufficient for the defence of it, to the peril and hazard of it: and therefore insomuch as saltpetre is within the realm, the king may take it according to the limitations following for the necessary defence of the realm.

There is little law in the case. Rather, it was a judicial decision accommodating a current State interest in securing war munitions, the judges declaring:

¹⁵³ The attachment of the great seal would be by the Lord Chancellor.

¹⁵⁴ See *op cit*, n 117.

¹⁵⁵ OED, *op cit*, n 55, "saltpetre is a white crystalline substance having a saline taste: it is the chief constituent of gunpowder, and is used medicinally".

¹⁵⁶ Encyclopedia Britannica "Black powder was adopted for use in firearms in Europe from the 14th century . . . [it] was not employed for peaceful purposes, such as mining and road building, until the late 17th century. It remained a useful explosive for breaking up coal and rock deposits until the early 20th century, when it was gradually replaced by dynamite for most mining purposes." See also T F Tout, *Firearms in England in the Fourteenth Century* (1911) 26 English Historical Review, at 606–702 and B J Buchanan, *Gunpowder, Explosives and the State: A Technological History* (Aldershot, Ashgate, 2006).

¹⁵⁷ Halsbury Laws, *op cit*, n 3, vol 12(1), para 221. In vol 8(2), para 812, it states "In time of war the Crown may enter on the land of a subject . . . to dig for saltpeter." This is correct. However, this prerogative is not limited to wartime.

¹⁵⁸ (1606) 12 Co Rep 12 (77 ER 1294). See also Coke, *op cit*, n 3, vol 3, at 82–4.

[T]his taking of saltpetre is a purveyance of it for the making of gunpowder for the necessary defence and safety of the realm. And for this cause, as in other purveyances, it is an incident inseparable to the crown, and cannot be granted, demised, or transferred to any other, but ought to be taken only by the ministers of the king (as other purveyances ought) and cannot be converted to any other use than for the defence of the realm, for which purpose only the law gave to the king this prerogative.¹⁵⁹

This right to take saltpetre soon became an object of extortion and the Long Parliament restricted its scope by Ordinances (now repealed).¹⁶⁰ An Act of 1640 permitting the import of saltpetre from abroad.¹⁶¹ The effect of this was that saltpetre was more easily imported from the East Indies, obviating much local demand.¹⁶² By the 19th century, the need to dig for saltpetre was surpassed by chemical processes. It is contented this Crown prerogative is obsolete for the following reasons:

- (a) Saltpetre is no longer used in gunpowder. And the latter is no longer used by the British military as a weapon of war – the basis for the recognition of the prerogative in the first place;¹⁶³
- (b) Digging for saltpetre is a form of Crown purveyance, and purveyances generally were abolished by the Tenures Abolition Act 1660;
- (c) The right of the Crown to saltpetre on other people's land conflicts with the ECHR, Protocol no 1, art 1. It provides that every natural, and legal, person is entitled to the peaceful enjoyment of his possessions.¹⁶⁴ Further, no provision is made for the Crown compensating the landowner in the taking of saltpetre.

It is asserted this Crown prerogative should be abolished, being manifestly obsolete.

CONCLUSION

Crown prerogatives remain obscure.¹⁶⁵ This is not good, since the effect is that many remain beyond Parliamentary scrutiny.¹⁶⁶ Lord Browne-Wilkinson observed:

¹⁵⁹ *Ibid.* Coke says that the first two licences granted were in 1589. One was virtually a monopoly. Given to George Evelyn and others it extended to all the realm of England, Ireland and all the dominions of the sovereign "as well within our own lands, grounds, and possessions, as also within the lands, grounds, and possessions of any of our subjects." This licence was amended in 1605; see Viner, *op cit*, n 13, vol 16, at 568. The Statute of Monopolies 1623 (21 Jac 1 c 3 s 10 (rep) provided that its provisions did not extend to any commission *etc* for saltpetre for making gunpowder.

¹⁶⁰ The Remonstrance of the State of the Kingdom agreed on by the House of Commons in November 1641 referred to the vexation and oppression of salt petre men. See Parliamentary History, vol 10, at 67. Ordinances of 3 April 1644 and 9 February 1652 were passed to limit the effect of the *Case of the King's Prerogative in Saltpetre* (1606). See also Notes and Queries (7 May 1853), 'The Saltpetre Man'.

¹⁶¹ Cf. 1 Jac II c 8 s 3 (1685) (rep) (the importation of saltpetre was prohibited, save from licence from the Crown). See also Clode, *op cit*, n 47, at 15.

¹⁶² C M Hutchinson, *Saltpetre. Its Origin and Extraction in India* (1917). The Ganges Valley was the greatest source of supply of saltpetre into England in the 18th and 19th centuries.

¹⁶³ Halsbury, *op cit*, n 3, vol 12(1), para 221 "this right, being allowed to the Crown ... for the defence of the realm in connection with the making of gunpowder."

¹⁶⁴ "Every natural or legal person is entitled to the peaceful enjoyment of his possessions. No one shall be deprived of his possessions except in the public interest and subject to the conditions provided for by law and by the general principles of international law. The preceding provisions shall not, however, in any way impair the right of a State to enforce such laws as it deems necessary to control the use of property in accordance with the general interest or to secure the payment of taxes or other contributions or penalties." See generally, Janis *etc*, *European Human Rights Law* (Oxford University Press, 2008), ch 10.

¹⁶⁵ Sunkin & Payne, *op cit*, n 2, at 1. *Burmah Oil v Lord Advocate* [1965] AC 75, 148 *per* Lord Pearce "The law and Parliament have so altered and curtailed (and in parts confirmed) the various aspects of the prerogative that the whole subject is obscure and difficult."

¹⁶⁶ *Ibid.*, at 2. "the Crown, or more usually those members of the executive who act in its name, has remained comparatively free from both political controls exerted by parliament and legal controls exerted by the courts. The consequence is that much of what is done in the name of the Crown may be done in what has been described as the dead ground of the

The constitutional history of this country is the history of the prerogative powers of the crown being made subject to the overriding powers of the democratically elected legislature as the sovereign body.¹⁶⁷

In 1908, Maitland talked of prerogatives of ‘*doubtful existence*’ and ‘*prerogatives which exist by sufferance, merely because no one has thought it worth while to abolish them.*’¹⁶⁸ The prerogatives discussed in this article fall into those categories; and the purpose of this article has been to indicate that they are obsolete and unnecessary. In conclusion, Crown prerogatives to:

- i. impress subjects for the navy (no longer applied after 1814);
- ii. issue letters of marque (obsolete after 1856);
- iii. issue letters of safe conduct (obsolete c 1836);
- iv. prohibit subjects from leaving the realm (in abeyance pre-1688);
- v. order subjects to return to the realm (in abeyance pre-1688);
- vi. dig for saltpetre (obsolete by the 19th century, at the latest).

should be abolished. Finally, the House of Commons, Public Administration Select Committee in 2003 in a Report entitled ‘*Taming the Prerogative: Strengthening Ministerial Accountability to Parliament*’¹⁶⁹ expressed concern that, generally, many Crown prerogatives had come to be delegated by the sovereign to ministers and that they could be exercised without parliamentary approval or scrutiny. The Report there also indicated that various prerogatives were in need of reform and others obsolete.¹⁷⁰ Although not specifically referring to the prerogatives addressed in this article, it is likely that they would include the same as being in need of reform or obsolete. One would argue that they palpably fall into the latter category.

constitution, namely the territory which falls beyond the scope of both parliamentary and judicial scrutiny.” The reference to dead ground comes from *Ex p Fire Brigades Union* [1995] 2 All ER 244, 268, *per* Lord Mustill.

¹⁶⁷ *Ex p Fire Brigades Union* [1995] 2 WLR 464, 474. Ridges, *op cit*, n 3, at 183 (writing in 1934), “The history of the prerogative is thus a steady narrowing of its ambit and the substitution in lieu of statutory authority.”

¹⁶⁸ Maitland, *op cit*, n 1, at 421.

¹⁶⁹ Fourth Report of Session 2003–04 (HC 422, published 16 March 2004).

¹⁷⁰ The Report described one of the prerogatives referred to in this article (prerogative to impress men for the navy) as being a legal prerogative, distinguishing it from another (informal) category, executive prerogative (see at 6). This is not really accurate since that prerogative flows from the right to declare war and peace, one which the Report (it is asserted, correctly) categorized as an executive prerogative.

CONTRACTS FOR THE SALE OF LAND AND PERSONAL PROPERTY: THE EQUITABLE INTERESTS OF THE PURCHASER

MARK PAWLOWSKI* and JAMES BROWN**

INTRODUCTION

As property lawyers, we are all familiar with the general principle that a contract for the sale of land, which is capable of specific performance, operates in equity so as to confer a trust on the purchaser pending completion of the sale. Although some controversy exists as to the exact nature of the trust, it is well established that, upon exchange of contracts, equity will “treat that as done which ought to be done”¹ with the consequence that the purchaser acquires equitable ownership even though full (legal) title to the land will not pass until completion (and registration).

As land is unique, specific performance is readily available in the context of sales of land where damages would, clearly, not be an adequate remedy. The same cannot be said for contracts for the purchase of personal property where invariably the subject matter is not unique and where a substitute can easily be acquired in the open market. In circumstances, however, where the property is unique or scarce (for example, a rare painting or vintage car), the maxim that “equity treats as done that which ought to be done” may be invoked so as to confer on the seller an equitable obligation to transfer the property to the purchaser in fulfilment of the contract. Where, therefore, the contract is specifically enforceable in this way, the seller, it is submitted, will again hold the property on trust for the purchaser where, as in a contract for the sale of land, there is an interval between the date of the contract and completion of the sale. The notion that a seller holds personal property upon trust for the purchaser pending completion of the sale is admittedly controversial, but this article seeks to argue that the same principles governing equity’s intervention in sales of land should apply in the context of sales of personalty. It is submitted that equity’s role in imposing a trust on the vendor both in relation to sales of land and personalty may be important in safeguarding the interests of the purchaser prior to, as well as after, completion of the transaction.

VENDOR AS CONSTRUCTIVE TRUSTEE OF LAND

It is well established² that, during the interim period between exchange of contracts and completion, the rights and duties of vendor and purchaser are defined in terms of a trust; the vendor holds the legal estate upon trust for the purchaser and the purchaser becomes a beneficial owner of the land.

Nature of the trust

The exact nature of the trust and the precise moment of its creation, however, has been the subject of some debate. Most agree that the trust operates not by virtue of the

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¹ See, *Walsh v Lonsdale* (1882) 21 Ch D 9.

² See, for example, *Holroyd v Marshall* (1862) 10 HLC 191 and *Lysaght v Edwards* (1876) 2 Ch D 499.

intention of the parties but by operation of law and, therefore, falls to be classified as a constructive trust. In other words, the trust arises on the basis that it would be unconscionable for the vendor to refuse to perform his contractual obligation to transfer the land. This classification, however, is not without its difficulties as a constructive trust normally requires no formality, yet a contract for sale of land will only be enforceable if it is in writing complying with the Law of Property (Miscellaneous Provisions) Act 1989, section 2(1). Thompson, therefore, argues that the trust should be viewed as *sui generis*.³

Timing of the trust

There is also some controversy as to the precise timing of the trust. In *Rayner v Preston*,⁴ Cotton LJ characterised the unpaid vendor as being a trustee “in a qualified sense only”⁵ and Brett LJ expressly rejected the notion that the vendor is a trustee from the time of making the contract. In his view, if that were the true position, then the vendor would be accountable to the purchaser for all rents accrued due and received pending completion, which is clearly not the law. James LJ also considered it inaccurate to treat the vendor as trustee upon the making of the contract because (pending completion) it is uncertain whether the contract will actually be performed or not. Once, however, the contract is mutually performed, in his view, the completion relates back to the contract and “it is thereby ascertained that the relation was throughout that of trustee and [beneficiary].” Only at that point, according to his Lordship, is there “a complete and perfect trust, the legal owner is and has been a trustee, and the beneficial owner is as has been a *cestui que trust*.”⁶

This is in contrast to the notion that the trust arises at the moment of contract irrespective of the availability of specific performance.⁷ In *Lysaght v Edwards*,⁸ Jessel MR was quite emphatic that “the vendor is a constructive trustee for the purchaser of the estate from the moment the contract is entered into.”⁹ However, as Thompson argues, it is difficult to view the trust as being entirely independent of the availability of specific performance.¹⁰ Indeed, several of the English cases emphasise the need for the contract to be capable of specific performance.¹¹ In *Central Trust and Safe Deposit Co v Snider*,¹² for example, Lord Parker made clear that in each case “it is tacitly assumed that the contract would in a Court of Equity be enforced specifically.”¹³ So, if for some reason, equity would not enforce the contract, “the vendor . . . either never was, or has ceased to be, a trustee in any sense at all.”¹⁴ In the context of equitable tenancies, for example, no equitable lease arises unless the court is willing to order specific performance.¹⁵ As Thompson observes, “in the sphere of landlord and tenant,

³ See, M P Thompson, “Must a Purchaser Buy a Charred Ruin?”, (1984) Conv 43, at 44. For an interesting historical account, see D Waters, “Constructive Trustee – Vendor and Purchaser”, (1961) 14 CLP 76.

⁴ (1881) 18 Ch D 1.

⁵ *Ibid*, at 6.

⁶ *Ibid*, at 13.

⁷ See, *White v Nutts* (1702) 1 PW 61; *Green v Smith* (1738) 1 ATK 572; *Shaw v Foster* (1872) LR HL 321, *Lysaght v Edwards* (1876) 2 Ch D 499, *Gordon Hill Trust Ltd v Segall* [1941] 2 All ER 379, and *Lake v Bayliss* [1974] 1 WLR 1073.

⁸ (1876) 2 Ch D 499.

⁹ *Ibid*, at 510.

¹⁰ See, M P Thompson, “Must a Purchaser Buy a Charred Ruin?”, (1984) Conv 43.

¹¹ See, *Howard v Miller* [1915] AC 318, at 326, *per* Lord Parker. The notion that specific performance must be available at all times if the trust is to subsist is also supported by *dicta* in *Plews v Samuel* [1904] 1 Ch 464 and *Central Trust and Safe Deposit Co v Snider* [1916] 1 AC 266, cited by M P Thompson, [1984] Conv 43, at 45.

¹² [1916] 1 AC 266.

¹³ *Ibid*, at 272.

¹⁴ *Ibid*, at 272.

¹⁵ See, *Warmington v Miller* [1973] QB 877.

the availability of specific performance is regarded as a *sine qua non*, without which an equitable lease cannot arise; a proposition . . . which is equally true before a trust arises in the case of a contract to sell land.”¹⁶

Qualified trusteeship

Whatever the precise nature of the trust, it undoubtedly gives rise to only a qualified form of trusteeship.¹⁷ As trustee, the vendor is placed under a duty to take reasonable care of the property.¹⁸ At the same time, he retains a right to remain in occupation of the land (and keep rents and profits) until the purchase price has been paid. At common law, this amounts to a lien on the land for any purchase money unpaid. If, on the other hand, the vendor has given possession to the purchaser, he retains an equitable lien on the land for the outstanding purchase price. Correspondingly, however, the risk of damage or destruction to the land (other than that associated with the vendor's duty of care) passes at common law to the purchaser on exchange of contracts as beneficial owner of the property.¹⁹ In *Raynor v Preston*,²⁰ for example, the house was damaged by fire after the date of the contract but before completion. The vendor had insured against fire and the purchaser claimed he was entitled to the benefit of the insurance money. The majority of the Court of Appeal held that the vendor was not a trustee for the purchaser of insurance monies since the insurance policy did not form part of the trust which was limited to the property contracted to be sold.

As well as bearing the risk, the purchaser is entitled to certain benefits as beneficial owner of the land. He will be entitled to any improvements to the land pending completion, as well as the right to effect a sub-sale of the property or to charge it, if he so wishes.²¹ Like the vendor, the purchaser may also have an equitable lien over the property pending completion for any of the purchase money in the event of the vendor's default.

Proprietary remedies

Although several commentators²² have questioned the appropriateness of the trust device in the context of the relationship between vendor and purchaser (preferring an implied contractual model instead), there seems little doubt that its primary benefit to the purchaser is to afford him a significant measure of protection (beyond his contractual remedies) prior to completion of the sale in circumstances where the sale contract has not been registered so as to bind third party purchasers pending completion. In this connection, it is trite law that the burden of a contract is incapable of simple assignment. At common law, therefore, if a vendor (V) contracts to sell to a purchaser (P) and, before completion, V transfers the land to a third party (TP) in breach of contract, P cannot enforce the contract against TP. Where the contract has

¹⁶ M P Thompson, “Must a Purchaser Buy a Charred Ruin?”, (1984) Conv 43, at 44.

¹⁷ See, generally, V G Wellings, “The Vendor as Trustee”, (1959) 23 Conv (NS) 173.

¹⁸ See, *Clarke v Ramuz* [1891] 2 QB 456, at 459–460, *per* Coleridge C J.

¹⁹ See, *Vesey v Elwood* (1843) 3 Dr War 74. The Standard Conditions of Sale, normally used in sales, now provide that the vendor undertakes to transfer the property in the same physical state (fair wear and tear excluded) as it was in at the date of the contract.

²⁰ (1881) 18 Ch D 1.

²¹ See *Shaw v Foster* (1872) LR 5 HL 321.

²² See, for example, D Waters, “Constructive Trust – Vendor and Purchaser”, (1961) 14 CLP 76, and J E Martin, *Hanbury & Martin, Modern Equity*, (18th ed, Sweet & Maxwell, 2009), at 355–356: “No doubt it is too late now to say that the relationship between vendor and purchaser is not that of trustee and beneficiary. The terminology must, however, be received with reserve. Unlike other cases of constructive trusts, the element of improper conduct is absent and the situation must, at best, be treated as anomalous.”

not been registered and (in the case of registered land) P is not in actual occupation,²³ P's only remedy, in the absence of equity's intervention, is a common law action for damages for breach of contract against V. In order to enforce the contract via a proprietary claim, P must rely on a specifically enforceable contract in equity.²⁴

Assuming V has gone ahead and sold to TP at a higher price, P may claim the proceeds of sale in a tracing action against V (on the basis that the sale proceeds now represent the trust property).²⁵ In this sense, therefore, the constructive trust may play an important role in securing the interests of the purchaser, especially if the proceeds of sale have been used by V in acquiring a valuable asset which itself has increased in value. If P's contract has not been registered or P is not in actual occupation (so as to bind TP), the trust relationship permits P to pursue V using a proprietary claim in equity.²⁶

Although a claim for damages by P against V for breach of contract will normally suffice as a remedy in most cases, this will not always be so, especially where (in the scenario posed above) V uses the proceeds as means of acquiring another asset (a valuable investment) which itself appreciates significantly in value. In these circumstances, a contractual claim for damages will give P the difference between the contract price and the market value of the land contracted to be sold, whereas the tracing claim will afford P the right to treat the newly acquired asset (together with its increased value) as his own (trust) property. The difference in terms of remedies may be particularly significant where V has gone bankrupt (or gone into liquidation) in which case P's proprietary claim in equity (as opposed to any contractual claim in damages) will rank in priority over V's general creditors. Thompson, however, argues that because the trust is dependent on the availability of specific performance, it, therefore, ceases to exist once the property falls into the hands of a subsequent purchaser. In his view, unless P's contract is registered, the tracing claim should be of no use to P.²⁷ This, however, is a point that was argued in *Lake v Bayliss*²⁸ itself, and emphatically rejected by Walton J. In his Lordship's view:

... it would be *peccata minora* if a vendor was entitled to shed the character of a trustee by a wholly wrongful act on his or her part. Once he has undertaken the role of trustee then it is a role which, unless discharged by some external circumstance, one must carry out to the bitter end if so required by the other party to the contract. The vendor cannot be heard to say that because of her wrongful act in reselling the property she never was a trustee.²⁹

On this reasoning, therefore, V (in our example) would remain a constructive trustee right up to the time of the resale to TP and, accordingly, bound to hold the proceeds

²³ The purchaser's equitable interest is capable of registration as land charge under the Land Charges Act 1972 (unregistered land) or capable of protection by notice or actual occupation as an interest which overrides under the Land Registration Act 2002 (registered land).

²⁴ See *Lake v Bayliss* [1974] 1 WLR 1073.

²⁵ See *Lake v Bayliss* [1974] 1 WLR 1073 and *Shaw v Foster* (1872) Ch D 1.

²⁶ If TP has dishonestly assisted in V's breach of trust, he may be liable as constructive trustee of the land in his own right: see, generally, *Royal Brunei Airlines v Tan* [1995] 2 AC 378, *Barlow Clowes International Ltd v Eurotrust International Ltd* [2005] UKPC 37 and *Abou-Ramah v Abacha* [2006] EWCA Civ 1492. Similarly, TP may be a constructive trustee if he has knowledge of P's equitable interest such as to make it unconscionable for him to retain the benefit of the receipt: see, *Bank of Credit and Commerce International (Overseas) Ltd v Akindele* [2001] Ch 437 and *Starglade Properties Ltd v Nash* [2009] EWHC 148 (Ch).

²⁷ See, M P Thompson, "Must a Purchaser Buy a Charred Ruin?", [1984] Conv 43, at 47–48. See also, F Crane, [1974] 38 Conv (NS) 357, at 359, who also suggests that the contract ceases to be enforceable on an effective sale elsewhere. He asks: "Is it not only at [completion] that a vendor who retains the legal estate and sells elsewhere should be held to be a trustee of the purchase money received from the third party?"

²⁸ [1974] 1 WLR 1073.

²⁹ *Lake v Bayliss* [1974] 1 WLR 1073 at 1076.

of sale (or any new asset acquired from those proceeds) as trust property to hand over to P on P completing his own obligations under the original contract.

It should also be possible to argue that P's equitable interest, upon payment of the full purchase price on completion, should bind TP, if (in the case of unregistered land³⁰) TP has actual (or constructive) notice of P's interest. There is, however, English authority against this view. In *Lloyds Bank plc v Carrick*,³¹ the defendant, a widow, sold her house and gave the proceeds of sale to her brother-in-law on the basis of an oral agreement that it would form the purchase price for a maisonette where she would live, the lease of which was owned by him. He subsequently charged the lease as security for a loan in favour of the claimant bank. Title to the maisonette was unregistered and the lease remained in the brother-in-law's name. The Court of Appeal held that the widow had no interest valid against the bank sufficient to raise a defence against its claim for possession when the brother defaulted on the mortgage. The bank's primary contention was that the widow's interest in the maisonette arose out of her contract with her brother-in-law which was void for want of registration against the bank as a purchaser for money or money's worth.³² As against this, it was argued on behalf of the widow that she had an interest separate and distinct from that which arose under the unregistered contract by virtue of a constructive trust. Morritt LJ who gave the leading judgment, concluded that whilst the brother-in-law could properly be described as a bare trustee, nevertheless, the source of the trust was the contract which, by virtue of the Land Charges Act 1972, section 4(6), was void against the bank in the absence of prior registration. In other words, his Lordship was not prepared to superimpose a further trust on the vendor other than that which already existed in consequence of the parties' contractual relationship.

The reasoning of the Court of Appeal has been open to criticism on the ground that the bare trust arising from the completion of the sale should have been regarded as entirely distinct from the constructive trusteeship arising from the contract. This bare trust should, it is submitted, have been regarded as exempt from the requirements of registration under the 1972 Act. It is unfortunate that this vital distinction between bare trust and constructive trust was not made more apparent in *Carrick*. On exchange of contracts, as we have seen, the vendor becomes a constructive trustee of the property; he is not, at this stage, a bare trustee. Until mutual performance of the contract by the vendor and purchaser (including, of course, payment of the purchase money), he retains, as outlined earlier, a personal interest in the property including a right to protect and maintain the property. Conversely, the purchaser's equitable interest remains qualified in the sense that it is dependent upon the continuing availability of specific performance. On completion, however, when the balance of the purchase price is paid, the full relation of trustee and beneficiary becomes established, which then relates back to the time of the contract.³³ It is submitted, therefore, that, in *Carrick*, the widow's equitable interest under the bare trust should have bound the bank irrespective of the fact that the parties' agreement had not been registered. In other words, the trust device should have prevailed in order to secure the purchaser's equitable interest against the third party notwithstanding the lack of registration.

³⁰ In the case of registered land, P's equitable interest would need to be either protected by notice on the register or be coupled with actual occupation of the land in order to rank as an overriding interest under the Land Registration Act 2002k, Sched. 3, para. 2.

³¹ [1996] 4 All ER 630. See further, M P Thompson, "The Widow's Plight", [1996] Conv 295.

³² See, for example, *Midland Bank Trust Co Ltd v Green* [1981] AC 513.

³³ See, *Raynor v Preston* (1881) 18 Ch D 1, at 13, per James LJ. Upon payment of the purchase price, the purchaser becomes fully entitled to the beneficial interest: see, *DHN Food Distributors Ltd v London Borough of Tower Hamlets* [1976] 1 WLR 852 and *Bridges v Mees* [1957] 2 All ER 577.

VENDOR AS CONSTRUCTIVE TRUSTEE OF PERSONAL PROPERTY

As already mentioned, specific performance is not usually granted in respect of contracts for the sale of personal property. This is not because the subject matter is of a personal nature, but because chattels are normally not unique and so damages at common law may represent an entirely satisfactory remedy for the purchaser if the subject matter can be bought elsewhere on the open market. Further, entry into the contract and completion are often simultaneous events. If, on the other hand, the property is either unique or scarce, specific performance is usually available provided that the court, in its equitable discretion, is satisfied that this is the most appropriate remedy. Thus, in *Michaels v Harley House (Marylebone) Ltd*,³⁴ involving a sale share agreement, Robert Walker LJ stated:

... a contract for the sale of shares (at any rate in a company whose shares are not quoted and readily available on the market) is, like a contract for the sale of land, at first sight enforceable by specific performance; and that the effect of specific performance being available is to make the vendor under an uncompleted contract of sale a trustee of some sort for the purchaser.

It will be convenient to first explore the applicability of this general principle to contracts for the sale of goods.

Sale of goods

In most contracts for the sale of personal property, the passing of property takes place when the contract is made;³⁵ there is simply no equivalent of exchange of contracts and completion to be found as in the sale of land. However, the Sale of Goods Act 1979, section 17 states that property in the goods is transferred to the buyer at such time as the parties to the contract intend it to be transferred.³⁶ In some cases, therefore, the passing of property in goods (even where the buyer is given immediate possession) may be postponed until a later date (for example, where the contract stipulates payment by instalments or is conditional upon the receipt of cleared funds³⁷) and the question then arises as to whether the seller should be treated as trustee of the goods for the purchaser in the period prior to completion. To put it another way, should the purchaser, in such cases, be treated as owning a beneficial interest in the property prior to the sale contract being completed? The notion of a division of legal and beneficial ownership in the context of a sale of goods may seem somewhat odd at first glance, but it is submitted that the relationship of trustee/beneficiary should also represent an accurate reflection of the parties' position where the subject matter of the sale is unique (and, hence, the contract specifically enforceable) and where it is intended that no legal title should pass (even where possession of the goods is given to the buyer) until some future date.

This was certainly the view taken by Lord Westbury in *Holroyd v Marshall*,³⁸ where his Lordship opined that the transfer of equitable ownership upon entry into a contract applied "not only [to] contracts relating to real estate, but also to contracts relating to personal property, provided that the latter are such as a court of equity would direct

³⁴ [2000] Ch 104.

³⁵ See the Sale of Goods Act 1979, s.18.

³⁶ See *Re Goldcorp Exchange Ltd (in receivership)* [1994] 2 All ER 806, at 814, PC.

³⁷ See, for example, *Dennant v Skinner and Collom* [1948] 2 KB 164, where the parties had expressly stipulated that title should not pass "until a cheque was cleared".

³⁸ (1862) 10 HLC 191.

to be specifically performed”.³⁹ Two English cases, however, suggest a contrary view, namely, that the vendor retains full legal and beneficial title until the property passes to the purchaser or possession has been delivered to him. In *Re Wait (trading as Wait and James)*,⁴⁰ Aitkin LJ, in the context of the Sale of Goods Act 1893, without expressly deciding the point, opined that:

It would have been futile in a code intended for commercial men to have created an elaborate structure of rules dealing with rights at law, if at the same time it was intended to leave, subsisting with the legal rights, equitable rights inconsistent with, more extensive than, and coming into existence earlier than the rights so carefully set out in the various sections of the [the 1893 Act]⁴¹.

It is pertinent to observe, however, that in this case, there was a direct conflict between the remedy which the court was being asked to grant and the restrictions on the award of specific performance set out in (what is now) the Sale of Goods Act 1979, section 52. So here, the equitable rule in question was clearly inconsistent with the express provisions of the Act.

Aitkin LJ's *dictum* was, however, endorsed by Lord Brandon in the subsequent case of *Leigh & Sillivan Ltd v Aliakmon Shipping Co Ltd, The Aliakmon*.⁴² His Lordship's view, however, was once again stated to be provisional only:

I do not doubt that it is possible, in accordance with established equitable principles, for equitable interests in goods to be created and to exist. It seems to me, however, extremely doubtful whether equitable interests in goods can be created or exist within the confines of an ordinary contract of sale. The Sale of Goods Act 1893 . . . is a complete code of law in respect of contracts for the sale of goods. The passing of the property in goods the subject matter of such a contract is fully dealt with in sections 16 to 19 of the Act (now the Sale of Goods Act 1979, sections 16 to 19). Those sections draw no distinction between legal and the equitable property in goods, but appear to have been framed on the basis that the expression 'property', as used in them, is intended to comprise both the legal and the equitable title.⁴³

Despite their *obiter* nature, the observations of both Aitkin LJ and Lord Brandon clearly point to the conclusion that, because the Sale of Goods Act 1979 is silent as regards the creation of any trust in favour of the purchaser of goods coming within the ambit of the Act, no separation of legal and equitable title may arise notwithstanding that the sale contract may be specifically enforceable. Until, therefore, the property passes to the purchaser, the matter lies solely in contract and the purchaser acquires no interest in the goods pending transfer of the legal title.

As against this, however, reference may be made to the 1979 Act, section 62(2) which provides that “the rules of the common law . . . except in so far as they are inconsistent with the provisions of this Act . . . apply to contracts for the sale of goods.” This would suggest that the principles of the general law (including equity) continue in operation to supplement the legislation; the expression “rules of the common law” referring (in broad terms) to “judge made law” (as opposed to statute law) and not, more technically, to those rules in contradistinction to the rules of equity. There is authority in both Australia⁴⁴ and New Zealand⁴⁵ which supports this wider interpretation of the

³⁹ Lord Wetsbury in *Holroyd v Marshall* (1862) 10 HL Cas at 209.

⁴⁰ [1926] All ER at 433 See also *Re Goldcorp Exchange Ltd (in receivership)* [1994] 2 All ER 806, at 815, *per* Lord Mustill: “under a simple contract for the sale of unascertained goods no equitable title can pass merely by virtue of the sale.”

⁴¹ *Re Wait (trading as Wait and James)* [1926] All ER 433, at 446, *per* Atkin LJ.

⁴² [1986] 2 All ER 145.

⁴³ *Ibid*, at 151.

⁴⁴ See *Graham v Freer* (1980) 35 SASR 424, *Leason Property Ltd v Princes Farm Property Ltd* [1983] 2 NSWLR 381 and *Vinig Property Ltd v Contract Tooling Property Ltd* (1986) 9 NSWLR 731. Contrast, *Watt v Westhoven* [1933] VLR 458.

statute. It seems also that most academic writers prefer the wider interpretation.⁴⁶ According to *Benjamin's Sale of Goods* "... it would now be difficult to argue that the principles of equity are not applicable to sale of goods, in view of the many cases in which they have been tacitly assumed to apply".⁴⁷

As *Benjamin* observes, "the courts may yet be obliged to consider how far a particular equitable rule is consistent with express provisions of the Act",⁴⁸ so it is conceivable that the device of the trust may yet be called into play in the context of a sale of goods in order to confer on the purchaser an equitable interest in the property pending transfer of legal ownership. This, in turn, it is submitted, would open up the possibility of allowing the purchaser to claim priority over the seller's creditors in the event of the latter's bankruptcy. In this connection, under the Insolvency Act 1986, section 306, the bankrupt's estate vests automatically in the trustee in bankruptcy as soon as the trustee is appointed without the need for any formal conveyance, assignment or transfer. The seller's assets can then be sold off for the benefit of creditors. Certain property is exempt from sale, including property formerly held by the bankrupt on trust for any other person.⁴⁹ Similarly, if the seller is a limited company which has gone into liquidation, the liquidator (although not a trustee) acts as a fiduciary and agent of the company with a statutory duty to ensure that the assets of the company are called in, realised and distributed to creditors. Here again, the liquidator takes the company's assets subject to prior equities, including any equitable interest arising under a trust.

Apart from the potential benefit of priority over the seller's creditors, the purchaser may also have the advantage of asserting a tracing claim in equity, consistent with the *Lake v Bayliss* ruling, against the seller in respect of the proceeds of sale where the latter has re-sold the property in breach of contract to a third party before completion of the sale.⁵⁰ Significantly, such an equitable proprietary claim would not be dependent on the purchaser's right to possession or legal ownership of the goods (which, of course, remain necessary prerequisites to possessory actions in tort).

Contracts to sell or transfer other personal property

The use of the trust in the context of other contracts for the sale (or transfer) of personal property has been more rewarding in terms of judicial development. Thus, Lord Jenkins in *Oughtred v IRC*,⁵¹ in the context of a contract for the sale of shares in a private company, accepted that an agreement involving a surrender of a reversionary interest in shares for valuable consideration was similar to that of a purchaser of land between contract and completion. In his Lordship's view, the purchaser's interest was "no doubt a proprietary interest of a sort, which arises, so to speak, in anticipation of the execution of the transfer for which the purchaser is entitled to call." Lord Radcliffe (in his dissenting speech in the same case) was more robust,

⁴⁵ See *Thomas Borthwick & Sons (Australasia) Ltd v South Otago Freezing Co Ltd* [1978] 1 NZLR 538, at 545 and *Timmerman v Nervina Industries (International) Property Ltd* [1983] Qd R 1. Contrast, *Riddiford v Warren* (1901) 20 NZLR 572, at 576 and 582, and *Re Martin, ex parte Avery Motors Ltd* [1991] 3 NZLR 630.

⁴⁶ See, for example, G Williams, (1945) 61 LQR 302, J G Fleming, (1951) 25 ALJ 443, P S Atiyah, *The Sale of Goods*, (11th ed, Pearson), at 530–531, G Treitel, *The Law of Contract*, (11th ed, Sweet & Maxwell), at 374–375 and E McKendrick, *Goode on Commercial Law*, (3rd ed, LexisNexis), at 192.

⁴⁷ *Benjamin's Sale of Goods*, (7th ed, 2006, Sweet & Maxwell), at para. 1–009.

⁴⁸ *Ibid*, at para. 1–011.

⁴⁹ In this regard, the trustee in bankruptcy takes the bankrupt's property "subject to all equities" existing prior to the bankruptcy: see, *Re Wallis, ex parte Jenks* [1902] 1 KB 719, *per* Wright J, In *Re Eastman, ex parte Ward* [1905] 1 KB 465, at 467 and *Tilley v Bowman* [1910] 1 KB 745.

⁵⁰ See, *Bunny Industries Ltd v FSW Enterprises Property Ltd* [1982] Qd R 712.

⁵¹ [1960] AC 206, at 240.

adopting the view that the parties' agreement gave rise to equitable ownership in the reversionary interest in the shares by virtue of a contract which was specifically enforceable in equity.⁵² Upon payment of the consideration, the seller "became in a full sense and without more the trustee . . . [and the purchaser] effective owner of all outstanding equitable interests."⁵³ The result, in his view, was that the contract gave rise to a constructive trust which was capable of avoiding the formal requirements of writing contained in the Law of Property Act 1925, section 53(1)(c). Similarly, in *Re Holt's Settlement*,⁵⁴ Megarry J, relying on the dissenting speeches in *Oughtred*, held that an agreement to surrender a life interest in the income of a trust fund made for valuable consideration, which was specifically enforceable in equity, passed the beneficial interest to the purchaser by virtue of a constructive trust. Such trust, in his words, was "made familiar by contracts for the sale of land, whereunder the vendor becomes a constructive trustee for the purchaser as soon as the contract is made, albeit the constructive trust has special features about it."⁵⁵ More recently, in *Chinn v Collins (Inspector of Taxes)*,⁵⁶ Lord Wilberforce expressly approved the suggestion that a contract for the sale of shares, "accompanied or followed by payment of the price"⁵⁷, passed "at once" the equitable interest in the property so that the purchaser was entitled to call for an immediate transfer of the shares from the trustee.

The upshot of this analysis is that the device of the constructive trust arising on a specifically enforceable contract for sale is not limited to transactions involving the sale of land; the trust may also be employed to characterise a purchaser of personal property as equitable owner provided the contract is capable of specific performance. Similar to the principle which operates between a vendor and purchase of land, equity will "treat that as done which ought to be done" with the consequence that a contract to sell or transfer personal property will generate a constructive trust pending formal completion of the transaction. Hudson, however, has gone further in suggesting that the cases on contractual transfers, referred to above, point to a more simplified approach based purely on the operation of the constructive trust regardless of whether or not the contract itself is specifically performable.⁵⁸ The main advantage of this approach, he argues, is that the constructive trust would permit proprietary rights to be transferred automatically without any formality in its creation. In this connection, he cites *Neville v Wilson*⁵⁹ where the Court of Appeal held that the creation of the agreement caused the equitable interest in the subject shares to pass automatically by virtue of a constructive trust. The more correct analysis, however, by analogy with the position as between vendor and purchaser, may be that a bare trust only arises so as to automatically pass the equitable title when the purchase money is paid in full. Until then, the constructive trust arising under the contract, under general principles, remains dependent on the availability of specific performance.⁶⁰ As with contracts for the sale of land, therefore, the purchaser can be seen as acquiring two distinct and separate

⁵² *Ibid*, at 227–228.

⁵³ *Ibid*, at 227–228.

⁵⁴ [1968] 1 All ER 470. See also, *Neville v Wilson* [1997] Ch 144, where Nourse LJ (giving the judgment of the Court of Appeal) concluded that: "the analysis of Lord Radcliffe [in *Oughtred*], based on the proposition that a specifically enforceable agreement to assign an interest in property creates an equitable interest in the assignee, was unquestionably correct." See further, *Chin v Collins (Inspector of Taxes)* [1981] AC 533 and *Michaels v Harley House (Marylebone) Ltd* [2000] Ch 104.

⁵⁵ Megarry J in *Re Holt's Settlement* [1968] 1 All E R 470 at 476.

⁵⁶ [1981] AC 533.

⁵⁷ Lord Wilberforce in *Chin v Collins* [1981] AC 531 at 548.

⁵⁸ See, A Hudson, *Equity and Trusts*, (6th ed, 2010, Routledge Cavendish), at 264–267.

⁵⁹ [1997] Ch 144. See also, *Sahota v Bains* [2006] EWHC 131 (Ch).

⁶⁰ See, more fully, N Hopkins, "Acquiring Property Rights from Uncompleted Sales of Land", (1998) MLR 486, at pp 492–494.

rights, namely, the equitable interest arising by virtue of the sale contract (which is linked to the availability of specific performance) and the equitable interest arising under a bare trust arising on full payment of the consideration.⁶¹

CONCLUSION

We come back to basic principles. A contract for the sale of land generates a form of constructive trust which is dependent on the availability of specific performance. The position of the parties pending completion is neatly summarised by Lord Walker in *Jerome v Kelly* in the following terms:

It would . . . be wrong to treat an uncompleted contract for the sale of land as equivalent to an immediate, irrevocable declaration of trust (or assignment of beneficial interest) in the land. Neither the seller nor the buyer has unqualified beneficial ownership. Beneficial ownership of the land is in a sense split between the seller and the buyer on the provisional assumptions that specific performance is available and that the contract will in due course be completed, if necessary by the court ordering specific performance.⁶²

Although, therefore, the vendor's qualified trusteeship⁶³ makes the constructive trust somewhat unique, it does allow the purchaser, as a beneficial owner, to assert an equitable proprietary claim against the vendor in respect of the proceeds of sale in the event of the vendor re-selling the property to a third party prior to completion. At this stage, however, the vendor's trusteeship applies only as between the parties to the contract⁶⁴, so that the purchaser's equitable interest ranks against third parties in the same way as other equitable interests and is subject to the requirements of registration for both registered and unregistered land.

Upon completion of the sale, however, the full relationship of trustee and beneficiary is established in the form of a bare trust (relating back to the date of the contract). Again, in the words of Lord Walker in *Jerome*: "If the contract proceeds to completion the equitable interest can be viewed as passing to the buyer in stages, as title is made and accepted and as the purchase price is paid in full."⁶⁵

The consequence of this, it is submitted, is that the purchaser now acquires a full equitable proprietary interest which, in the context of unregistered land, is enforceable against a third party with notice of the interest regardless of registration. A different conclusion, as we have seen, was reached in *Carrick*, where the Court of Appeal refused to recognise the nature of the bare trust (arising on completion) as being essentially different from the constructive trust (arising on exchange of contracts). In the writers' view, however, the widow's equitable interest under the bare trust, consistent with the nature of that trust and coupled with the bank's constructive notice of her interest, should have bound the bank irrespective of registration.⁶⁶ Moreover, had the title comprised registered land, her equitable interest coupled with actual

⁶¹ There may still be an interval between payment of the full purchase money and formal registration of title during which time the purchaser will retain only an equitable interest in the property under the bare trust. Upon, however, acquiring full legal and equitable title, the bare trust will naturally come to an end.

⁶² [2004] 1 WLR 1409, at para. 32.

⁶³ See, *Rayner v Preston* (1881) Ch D 1, at 6, per Cotton L J.

⁶⁴ See, *Tasker v Small* (1837) 3 My & Cr 63, at 70–71, per Lord Cottenham L C.

⁶⁵ [2004] 1 WLR 1409, at para. 32.

⁶⁶ Although the bank's charge was preceded by a questionnaire signed by the brother-in-law to the effect that, to the best of his knowledge, there were no other persons in occupation of the property, the bank was not entitled to rely simply on the questionnaire because it knew (through one of its officers) that the widow was resident. See, generally, *Kingsnorth Finance Co v Tizard* [1986] 1 WLR 783.

occupation would have ranked as an overriding interest under (what was then) section 70(1)(g) of the Land Registration Act 1975.⁶⁷

By analogy with sales of land, a contract for the sale of personal property which is unique or scarce generates equity's intervention by means of the remedy of specific performance. This, in turn, it is submitted, operates so as to make the seller under an uncompleted contract a trustee of the property for the purchaser. In the context of certain sales of unique goods, despite English *dicta* to the contrary, it is submitted that the trust device has a useful role to play in providing the purchaser with priority over the seller's creditors and an equitable proprietary claim to the proceeds of sale where the seller re-sells to a third party prior to completion. If the seller uses the proceeds to acquire another asset (for example, shares) which increase in value, the purchaser will be entitled to trace into that asset as trust property. Once the purchase money is paid in full, however, consistently with the notion of the bare trust arising in contracts for the sale of land, the nature of the equitable proprietary right changes so that the purchaser now acquires, consistent with current authority, a full equitable interest in the property which, it is submitted, is capable of binding third parties.⁶⁸ Here again, the distinction between the constructive trust and bare trust becomes significant: the latter conferring an automatic proprietary claim to the property which is no longer personal to the parties and independent of the availability of specific performance.

⁶⁷ See now, the Land Registration Act 2002, Sched. 3, para. 2. As Morritt L J himself points out in *Carrick*: "the result would have been different if the title to the maisonette had been registered. In such a case the interest of Mrs Carrick, who was in possession of the maisonette and of whom no enquiry had been made, would have been an overriding interest . . . As such it would have been binding on the bank."

⁶⁸ A bona fide purchaser of the property would, of course, take free of the purchaser's prior equitable interest. As we have seen, however, the seller's trustee in bankruptcy (or liquidator) takes the property subject to prior equities.

ASSURING FORBEARANCE IN MORTGAGE ARREARS MANAGEMENT: A REGULATORY BLIND SPOT

PER T.T. LINDBERG*

INTRODUCTION

If one would have to extract something positive out of economic crises, it must be the hard lessons learnt. Every flaw of the financial system becomes magnified and scrutinised. One can only hope that for the hundreds of thousands of people detrimentally affected, steps are taken in accordance with the lessons learnt. During the 2008–2009 economic crisis, one flaw that has been magnified is the failure of the mortgage market regulator, the Financial Services Authority (FSA), to ensure forbearance in mortgage arrears practices. While these practices were the subject of criticism long before the crisis¹, it is hoped that it will ensure that the calls do not fall on deaf ears. In response to the radical increase of mortgage arrears and repossessions², politicians, the housing advice sector,³ and the FSA itself have scrutinised the mortgage market and recognised inadequacies in its regulatory framework. Responding to these inadequacies, the *Pre-Action Protocol for Possessions Claims Based on Mortgage or Home Purchase Plan Arrears in Respect of Residential Property*⁴ (the Protocol) was implemented in November 2008 to curb the rising number of repossessions and in June 2010, the FSA reformed section 13 (arrears and repossessions) of their *Mortgages and Home Finance: Conduct of Business Sourcebook* (MCOB).⁵ While all parties agreed that reform was needed within the regulatory framework, few have questioned whether the FSA is indeed institutionally and operationally capable of assuring forbearance amongst mortgage lenders to the extent required to protect vulnerable home-owners. This article intends to question exactly why the FSA has failed its regulatory responsibility thus far and whether, in light of the MCOB reforms, the FSA is capable of meeting the demands made of it; or should we put more emphasis on other means, such as the Protocol?

This article argues that the FSA's regulatory approach and operative framework is ill-equipped to ultimately assure forbearance in mortgage arrears management. This is mainly due to what this article labels a regulatory "blind spot": an inability of the FSA's operative framework, ARROW, to effectively monitor and assess qualitative measures, such as treating customers fairly. Although the government intends to abolish the FSA and instigate a new regulatory regime, it remains questionable as to the extent the new regime will provide better protection against unscrupulous mortgage arrears practices. In any event, the new regulatory system will not come into effect until

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¹ See L Whitehouse, "The Home-Owner: Citizen or Consumer?" in S Bright and J Dewar (eds), *Land Law: Themes and Perspectives*, (Oxford University Press, 1998); L Whitehouse, "The Impact of Consumerism on the Home Owner", in D Cowan, *Housing: Participation and Exclusion. Collected Papers from the Socio-Legal Studies Annual Conference 1997*, (University of Wales, Cardiff, 1998); M Dixon, "Sorry, we've sold your home: mortgagees and their possessory rights", (1999) 58(2) CLJ 265; Law Commission Report, *Transfer of Land – Land Mortgages*, (1991) Law Com No 204; see also Clarke L J comments in *Ropaigealach v Barclays Bank plc* [2000] 1 QB 263, at 283.

² 40 000 repossessions in 2008, 46 000 in 2009, 36 000 in 2010 and an estimated 40 000 in 2011, see repossession statistics from the Council of Mortgage Lenders, available at <http://www.cml.org.uk/cml/statistics>.

³ Including AdviceUK, Citizens Advice, Money Advice Trust and Shelter.

⁴ Civil Justice Council, *Pre-Action Protocol for Possessions Claims Based on Mortgage or Home Purchase Plan Arrears in Respect of Residential Property*, November 2008, available at http://www.civiljusticecouncil.gov.uk/files/Mortgage_Pre-Action_protocol_21_Oct.pdf.

⁵ Financial Services Authority, *Handbook Notice 101*, 25 June 2010.

the end of 2012. Therefore, this article calls for an approach which will realistically, efficiently and continuously assure forbearance in arrears management. It is argued that an upgraded version of the Protocol has the capabilities necessary to answer these calls.

This article is divided into four parts. The first part aims to briefly introduce the evolution of home-ownership and mortgage regulation in the UK and present the previous and reformed MCOB 13. Part three of this article will analyse why the FSA is ill-equipped in assuring forbearance amongst mortgage lenders, despite the reformed MCOB 13. However, to understand why this is so we must have an understanding of how the FSA is structured and functions, including its regulatory approach and operative framework. This is therefore examined in part two. After illuminating the FSA's limited operative ability to ensure forbearance amongst mortgage lenders, the final part will demonstrate how an upgraded version of the Protocol retains the capabilities of assuring greater protection against unscrupulous mortgage arrears practices.

HOME-OWNERSHIP AND MORTGAGE REGULATION

The home-ownership bubble

The UK housing market has experienced a radical increase in home ownership since the latter half of the 20th century.⁶ Governmental encouragement of mortgage finance take-up surged in the 1980s with schemes such as Mortgage Interest Tax Relief (MITR). Most efficient of all was the Thatcher government's "Right to Buy" scheme under the Housing Act 1980 which provided council tenants with a discount on the price of the property and a right to a mortgage.⁷ The final move towards a "home-owning democracy" was taken with the financial deregulatory measures during the 1980s which opened up the mortgage market to banks and specialised lenders.⁸ More actors in the mortgage market meant greater competition which in turn resulted in greater access to mortgage finance, both in terms of eligibility and quantity. Introducing banks, or more precisely specialised lenders, into the mortgage market effectively provided potential home owners with less strenuous lending criteria and greater loan-to-value loans. Sub-prime⁹ lending increased contributing to a volatile and vulnerable mortgage market.

Along came the burst

However, the dramatic increase has not taken place without casualties. The housing bubble burst in the early 1990s. Between 1991–1994 one in every five households were unable to pay their mortgage. In the mid 1990s over a million households faced negative equity and repossessions became a reality for at least 1000 households a week.¹⁰

⁶ For more exhaustive reviews of the evolution of home-ownership, see further, A March and D Mullin, *Housing and Public Policy: Citizen, Choice and Control*, (Open University Press, 1998); R Forrest and A Murie, *Right to Buy? Issues of Need, Equity and Polarisation in the Sale of Council Houses*, (Bristol: School for Advanced Urban Studies, 1984); G Goodwin and C Grant, *Built to Last? Reflection on British Housing Policy*, 2nd ed, (Nottingham: ROOF Magazine, 1997); M Kleinman and C Whitehead, "British Housing since 1979: has the system changed?" (1988) 3(1) *Housing Stud.* 3; P Malpass, "The Unravelling of Housing Policy in Britain", (1996) 11(3) *Housing Stud.* 459.

⁷ The "Right to Buy" scheme assured that around 1.75 m council houses were sold between 1980 and 2007. A Murie, "The Modernisation of Housing in England", (2009) 100 (4) *Tijdschr. Econ. Soc. Ge.* 535, at p 537.

⁸ See, eg, the Special Supplementary Deposits Schemes and Building Societies Acts (BSA) 1986 and 1997.

⁹ Office of Fair Trading's definition of sub-prime mortgages are: "... those with impaired or low credit ratings and who would find it difficult generally to obtain finance from traditional sources on normal terms and conditions." (OFT, 2002).

¹⁰ P Malpass, above n 6, at p 469.

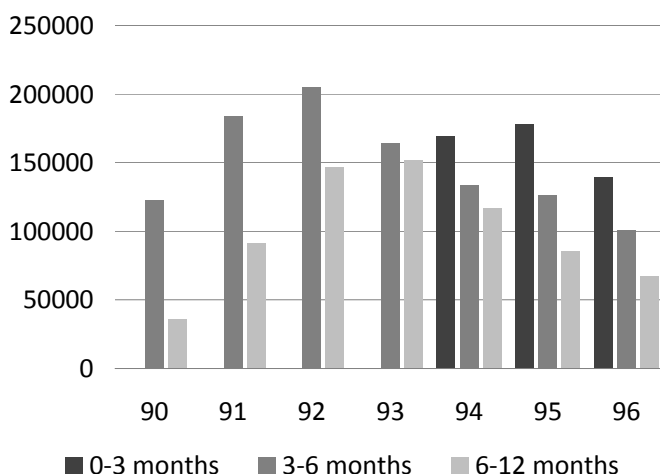


Figure 1: Mortgage in arrears

Source: Council of Mortgage Lenders.

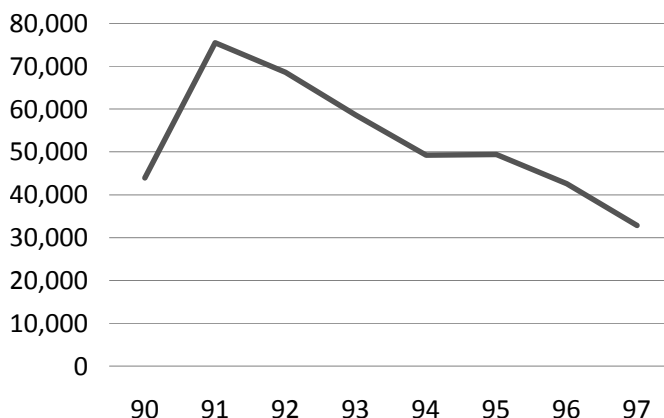


Figure 2: Repossessions

Source: Council of Mortgage Lenders.

The housing crisis of the 1990s showcased the devastation an unregulated mortgage market could cause. Up until 1997 the Conservative government had relied on the consumerist model of free-market competition and choice to ensure consumer protection. This is evident through a number of deregulatory measures taken by the Conservatives since the 1980s, including the Building Societies Act 1986 and 1997, the purpose of which was to increase scope and availability of mortgage finance to bring “healthy competition into housing and finance”¹¹. As the housing crisis of early 1990s illustrated, this was clearly not enough. It was not, however, until 1997 the Council of Mortgage Lenders (CML) issued a *Statement of Practice* concerning arrears handling and it took yet another seven years for the government to step in and provide at least a figurative backbone to mortgage regulation.

¹¹ Statement made by the former Economic Secretary to the Treasury, Ian Stewart, (HC Deb. (1985–6), 89, c 592).

Mortgage Conduct of Business (MCOB) Sourcebook

In January 2000 the Treasury announced its plans to introduce a statutory regime to regulate mortgages. Four years later, in October 2004, the FSA launched MCOB and assumed responsibility for regulating first charge loans issued after 31 October 2004. Notably, not all mortgages became subject to MCOB. Mortgages taken out before October 2004 and second mortgages which did not surpass £25,000 are regulated by the Office of Fair Trading (OFT) under the Consumer Credit Act (CCA) 1974. Second mortgages which exceeded the £25,000 limit were previously neglected by both regulatory frameworks. Later, the CCA 2006 remedied this omission by removing the monetary limit.¹²

Forbearance in arrears management

In an effort to regulate mortgagees' arrears and repossession management, MCOB 13 outlined "rules", "evidential provisions" and "guidelines"¹³ of how to adequately and equitably treat mortgagors who had fallen into arrears. As such, MCOB 13.3.1R (1) stated that "a firm must deal fairly with any customer who (a) is in arrears on a regulated mortgage contract" and further in MCOB 13.3.1R (2) that a "firm must put in place, and operate in accordance with, a written policy ... and procedures for complying with (1)". Notably, prior to the MCOB reforms in June 2010, within MCOB 13 these¹⁴ were the only rules a firm was legally bound to follow. The rest of MCOB 13 consisted of guidelines and evidentiary provisions generally advocating forbearance and recommended conduct.

Assuring forbearance

Studies show that the FSA has been ineffective to date in ensuring uniform and consistent adherence to MCOB 13, particularly amongst sub-prime, specialist lenders.¹⁵ Shelter has remarked that the variation of practices amongst lenders has resulted in a "lender lottery" where some borrowers have been "particularly vulnerable to harsh and unfair treatment".¹⁶ Research undertaken by AdviceUK *et al.* reveals that 57% of mortgagors in arrears were satisfied with the way they were treated by lenders, however, 27% stated they had been offered no help when running into arrears.¹⁷ In a separate study of sub-prime lenders Shelter reveals that 20% of mortgagors in arrears reported that the lender had *not* been in contact with them.¹⁸ Amongst those that had been in contact, 38% of the mortgagors indicated that the "lender's willingness to renegotiate a new payment plan was poor/very poor, compared to 27% who rated it as good/excellent".¹⁹ Interestingly, Shelter has indicated that where lenders increase forbearance, the incentive derives predominately from avoiding losses in a declining market rather than regulation.²⁰

¹² CCA 2006, s 2.

¹³ For definitions see glossary to MCOB, available at <http://fsahandbook.info/FSA/html/handbook/Glossary/>.

¹⁴ Together with MCOB 13.3.9 (1).

¹⁵ See Financial Services Authority, *Mortgage Effectiveness Review: Arrears Findings*, August 2008, available at http://www.fsa.gov.uk/pubs/other/mer_report.pdf and *Mortgage Market Review*, October 2009, available at http://www.astrid-online.it/rassegna/06-11-2009/FSA_Mortgage-Market-Regulation_10_2009.pdf; and AdviceUK *et al.*, *Mortgage and secured loan arrears: Adviser and Borrower Surveys April 2009*, May 2009, available at http://england.shelter.org.uk/_data/assets/pdf_file/0004/192685/Mortgage_and_secured_loan_arrears_Final_Report.pdf.

¹⁶ House of Commons Treasury Committee, *Mortgage arrears and access to mortgage finance*, Fifteenth Report of Session 2008-09, Ev 132 para 3, available at <http://www.publications.parliament.uk/pa/cm200809/cmselect/cmtreasy/766/766.pdf>.

¹⁷ AdviceUK *et al.*, above n 15, at p 3.

¹⁸ House of Commons Treasury Committee, above n 16.

¹⁹ *Ibid.*

²⁰ Shelter, *Uncharted territory? Managing mortgage arrears and possessions*, July 2009, available at http://england.shelter.org.uk/_data/assets/pdf_file/0017/203705/Uncharted_Territory.pdf.

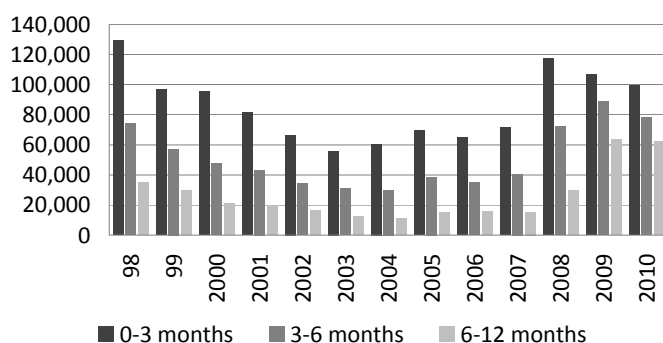


Figure 3: Mortgage in arrears

Source: Council of Mortgage Lenders.

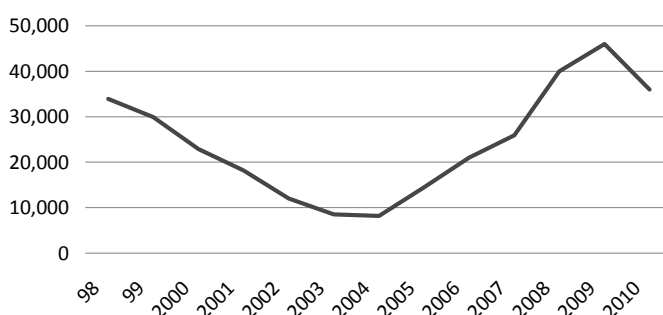


Figure 4: Repossessions

Source: Council of Mortgage Lenders.

As illustrated by figures 3 and 4, MCOB was written at a time when the economy was healthy and arrears and repossessions were particularly low. However, as soon as the economy falters and house prices fall, *ie* at times where MCOB 13 matters the most, it has proven ineffective. The professed problem, of which the Financial Services Consumer Panel has similarly expressed²¹, was that MCOB 13 contained few actual rules that were binding on the lenders.

Reformed MCOB 13

The shortcomings of the previous MCOB 13 were summated in the FSA's Discussion Paper (DP) published in September 2009.²² While reiterating the inability of MCOB 13 to ensure forbearance amongst, in particular, specialist lenders, the DP proposed to change most of its guidelines and evidential provisions into binding rules. These reforms were presented in a "Consultation Paper" (CP) published in February 2010²³ and implemented with some alterations in June 2010²⁴. The new MCOB 13 transformed evidential provisions such as MCOB 13.3.2E into rules, including that the firm "*must* ... not repossess the property unless all other reasonable attempts to

²¹ House of Commons Treasury Committee, *Mortgage arrears and access to mortgage finance*, above n 16, *Written Evidence from the Financial Services Consumer Panel*, Ev 150 para 4 (a).

²² Above n 15.

²³ Financial Services Authority, *Mortgage Market Review: Arrears and Approved Persons*, January 2010, available at http://www.fsa.gov.uk/pubs/cp/cp10_02.pdf.

²⁴ Financial Services Authority, *Handbook Notice 101*, 25 June 2010.

resolve the position have failed”²⁵. Similarly, the guidelines in MCOB 13.3.4 G (1) was converted into rules so that

“a firm must consider whether, given the individual circumstances of the customer it is appropriate to do one or more of the following . . . with the agreement of the customer . . . (a) extend its [the mortgage’s] term; or (b) change its [the mortgage’s] type”²⁶.

These reforms are welcomed.

Still, whilst it is true that some of the poor practices adopted by mortgagees are attributable to the inadequacy and ambiguity of the previous regulatory framework including MCOB 13. It is equally true, however, that much of the poor and arbitrary arrears management has in fact been contrary, not only to the guidelines, but to the rules of MCOB 13 and the FSA’s sixth Principle, “Treating Customers Fairly”, suggesting that the problem transcends the verbatim of MCOB. There has been a serious flaw in monitoring mortgage lenders and ensuring compliance.²⁷ Indeed, it is questionable whether the reforms of MCOB 13 will in isolation remedy the situation. Relying solely on the FSA to ensure compliance will inhibit the full capacity of the new MCOB to ensure forbearance amongst mortgage lenders. Before analysing why the FSA is ill-equipped in assuring forbearance amongst mortgage lenders we must, however, first appreciate how the FSA is structured and functions.

THE FINANCIAL SERVICES AUTHORITY

In 1997 the former Chancellor of the Exchequer, Gordon Brown, announced that the financial services regulation in the UK would fall under one single regulatory body, the FSA. This entailed the amalgamation of nine regulators, including regulators responsible for banking, securities, insurance and for markets and exchange. Traditionally, financial regulation distinguished between entities that focused on prudential regulation, *ie* financial soundness, and conduct of business regulation, such as customer relations. However, the regulatory consolidation deviated from this separation and created one of the first integrated financial regulators in the world. This, as we will see, would have a significant impact on FSA’s regulatory approach and framework. The Financial Services and Markets Act (FSMA) was passed in 2000 and the FSA received its statutory powers in 2001.²⁸

In discharging its general duties, the FSA must act in a way “which is compatible with the regulatory objectives”²⁹, being: a) market confidence; b) public awareness; c) the protection of consumers; and d) the reduction of financial crime.

Regulatory approach and philosophical underpinnings

The backbone of the FSA’s regulatory approach and policy is its endorsement of the “market failure” thesis.³⁰ A consumer oriented theory of regulation that proposes that

²⁵ MCOB 13.3.2AR (6).

²⁶ MCOB 13.3.4AR (1)(a)–(b).

²⁷ Even the FSA has conceded to their ‘insufficiency’ in this respect, see Financial Services Authority, *Mortgage Market Review*, above n 15, para 7.4; see also at p 3.

²⁸ See further C Briault, *The Rationale for a Single National Financial Services Regulator*, (Occasional Paper No. 2, FSA, London, 1999).

²⁹ Section 2 (1) (a) FSMA 2000.

³⁰ See H Davies, *Why Regulate?*, (Henry Thornton Lecture, City University Business School, 4 November 1998), esp. para 2, available at <http://www.fsa.gov.uk/Pages/Library/Communication/Speeches/1998/SP19.shtml>; see also A M Whittaker, *The Role of Competition in Financial Services Regulation*, (Speech to the Regulatory Policy Institute, 27 April 2001), esp. para 26, available at <http://www.fsa.gov.uk/Pages/Library/Communication/Speeches/2001/sp79.shtml>; See also Financial Services Authority, *Reasonable Expectations Regulation in a non-zero failure world*, September 2003, para 1.1, available at http://www.fsa.gov.uk/pubs/other/regulation_non-zero.pdf.

the best assurance of consumer protection and preferences is the free market. The market failure thesis suggests that “an unregulated marketplace is the norm”³¹. This does not necessarily render regulation disruptive of market equilibrium; rather the belief is that regulation “should only be undertaken for a specified and carefully articulated reason”³². The conceptualisation of and justification for regulation has enormous significance as it determines where the mischief lies and how the regulatory body should respond to it. This becomes apparent when scrutinising the FSA’s regulatory approach.

Risk-based approach

In *A New Regulator for the New Millennium*³³ the FSA proudly outlined their regulatory approach and strategy founded upon the contours of “risk-based” regulation. Risk-based regulation has generally two meanings. The first and obvious meaning refers to regulation of risks posed to the society, such as health, safety and the environment. The second meaning, and the one that captures the approach taken by the FSA, refers to risks posed to the regulatory objectives or the institution itself. In other words, risk posed to the FSA in achieving its statutory objectives. This fine, but very important, shift of emphasis allows the regulator to prioritise and allot resources so as to target issues which they believe jeopardise the achievement of its statutory objectives. Importantly, a risk-based approach serves as a legitimate defence for the regulator when held accountable for its actions or, more commonly, inactions.³⁴

So, how are risks that might in fact threaten FSA’s statutory objectives identified, assessed and neutralised? Here, we embark upon the traditional dilemma of which type of error a regulator is prepared to make. Type I error, assuming something is risky when it is not; or type II error, assuming that something is safe when it is not.³⁵ This heuristic device can be easily translated to questioning whether the regulator should err to protect consumers or favour producers. Surprisingly, the FSA has been quite open to the fact that it prefers making type II errors. Indeed, type II errors follow naturally from the market failure thesis and risk-based approach.³⁶

The launch of ARROW

Replacing the Bank of England’s “Risk-Assessment, Tools and Evaluation” system in 2003, the “Advanced Regulatory Risk Operating Framework” (ARROW) became the FSA’s primary tool in identifying and assessing risk in the financial market. ARROW was designed to meet the demands of a single integrated financial regulator and its four statutory objectives.³⁷ In determining “risk”, ARROW employs a formula that calculates *impact* (potential harm that could be caused) multiplied with *probability* (the likelihood of the particular problem occurring).³⁸ ARROW first conducts an impact assessment of the firm, which is initially calculated by using numerical data, such as

³¹ S Breyer, “Analysing Regulatory Failure: Mismatches, Less Restrictive Alternatives, and Reform”, (1979) 92 HLR 549, at p 552.

³² E L Rubin, “Deregulation, Reregulation, and the Myth of the Market”, (1988) 45 Wash & Lee L. Rev. 1249, at p 1258.

³³ Financial Services Authority, January 2000, available at <http://www.fsa.gov.uk/pubs/policy/p29.pdf>.

³⁴ See J Black, “The Emergence of Risk-Based Regulation and the New Public Risk Management in the UK”, (2005), Autumn, P L 512, particularly at p 522.

³⁵ See K S Schrader-Frashette, *Risk and Rationality*, (University of California Press, Berkeley, 1991), at p 519.

³⁶ See FSA’s “non-zero failure” policy in *Reasonable Expectation*, above n 30; see also Financial Services Authority, *The FSA’s risk assessment framework*, August 2006, para 2.7, available at <http://www.rdec.gov.tw/public/Data/851414194871.pdf>.

³⁷ See generally, Financial Services Authority, *The FSA’s risk assessment framework*, *ibid*.

³⁸ *Ibid*, para 3.1.

assets, liabilities and sector-weighted deposits.³⁹ When assessing the *probability* of harm to the statutory objectives, ARROW analyses the gross risk of certain products or businesses and subsequently the quality of controls the firm has in place to mitigate those risks.⁴⁰ Thereafter, the firm is placed in a “relationship category” which determines the type of relationship the firm will have with the FSA.⁴¹ Depending on the level of impact, the firm will fall into one of the four categories: Low, Medium Low, Medium High and High.⁴² Firms that are allocated to the Low Impact category are predominately small firms that receive no individual assessments but merely “baseline monitoring”.⁴³ Although random visits and inspections are not exercised against Low Impact firms⁴⁴, the FSA might pay the firm a visit during one of their thematic reviews. In 2006, close to 95% of FSA’s approximately 29 000 firms were considered to belong to the Low Impact category.⁴⁵ Firms that belong to the Medium to High Impact categories are allocated a relationship manager who carries out risk assessments by either utilising Full ARROW (a full risk assessment of probabilities (all business risks and control risks) within the firm⁴⁶) or ARROW Light (a reduced-scope risk assessment covering certain core areas and sectorally-important issues only⁴⁷) on a cycle of one to four years. In 2007, the then Director of Retail Firms Division of the FSA, Sarah Wilson, stated that 6% of all risks assessments are employed at an interval of less than two years; 35% at an interval up to three year; and the remainder at an interval of three years or more.⁴⁸ For High Impact firms the FSA conducts “close and continuous work” where the relevant supervisory team frequently liaise with the firm’s senior management. In 2006, 0-33% of all firms were categorised as High Impact firms, however, these amounted to 64-20% of the markets impact.⁴⁹

Summary

Regulating approximately 29,000 firms with a staff of around 2,500 is a huge task. The decision to employ a risk-based approach with a non-zero policy by utilising the ARROW framework clearly reflects the reality that not all risks deserve the FSA’s attention on a regular basis. The next part will thus analyse the difficulties faced by the FSA in supervising effectively and ensuring forbearance in mortgage arrears management.

THE REGULATORY BLIND SPOT

Market failure thesis revisited

Illuminating the *raison d’être* for regulation does not only determine the regulatory approach, but significantly, it reveals what regulation is *not* set out to achieve. Here,

³⁹ *Ibid*, Annex 2.

⁴⁰ *Ibid*, para 3.12.

⁴¹ *Ibid* para 3.2.

⁴² *Ibid* para 3.3.

⁴³ See Financial Services Authority, *How We Regulate*, available at <http://www.fsa.gov.uk/Pages/Doing/Regulated/Promo/regime/regulate/index.shtml> and Financial Services Authority, *How we supervise firms*, available at <http://www.fsa.gov.uk/Pages/Doing/Regulated/supervise/index.shtml>.

⁴⁴ J Black, above n 34, at p 532.

⁴⁵ Financial Services Authority, *The FSA’s risk assessment framework*, above n 36, para 4.2.

⁴⁶ *Ibid*, para 4.5.

⁴⁷ *Ibid*, para 4.5.

⁴⁸ Speech by Sarah Wilson, Director Retail Firms Division, FSA, *Supervision in a Principles Based World*, 27 February 2007, (FSA Retail Firms Division Conference, London) available at http://www.fsa.gov.uk/pages/Library/Communication/Speeches/2007/0227_sw.shtml.

⁴⁹ *Ibid*, para 4.2.

McVea potently argues how the market failure thesis blindly adheres to consumer preferences while neglecting our interests as citizens.⁵⁰ While espousing the market failure thesis as a reductionist theory that “treat individuals as consumers”⁵¹, McVea accentuates that financial services’ regulation should be about more than “the sum of consumer interests”⁵². There lays a distinction, McVea argues, between what one might prefer as a consumer and what one might prefer as a citizen. Indeed, as Barron and Dunoff evince, maximising our consumer preferences “tells us nothing about . . . whether those preferences are preferences worth having”⁵³. According to Sagoff, “we are not simply a group of consumers, nor are we bent on satisfying only self-regarding preferences”⁵⁴. Sunstein goes on and state that “people’s preferences, in their capacities as voters or citizens, are quite different from what they are when people act in their purely private or market capacities”⁵⁵. McVea illustrates this by claiming that what one might endorse as a consumer, *eg* maximisation of wealth, may be counterclaimed by the “morality of how that maximisation takes place and the consequences which flow from it”⁵⁶. What McVea is concerned about here is the apparent neglect the market failure thesis poses to interests which are not readily priced⁵⁷, such as losing one’s home. An example of this is put forward by Whitehouse who critically reflects how home-owners have detrimentally strayed from citizens to consumers in the housing market.⁵⁸ Here, Whitehouse argues that housing is a “precondition of citizenship” and must not be conceptualised as a commodity.⁵⁹ By treating home-owners as consumers involves risks of neglecting values and interests that are not ancillary to the market failure thesis.

Risk-based approach revisited

When examining the operative framework of the FSA, the ARROW, it is hard not to be impressed. In a systemic way, ARROW calculates risk by assessing a firm’s impact on the FSA’s statutory objectives multiplied by probability. The regulated firms are then put in different categories which in turn determine the amount, rigour and frequency of regulatory supervision. By doing this, however, the regulatory framework neglects a significant amount of “lower level risk”, which can, if sufficiently numerous and widespread, amount to a cumulative “high level risk”. Indeed, the numerical product of probability and impact may be identical if calculated with high probability/low impact as for low probability/high impact; however, the regulatory response to the risk may not reflect equally. This can be illustrated by the well rehearsed example of train regulation.⁶⁰ Whilst regulators are frequently put under pressure (due to media attention *etc*) to allocate resources to prevent infrequent (low probability)

⁵⁰ H McVea, “Financial Services Regulation under the Financial Services Authority: A Reassertion of the Market Failure Thesis”, (2005) 64(2) CLR 413.

⁵¹ *Ibid*, at p 439.

⁵² *Ibid*, at p 448.

⁵³ J Barron and J Dunoff, “Against Market Rationality: Moral Critiques of Economic Analysis in Legal Theory”, (1996) 17 Cardozo L. Rev. 431, at p 494.

⁵⁴ M Sagoff, “Economic Theory and Environmental Law” (1981) 79 Mich. L. Rev. 1393, at p 1394. See also R Kuttner, *Everything for Sale: The Virtue and Limits of Markets*, (New York 1997), at p 338: “[c]itizen . . . express ideological preferences, beliefs about what is good for the collectivity.”

⁵⁵ C R Sunstein, *After the Rights Revolution: Reconceiving the Regulatory State* (Cambridge, Massachusetts 1990), at p 51.

⁵⁶ McVea, above n 50, at p 442.

⁵⁷ See also J Barron and J Dunoff, “Against Market Rationality”, above n 53, at p 494.

⁵⁸ L Whitehouse, “The Home-Owner: Citizen or Consumer?”, above n 1.

⁵⁹ *Ibid*, at p 204.

⁶⁰ See Rothstein *et al.*, “The risks of risk-based regulation: Insights from the environmental policy domain”, (2006) 32 Environ. Int. 1056, at p 1075.

multiple-fatality (high impact) accidents, they focus less on preventing individual fatality accidents (low impact) which occur more frequently (high probability), regardless whether it statistically involves more deaths. This is the bi-product of risk-based regulation where the “institutional risk”, *ie* the risk of not attaining its regulatory objectives, outweighs societal risks in real terms.⁶¹ The perception of regulatory failure is unavoidable with high impact/low probability, however, barely noticeable with low impact/high probability.

The FSA has neglected the individual home-owners who have been victims of unscrupulous arrears management and premature repossession proceedings as the mortgagees’ non-compliance have, though occurring frequently, had low impact on the financial market. This is where we find the regulatory blind spot of supervising forbearance in arrears management. The contours of ARROW allow non-compliance to occur as long as its impact does not affect the system as a whole, thereby neglecting the individuals losing their homes. Here, as Black would put it, “the concern of the individual and that of the system inevitably collide”⁶².

Baldwin and Black accentuate the importance of balancing the neglect of low impact offences by employing alternative supervising strategies, such as random inspections.⁶³ Without such a complementary tool risk-based approach can “under-deter . . . the ‘forgotten offenders’, who escape prioritisation”.⁶⁴ Analysing compliance from an economic perspective, the regulatory blind spot becomes directly linked to non-compliance. If it can be assumed that mortgagees do not comply with MCOB 13 because the compliance costs (U) (or the benefits of not complying), exceeds the probability of being detected, (p), and the penalty of getting caught (D), then there are little incentives for the mortgagee to comply, except moral ones.⁶⁵ The most secure and efficient way of ensuring compliance is either to increase D or the perception of p , so that U becomes less than pD . Yet, this deterrent formula is arguably rendered worthless if the mortgagee is unaware that it is non-compliant.⁶⁶ This might very well be the case in regards to MCOB 13.

Despite the MCOB 13 reforms, the rules, guidelines and evidentiary provisions are still prone to ambiguities and uncertainties, leading to potential non-compliance. The MCOB 13’s central rule 13.3.1, for instance, contain imprecise and discretionary wording such as, “a firm must deal *fairly* with any customer”. Amorphous terms like “fairly” and “reasonable” are recurrent in MCOB 13. While transforming guidelines into rules to ensure forbearance was salient, relying on interpretations by the mortgagees to yield efficacious results might seem precarious given some of their behaviour to date. Arguably though, given the varying circumstances in which the rules are to apply, it is impossible to rule out wording such as “fairly” and “reasonable”. When the problem is as complex as this, it is generally agreed that ensuring compliance is best achieved through cooperative and conciliatory strategies, rather than deterrence.⁶⁷ As Reiss contends, cooperative strategies are particularly pertinent when the

⁶¹ See Rothstein *et al.*, “A theory of risk colonization: the spiralling regulatory logics of societal and institutional risk”, (2006) 35 (1) *Econ. Soc.* 91, at p 91.

⁶² J Black, above n 34, at p 546.

⁶³ R Baldwin & J Black, “Really Responsive Regulation”, (2008) 71(1) *MLR* 59, at pp 66–67.

⁶⁴ *Ibid.*, at p 67.

⁶⁵ See R Fairman and C Yapp, “Enforced Self-Regulation, Prescription, and Conceptions of Compliance within Small Businesses: The Impact of Enforcement”, (2005) 27 (4) *Law & Pol.* 491, at 494; A Heyes, “Implementing Environmental Regulation: Enforcement and Compliance”, (2000) 17 (2) *J. Regul. Econ.* 107, at p 108.

⁶⁶ See R Fairman and C Yapp, *ibid.*, at p 514; see also J Braithwaite and T Makkai “Testing an Expected Utility Model Corporate Deterrence,” (1991) 25 *Law Soc. Rev.* 7.

⁶⁷ See L Carter and T Burke, *Reason in Law*, (London: Longman Publishing, 2004); B Hutter, *Compliance: Regulation and the Environment*, (Oxford: Clarendon Press, 1997).

harm, such as poor arrears management, derives out of individual or organisational behaviour in business.⁶⁸ Let us illuminate this point by the following case-study.

GMAC-RFC

When the FSA carried out a thematic review of arrears handling and repossessions of 13 mainstream lenders, specialist lenders and third-party administrators, between early 2008 and mid 2009, GMAC-RFC, a specialist lender, was one of the mortgagees under scrutiny. In June 2009, the FSA published a *Final Notice*⁶⁹ holding GMAC in breach of a number of principles including, “failure to take reasonable care to organise and control its affairs responsibly and effectively”⁷⁰, and failure “to pay due regard to the interests of its customers and treat them fairly”⁷¹, between the period 31 October 2004 and 30 November 2008. During this period GMAC administered 188,543 regulated mortgage contracts amounting to approximately £24.6 billion.⁷² The review also concluded that there was a discrepancy between GMAC’s collection policy and its implementation in practice. Although GMAC’s collection policy adhered to MCOB 13, such as including options to alter the payment date or repayment type, extend the mortgage or change the mortgage type, these tools were not considered or implemented regularly by GMAC staff.⁷³ For instance, extending the mortgage term or changing its type was only considered when requested by the customer, not offered by GMAC representative.⁷⁴

Although GMAC carried out reviews of its internal mortgage arrears management, it focused on quantitative measurements, rather than qualitative assessments such as how they treat customers.⁷⁵ The staff received little training of how to treat customers fairly and less so in how to treat them fairly in arrears management.⁷⁶

The case of GMAC patently illustrates how the combined organisational behaviour and culture of a firm breached FSA rules and principles. However, not only is the problem complex (when in the process does the firm start to treat customers unfairly?) it is extremely difficult to monitor and supervise. GMAC was held guilty of breaching Principle 3 (Management and Control), 6 (Treating Customers Fairly) and MCOB 12.4.1 and 13.3.1 during a time period of four years and 188,543 mortgage contracts, which resulted in a penalty fine of £2.4 million, because it *got included* in a thematic review where the participants are selectively sampled. Indeed, the FSA fined several other participants in the thematic review for similar breaches, including Kensington Mortgage Company Limited⁷⁷, Redstone Mortgages Limited⁷⁸, Bridging Loans Limited⁷⁹ and DB UK Bank Limited⁸⁰.

⁶⁸ A Reiss, “Selecting Strategies of Social Control over Organisational Life”, in Hawkins and Thomas (eds), *Enforcing Regulation*, (Boston: Kluwer-Nijhoff, 1984), at p 26 et seq.

⁶⁹ Financial Services Authority, *Final Notice to GMAC-RFC*, available at http://www.fsa.gov.uk/pubs/final/gmac_rfc.pdf.

⁷⁰ *Ibid*, para 2.2.

⁷¹ *Ibid*, para 2.3.

⁷² *Ibid*, para 4.1.

⁷³ *Ibid*, paras 4.8, 4.9, 4.11, 4.12.

⁷⁴ *Ibid*, para 4.9.

⁷⁵ *Ibid*, para 4.3.

⁷⁶ *Ibid*, para 4.3–4.5.

⁷⁷ Financial Services Authority, *Final Notice to Kensington Mortgage Company Limited*, available at <http://www.fsa.gov.uk/pubs/final/kensington.pdf>.

⁷⁸ Financial Services Authority, *Final Notice to Redstone Mortgages Limited*, available at <http://www.fsa.gov.uk/pubs/final/redstone.pdf>.

⁷⁹ Financial Services Authority, *Final Notice to Bridging Loans Limited*, available at http://www.fsa.gov.uk/pubs/final/bridging_loans.pdf.

⁸⁰ Financial Services Authority, *Final Notice to DB UK Bank Limited*, available at http://www.fsa.gov.uk/pubs/final/db_uk.pdf.

Furthermore, during the investigatory and enforcement process of GMAC approximately 40,000 more homes were repossessed. The average length of a regulatory enforcement investigation in 2007/08 was 10.6 months.⁸¹ Indeed, the then Chairman of the Treasury Committee, John McFall, was “shocked at the length of time is taking for the FSA to complete enforcement action against firms it suspects breaking the rules”⁸². Although heed must be paid to procedural fairness it is crucial that enforcement actions are swift as the costs include potentially the loss of a significant number of homes. However, the way in which the FSA detect and enforce non-compliance does not allow this.

The meta-regulatory challenge

As illustrated above, the FSA is incapable of actively and continuously monitoring mortgage lenders' arrears management. The FSA therefore puts significant reliance on self-regulation to ensure forbearance. This regulation of self-regulation is more commonly known as “meta-regulation”.⁸³ This is not an entirely satisfactory way of regulating as the objectives of the internal control or compliance departments of the firms generally differ from that of the regulator. Whereas firms are out to secure profits, market share and other shareholder interests, the FSA is primarily concerned with achieving its statutory objectives. This clash was evident in the case of Kensington Mortgage Company Limited which was fined by the FSA for breaching, amongst others, Principles 3 (Management and Control) and 6 (Treating Customers Fairly). While the FSA found that Kensington reviewed the servicing of its mortgage accounts, it paid little attention to qualitative reviews such as the treatment of its customers. Instead, according to the FSA's findings, “the Firm's management information focused on the performance of the Firm's mortgage book and the profitability of the business”⁸⁴.

Fairman and Yapp illuminate how self-regulation depends on worker empowerment (eg to work as an internal inspector), market conditions (economic incentives), knowledge within the company (how to implement the regulation) and “capacity for change and motivation”.⁸⁵ In the case of GMAC, arguably, none of these components existed internally to ensure *correct* compliance with MCOB. According to Kagan and Scholtz, there are three “images” and corresponding theories of why firms fail to comply.⁸⁶ The “amoral calculators” disregard regulation on risk-benefit criteria, the “political citizen” choose not to comply as it disagrees with the rules, and the “organisationally incompetent” fails to comply due to inadequate management, systems and controls.⁸⁷ The different “images” require different types of regulatory strategy to ensure compliance. Clearly, the first two are well aware of the rules, however, choose to disregard them. These are not in need of cooperative strategies to enhance understanding and compliance; rather these require deterrence where U is less than pD . The third image, however, require a regulatory framework which is sufficiently resourceful to invest time on cooperating and educating the firm towards compliance through self-regulation. GMAC breached FSA principles and rules because

⁸¹ Financial Services Authority, *Enforcement annual performance account 2007/08*, p 9, available at http://www.fsa.gov.uk/pubs/annual/ar07_08/Enforcement_report.pdf. Data for 2008/09 was not included in the 2008/09 report.

⁸² Statement made by John McFall in a Treasury Committee Press Notice 8 August 2009, available at http://www.parliament.uk/parliamentary_committees/treasury_committee/tc0809pn080809.cfm.

⁸³ See J Black, above n 34.

⁸⁴ Financial Services Authority, *Final Notice to Kensington Mortgage Company Limited*, para 4.19.

⁸⁵ R Fairman and C Yapp, above n 65, at p 494.

⁸⁶ R Kagan and J Scholtz, “The ‘Criminology of the Corporation’ and Regulatory Enforcement Strategies” in Hawkins and Thomas (eds) *Enforcing Regulation*, above n 68.

⁸⁷ *Ibid*, at pp 67–68.

it, in a nutshell, failed to “Treat Customers Fairly”. This conclusion was drawn upon a holistic examination considering a wide array of practices taken by GMAC during a period of four years. While GMAC’s conduct is indefensible, legally it is not a clear cut breach. If such a principles-based regime is in force, the FSA must interactively cooperate and educate the mortgagees to ensure they comply with the standard in the way FSA expects them to. If the staple of breach comes down to an interpretation of “fairly” and “reasonably”, the mortgagees require clear guidance of conduct which is actively enforced, first through their own control systems and secondly through the FSA. This, however, requires the type and amount of resources the FSA is not able or willing to direct, considering its risk-based approach.

The FSA’s Response

The 2008 financial crisis significantly curbed the FSA’s credibility as a financial “watch-dog” as it became heavily criticised for its “light touch” supervisory approach of regulation. The FSA has since been keen to regain trust and has consequently introduced tougher and more intensive supervisory measures. According to the *Turner Review*, published in March 2008, “[t]he FSA’s new supervisory approach is significantly different and underpinned by a different philosophy of regulation”⁸⁸. A new operating platform, the *Supervisory Enhancement Programme* (SEP), was completed in August 2009 which, amongst other things, increased specialist and supervisory staff and implemented a new supervisory training and competence regime.⁸⁹ The *Turner Review* was particularly concerned with increasing resources to deal with prudential risk, particularly from high impact and complex banks, and paying more attention to cross-sector trends that may create systemic risks.⁹⁰ Enthused to tighten the regulatory belt around the financial market, the FSA has, since it introduced the SEP, significantly increased investigatory work and imposed more penalties than ever before, including criminal prosecutions.⁹¹ However, although the FSA has duly responded to the financial crisis and learnt from many of its past mistakes, it has focused primarily on remedying what caused the crisis in the first place, rather than its ramifying and peripheral processes, such as monitoring arrears management. This is not surprising given FSA’s risk-based approach and focus on high impact/low probability risk. In speeches delivered by Hector Sants, the Chief Executive of the FSA, and Jon Pain, then Managing Director (Supervision) of the FSA, they explicitly and proudly used the case of GMAC as an example of the “new” FSA and its “credible deterrence” scheme.⁹² While the credible deterrence scheme might have caused the FSA, with its additional and more competent staff, to investigate GMAC closer and harder and impose higher fines, the scheme provides few suggestions as to how, apart from a continuing reliance on thematic reviews and meta-regulation, non-compliance is spotted in the first place. Therefore, despite the internal reforms of the FSA, there is a gap in the system that must be filled.

⁸⁸ Financial Services Authority, *The Turner Review: A regulatory response to the global banking crisis*, March 2008, at p 88, available at http://www.fsa.gov.uk/pubs/other/turner_review.pdf.

⁸⁹ H Sants, *Intensive Supervision: delivering the best outcomes*, (Bloomberg, 9 November 2009) available at http://www.fsa.gov.uk/pages/Library/Communication/Speeches/2009/1109_hs.shtml.

⁹⁰ Financial Services Authority, *The Turner Review*, above n 88, at pp 88–89.

⁹¹ See statistics at Financial Services Authority, *FSA Annual Report 08/09*, at p 12, available at http://www.fsa.gov.uk/pubs/annual/ar08_09/ar08_09.pdf.

⁹² See H Sants, above n 89, and J Pain, *How the regulator views the mortgage market*, (Speech at Council of Mortgage Lenders’ Mortgage Industry Conference and Exhibition, 13 November 2009) available at http://www.fsa.gov.uk/pages/Library/Communication/Speeches/2009/1113_jp.shtml.

New regulatory structure under the new government

When the new Chancellor of the Exchequer, George Osborne, published his Consultation Paper (CP) in July 2010 labelled *A new approach to financial regulation*⁹³, which effectively proposed to abolish the FSA as an integrated financial regulator and the overall tripartite regulatory system of the FSA, Bank of England and the Treasury, few were surprised.⁹⁴ In its election Manifesto, the Conservatives struck hard against the FSA and the tripartite system for failing to adequately and effectively monitor systemic and prudential risks.⁹⁵ This criticism was echoed in the CP where it accentuated the three authorities' collective failure to identify problems in the financial system, mitigate those problems before they led to instability and respond adequately to the crisis.⁹⁶

Accordingly, the CP proposed instead the creation of three new bodies: the Financial Policy Committee (FPC), the Prudential Regulation Authority (PRA) and the Consumer Protection and Markets Authority (CPMA). The FPC will be part of the Bank of England and focus on macro-prudential analysis and action.⁹⁷ The PRA will be a subsidiary to the Bank of England⁹⁸ and complement the FPC by conducting prudential regulation of individual firms, micro-prudential regulation if you will. Finally, the CPMA will assume the role of "consumer champion" by regulating the conduct of firms towards retail customers and participants in the wholesale financial markets.⁹⁹

The idea behind establishing these three separate but (hopefully) closely coordinated and cooperative bodies is to coordinate a systemic approach of prudential supervision of the entire financial market but simultaneously carve out particular responsibilities (micro-prudential and conduct regulation) which require spearheaded regulation, supervision and enforcement. This was characterised as another pivotal failure by the FSA and one that provides backing to the submissions made in this article. As the CP emphasised "[p]rudential and conduct of business regulation require different approaches and cultures, and combining them in the same organisation is difficult"¹⁰⁰. As we have seen above, putting macro and micro responsibilities within one body, the FSA, creates counteracting responsibilities where the individual consumer gets neglected or disregarded in the pursuit of upholding the statutory objectives. The CP made a similar point in stating "as a result of the combined remit of the FSA, participants in financial services and markets, particularly ordinary consumers of retail products, did not always get the degree of regulatory focus or the protection they may have expected or required"¹⁰¹. Therefore, according to the CP, a new separate body which would focus entirely on conduct of financial firms is needed.

Consumer Protection and Market Authority

The objective of the CPMA is twofold: to protect consumers and to promote confidence in the integrity and efficiency of the UK's financial markets.¹⁰² The CPMA

⁹³ HM Treasury, *A new approach to financial regulation: judgement, focus and stability*, (July 2010), Cm.7874.

⁹⁴ See further, P. Rawlings, "Reform of bank regulation in the United Kingdom: the opening salvo", (2010) 25(10) JIBLR 522.

⁹⁵ Conservative Manifesto, 2010, available at <http://www.tinyurl.com/comcys>.

⁹⁶ *Ibid.*, 1.4.

⁹⁷ *Ibid.*, 1.10.

⁹⁸ *Ibid.*, 1.14.

⁹⁹ *Ibid.*, 1.19.

¹⁰⁰ *Ibid.*, 4.2.

¹⁰¹ *Ibid.*, 1.20.

¹⁰² *Ibid.*, 1.21.

will function as a “single integrated conduct regulator”¹⁰³ with both rule-making, supervisory and enforcement powers.¹⁰⁴ The CPMA’s aim proclaims to take a more proactive and focused approach to regulate business conduct, but will “build on the progress recently made by the FSA towards a more interventionist and pre-emptive approach to retail conduct regulation”.¹⁰⁵ For mortgage market regulation, this means continuing reliance on thematic reviews (Mortgage Market Reviews). The CP contains no other suggestions of how effective supervision of mortgage lenders might look like, suggesting that the issues previously illuminated in this article purportedly remains. While establishing a new and separate body to regulate conduct of business meets some of the issues raised in this article as it will somewhat close the operative gap between the regulator and the consumer, it remains to be seen how far the CPMA will ensure forbearance amongst mortgage lenders. Beyond Mortgage Market Reviews, which serves as a supervisory purpose *ex post facto*, how will the CPMA ensure compliance with MCOB 13 *ex ante* or in the instant case?

Combining the responsibilities of FSA and Office of Fair Trading (OFT) into CPMA

As mentioned above, mortgages taken out before October 2004 and second charge mortgages (which studies have shown are frequently taken up by sub-prime mortgagors and involve a higher frequency of reposessions¹⁰⁶) are not regulated by the FSA and MCOB but classified as “consumer” loans and regulated by the OFT under the Consumer Credit Act 1974, which lacks a prescriptive code of conduct tailored to the sensitive circumstances of the mortgage. The CP proposes to remedy this seemingly unjustified and confusing division of regulation by combining the two bodies’ (FSA and OFT) responsibilities under the CPMA. However, whether MCOB’s applicability to second charge mortgages will consequently follow remains to be seen. Further, as the CP itself acknowledges, to transfer the responsibility for consumer credit from the OFT to the CPMA is a laborious and challenging task which will take significantly longer than the two year plan set out in the CP. Until then, the current division and its shortfalls continue to determine the mortgage market.

Summary

The risk-based approach and regulatory framework operated by the FSA do not extend to the individual home-owners falling into arrears. While the regulatory machine is effective when it comes to quantitative measurements, it is blind when assessing the qualitative conduct of mortgagees, such as treating customers fairly. What the regulatory regime has boiled down to is an excessive reliance on irregular and infrequent thematic reviews that only examine a fraction of the mortgagees coupled with unreliable and inadequate self-regulation. While plans have been put forward to abolish the FSA and establish a new regulatory system where regulation and supervision of conduct of business will get carved out and fall under a separate body, the CPMA, questions remain as to how the new body will close the operative gap between the consumer, the lender and the regulator. In any event, the government’s new regulatory system will not help anyone within (at least) the next two years. As the economic crisis still claims homes through a relatively high rate of reposessions, we must still focus on the issues today, *ie* ensuring forbearance in mortgage arrears management. To do so we must accept the limits of the FSA but not forget the aims

¹⁰³ *Ibid*, 4.4.

¹⁰⁴ *Ibid*, 4.19 and 4.22.

¹⁰⁵ *Ibid*, 4.22.

¹⁰⁶ House of Commons Treasury Committee, *Mortgage arrears and access to mortgage finance*, above n 16, Ev 48 and 132.

of MCOB. In seeking to achieve those aims, we may have to look for an alternative approach. The following section argues that the Protocol presents a potential opportunity for this.

ASSURING FORBEARANCE

The Mortgage Pre-Action Protocol

In response to the growing amount of mortgage repossessions, the Civil Justice Council implemented the Protocol in November 2008.¹⁰⁷ The Protocol is more or less a reflection of MCOB 13 and is designed to “help make repossessions a last resort”¹⁰⁸ as it outlines “all the steps that a lender should take before issuing mortgage possession proceedings”¹⁰⁹. As most repossessions are taken via court orders, the Protocol provides the judiciary with additional considerations when handling such cases. Under section 36 of the Administration of Justice Act (AJA) 1970, the judge is awarded limited leeway to interpose in the repossession process including a discretion to adjourn, stay or suspend the proceedings for repossession “if it appears that the mortgagor is likely to be able within a reasonable period” to pay the “sums due”.¹¹⁰ As the lender enjoys an “inherent right to possession”¹¹¹ of the mortgaged property, the judge is only permitted to exercise this discretion if the mortgagor can prove a financial capability to pay back the accumulated arrears and the continuance of the mortgage. Thus, section 36 is uninterested in the conduct of the parties prior to court proceedings, insensitive to the reasons for the arrears, and oblivious to the social ramifications repossession might entail. The instigation of the Protocol has provided an additional layer in this rather static and inflexible process by allowing the judge to consider pre-action communication. For the champions of a more fair and equitable mortgage relationship, the Protocol serves as a crucial first step in the right direction. Not only was the judiciary’s hands tied to the meagre discretion provided for under section 36, they were also largely ignorant or indifferent to MCOB 13’s role in the process.¹¹² However, the Protocol indirectly educates the judiciary of the remit of MCOB 13 and synchronises the FSA and the courts’ expectations of the mortgage relationship.

Upon implementation, the Protocol did not reach the potential it could have. The lack of compulsory wording and sanctions for non-compliance are the main reasons why the Protocol has been argued to constitute an “opportunity lost”¹¹³ in answering the concerns of poor arrears management and premature repossession proceedings.¹¹⁴ The Financial Services Consumer Panel has proclaimed the Protocol to be “relatively toothless” and “a lack of clarity about how much judges can take failure to keep to

¹⁰⁷ Civil Justice Council, *Pre-Action Protocol for Possessions Claims Based on Mortgage or Home Purchase Plan Arrears in Respect of Residential Property*, November 2008, available at http://www.civiljusticecouncil.gov.uk/files/Mortgage_Pre-Action_protocol_21_Oct.pdf.

¹⁰⁸ HM Treasury, *Securing a fair framework for homeowners*, Press Notice 22 October 2008, para 1, available at http://www.hm-treasury.gov.uk/press_108_08.htm.

¹⁰⁹ Former Justice Minister Bridget Prentice, *ibid*, para 8.

¹¹⁰ The ambiguous wording of “sums due” and “reasonable period” got later defined by s 8 of the Administration of Justice Act 1973 and *Cheltenham and Gloucester Building Society v Norgan* (1996) 1 All ER 449, respectively.

¹¹¹ See *Four-Maids Ltd v Dudley Marshall (Properties) Ltd* [1957] Ch 317, per Harman J.

¹¹² See Financial Services Consumer Panel’s statement in the House of Commons Treasury Committee, *Mortgage arrears and access to mortgage finance*, above n 16, Ev 151 para 5.

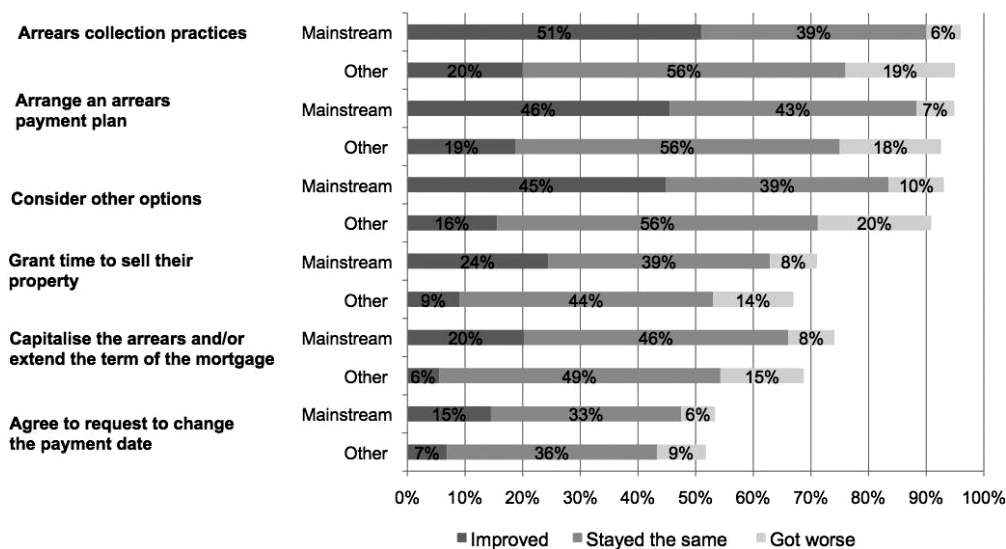
¹¹³ Whitehouse, L, “The Mortgage Arrears Pre-Action Protocol: An Opportunity Lost”, (2009) 72 (5) MLR 793.

¹¹⁴ See also P McAuslan, “Mortgage arrears: the repossession crunch”, (2009) 24 (3) JIBFL 137.

these rules into account in a possession action”¹¹⁵. Evidence in support of these claims has been offered by the Citizens Advice Bureau *et al.*’s December 2009 report, “Turning the Tide?”¹¹⁶, which summates data drawn from interviews with client advisors in 452 repossession cases in July 2009. The report concludes that in a third of recorded cases¹¹⁷ the advisers considered the lenders had not complied with the Protocol.¹¹⁸ In 63% of the cases the lender had not offered an arrears repayment plan and in 15% the arrears repayment plan was not affordable.¹¹⁹ In 71% of the cases no alternatives to repossession (such as time to sell the property¹²⁰ or vary the mortgage¹²¹) had been offered.¹²² The study also revealed that sub-prime lenders go to court earlier and more often than mainstream lenders. An examination of a court list of 2,444 cases revealed that 55% derived from sub-prime lenders, 34% from mainstream lenders and 7% from specialist second charge lenders, which is particularly notable considering sub-prime lenders hold a significantly smaller proportion of the market share.¹²³

Lenders’ arrears collection practices

As the figure below indicates, while arrears management has been improving since the implementation of the Protocol, it is clear that the Protocol has had a greater effect on mainstream lenders than sub-prime lenders. Research conducted by AdviceUK *et al.* from April 2009 reveals that whereas 51% of advisers reported improvements in mainstream lenders’ arrears collection practices since the implementation of the



Source: AdviceUK *et al.*

¹¹⁵ House of Commons Treasury Committee, above n 16, *Written evidence from the Financial Services Consumer Panel*, Ev 151 paras 5–6.

¹¹⁶ Citizens Advice Bureau *et al.*, *Turning the tide? Evidence from the free advice sector on mortgage and secured loan possession actions in England in July 2009*, December 2009, available at http://england.shelter.org.uk/_data/assets/pdf_file/0020/236342/Turning_the_tide_FINAL.pdf.

¹¹⁷ 101 out of 300 cases.

¹¹⁸ Citizens Advice Bureau *et al.*, *Turning the tide?*, above n 116, at p 12.

¹¹⁹ *Ibid.*

¹²⁰ Art 6.2 of the Protocol.

¹²¹ According to Art 5.4 of the Protocol.

¹²² Citizens Advice Bureau *et al.*, *Turning the tide?*, above n 116, at p 12.

¹²³ *Ibid.*, at p 21.

Protocol, only 20% reported improvements within the sub-prime and second charge lenders.¹²⁴ However, as statistics illustrate¹²⁵, there is great potential for this judicial instrument to provide MCOB 13 with “teeth”. The next sections will outline how the Protocol could reach its full potential and thus counteract the regulatory blind spot.

Call for upgrade

MCOB 13 and the Protocol serve two distinct but intertwined and related purposes. MCOB 13 is an industry instrument which sets the industry standard, thereby serving (supposedly) primarily a proactive and guiding purpose and secondary a reactive (enforcing) purpose. Similarly, the Protocol is an instrument which intends to determine the actions taken by the parties prior to court action, *ie* primarily a guiding and educating purpose. If the issue comes before the court, the Protocol becomes a judicial instrument serving a secondary evaluative purpose reflecting on actions taken. Both MCOB 13 and the Protocol’s primary and secondary purposes are operationally interlinked and mutually reinforcing. The FSA has thus far failed to proactively ensure forbearance due principally to its inability to spot and enforce non-compliance, leaving greater reliance on the Protocol. As demonstrated above, while improvement in arrears handling have been made, due, at least in part, to the implementation of the Protocol¹²⁶, there are still hurdles to overcome. Sub-prime lenders are unquestioningly the greatest threat to uniform and consistent adherence to MCOB 13 and thus the sustainability of home tenure amongst vulnerable borrowers. In 2005 the CML included 14 specialist lenders in its membership¹²⁷, amounting to a total of 9.5% of the mortgage market¹²⁸. In 2008 five out of 30 largest mortgage lenders in the UK were specialist lenders.¹²⁹ Importantly, MCOB 13 has limited applicability as it only applies to first charge loans issued after 31 October 2004. As many of the specialist lenders’ mortgage transactions are second charge mortgages, they fall outside the remit of MCOB 13 altogether. Consequently, the FSA’s MCOB reforms have no effect on sub-prime second charge lenders, who are purportedly those in greatest need of a tougher regulatory framework. The Protocol, conversely, applies to all types of mortgages. This is why it is of paramount importance to upgrade the Protocol in alignment with the MCOB reforms to ensure regulatory protection to every mortgagor in every instant case.

The Protocol must change its recommendatory language into compulsory to ensure compliance amongst these lenders and equip the judiciary with legitimate justification for intervening in the repossession process and demand evidence of equitable arrears management to ensure that repossession is indeed a last resort rather than first response. Incidentally, this type of language was included in the *draft* Protocol which, due to pressure from the CML and Building Societies Association, failed, leaving the *revised* and current protocol relatively toothless.¹³⁰ Indeed, a shift of language would

¹²⁴ AdviceUK *et al.*, *Mortgage and secured loan arrears: Adviser and Borrower Surveys April 2009*, above n 15, at p 3.

¹²⁵ The third quarter of 2009 showed a 37% decrease of mortgage repossession claims as compared to the third quarter of 2008. Citizens Advice Bureau *et al.*, *Turning the tide?*, above n 116, at p 16.

¹²⁶ We cannot discard other governmental actions, such as lender pledge to postpone repossession proceedings, mortgage rescue schemes and expansion of free legal aid. See <http://www.communities.gov.uk/documents/housing/pdf/1153110.pdf>.

¹²⁷ Munro *et al.*, *Lending to higher risk borrowers: Sub-prime credit and sustainable home ownership*, (Joseph Rowntree Foundation, 2005).

¹²⁸ M Stephens and D Quilgars, “Sub-prime Mortgage Lending in the UK”, (2008) 8 (2) *Europ. J. Housing Pol.* 197, at p 201.

¹²⁹ Council of Mortgage Lenders, *2008 Largest Mortgage Lenders*, available at <http://www.cml.org.uk/cml/publications/newsandviews/46/153>.

¹³⁰ For an in-depth analysis see L Whitehouse, “The Mortgage Arrears Pre-Action Protocol: An Opportunity Lost”, above n 113.

be the natural way of progression subsequent to the MCOB reforms. Here is one comparative example of how the Protocol might get upgraded to mirror MCOB 13.

As it stands, the Protocol states that “*the parties should take all reasonable steps to discuss with each other . . . the cause of arrears, the borrower’s financial circumstances and proposals for repayment of the arrears*”¹³¹, whereas the new MCOB rule stipulates that the *firm* “*must . . . allow a reasonable time over which the payment shortfall . . . should be repaired . . . having particular regard to the need to establish . . . a payment plan which is practical in terms of the circumstances of the customer*”¹³². In the new MCOB rules the onus of equitable progression lies with the lender, whereas the Protocol extends a more neutral and discretionary guidance on how pre-action communication *should* be exercised. Upgrading this provision in the Protocol to match the requirements of the new MCOB rule would oblige the parties to discuss options where the borrower’s individual circumstances are taken into consideration.

Similarly, Art 5.4 of the Protocol states that “[t]he lender *should consider* a reasonable request from the borrower to change the date of regular payment . . . or the method by which payment is made.” The new MCOB rules oblige the firm to “grant, *unless* it has good reason not to do so, a *customer’s* request for a change to (i) the date . . . (ii) the method [of payment]”¹³³. An upgraded version of the Protocol to match the new MCOB rules would thus put the lenders in a much tougher position as they become obliged to first consider any proposals for repayment, and second explain why the proposal is unsatisfactory. Importantly though, the judges must be provided with the authority to scrutinise the decisions taken by the lender during pre-action communication.

The law of mortgage needs to be reviewed by equitable considerations. Upgrading the recommendatory language in the Protocol to an obligatory one would not only put pressure on the lenders to deal equitably with borrowers in arrears, but it would allow the judge in all repossession proceedings to consider factors beyond the financial capability of the mortgagor. As such, it would significantly alter the imbalance in the current law of mortgage. As successive governments’ have been more concerned with facilitating mortgage finance than ensuring corresponding mechanisms for retaining homes during dire straits, an upgraded Protocol will rebalance the law of mortgages and *de facto* qualify the mortgagees’ inherent right to possession, at least where the cases are brought to court.¹³⁴ This is potentially a ground-breaking development within the law of mortgage. To render the inherent right to possession contingent upon meeting the demands of the Protocol, we can ensure forbearance in arrears management in every instant case.

However, a shift in tone will not suffice on its own. Clear sanctions are required to arm the judiciary with sticks to punish non-compliance. Indeed, in the Citizens Advice Bureau *et al.*’s December 2009 report the judges only applied sanctions in six of the cases that did not comply with the protocol.¹³⁵ This is not surprising considering all the Protocol stipulates in regards to compliance is that “*parties should be able . . . to explain the actions they have taken to comply with [the] protocol*”. If change is as dearly needed and wanted as the government claims, this is not acceptable. Applying sanctions upon non-compliance is absolutely essential in order to ensure that homes are

¹³¹ Art 5.2, Mortgage Pre-Action Protocol.

¹³² MCOB 13.3.2AR (3).

¹³³ MCOB 13.3.2AR (4)(a)–(b).

¹³⁴ However, it would not safeguard against circumstances illustrated with the cases of *Ropaigalach*, above n 1, and *Horsham Properties v Clark and Beech* [2008] EWHC 2327 (Ch), [2009] 1 WLR 1255.

¹³⁵ Citizens Advice Bureau *et al.*, *Turning the tide?*, above n 116, at p 12.

not lost unnecessarily. For instance, evidence suggests that court proceedings are often pursued by lenders to entice repayment of monies owed and not to actually take possession of the property.¹³⁶ This “debt recovery” strategy exacerbates the borrower’s situation as they are often contractually bound to pay court proceedings.¹³⁷ Equipping the judiciary with powers to actively intervene in the contractual relationship would counterweigh such potentially unfair contract terms.¹³⁸ Furthermore, sanctioning powers would also economically incentivise lenders to treat borrowers fairly.

Inevitably when discussing tightening the regulatory belt concerns arise as to the inhibiting flow and availability of mortgage finance, particularly to first time buyers. The CML continuously emphasise that any attempts to curtail the rights granted to lenders “would have severe consequences for the lending industry and therefore the borrower and for the economy as a whole”¹³⁹. Indeed, this response was one of the reasons why the *draft* Pre-Action Protocol failed. However, the CML’s contention is not necessarily true and in any event purportedly unwanted. While arguing for a fairer balance between mortgagors and mortgagees in repossession proceedings, Smith informs us that as mortgagees in the twenty-first century “appear to be more enthusiastic when it comes to lending money . . . than ever before”¹⁴⁰, the anticipated fear of restrained mortgage availability due to regulatory and legal measures may not be as acute as previously contended. In fact, while during the period between 1997–2007 mortgage debt rose by more than 200%¹⁴¹, there was actually a reduction of the number of households with a mortgage by 152,000¹⁴². Indeed, during the last 20 years the proportion of home owners in the UK has stagnated while mortgage finance has surged. So where does all the mortgage activity come from? What we have seen during the last two decades, and what contributed to an unsustainable and volatile mortgage market is a surging amount of *remortgaging* in order to consolidate debts and sustain perpetual consumption. As Lynda Blackwell, Mortgage Policy Manager at the FSA, correctly identifies, “remortgaging . . . did nothing to increase home ownership – but it had a very significant impact on house prices”¹⁴³. House prices almost doubled between 2000–2010 (taking into account inflation) rendering the average house worth 4.3 times more than the average borrower’s income, as compared to 3.2 times income in 2000.¹⁴⁴ The priority must not be securing home ownership for all no matter what cost, it ought to be creating a sustainable and responsible property and mortgage market. As I have previously argued, governments during the 20th century might have been right in claiming that home-ownership is a deep-rooted desire ingrained in the hearts of UK citizens. What the government is ultimately responsible for, however, is the formation of policies that correspond with the realities of contemporary politics,

¹³⁶ See Citizens Advice Bureau *et al.*’s December report, *Turning the Tide*, above n 116, at p 13; and L Whitehouse, above n 116, at p 810.

¹³⁷ Typically around £600 per hearing. L Whitehouse, above n 113, at p 810.

¹³⁸ See L Whitehouse, above n 113, p 809–810. This power was, incidentally, included in the *draft* Protocol. See Art 15, Civil Justice Council, *Consultation Paper: Mortgage Arrears Protocol*, 29 February 2008, available at <http://www.civiljusticecouncil.gov.uk/les/mortgage-pre-action-protocol-6nal290208.pdf>.

¹³⁹ Council of Mortgage Lenders *Mortgage Remedies (Possession and Sale) Review Response by the Council of Mortgage Lenders to the Ministry of Justice’s Initial Review* (14 January 2009).

¹⁴⁰ S Smith *Banking and Housing: Speculating the Role and Relevance of Housing Wealth in Britain*, paper prepared for the Joseph Rowntree Foundation Inquiry into Home ownership 2010 and beyond, 2005, at p 4.

¹⁴¹ Council of Mortgage Lenders, *Gross Mortgage Lending*, available at <http://www.cml.org.uk/cml/media/press/2861>.

¹⁴² Communities and Local Government, *Tables of Household Characteristics: Table 801 Tenure Trend*, available at <http://www.communities.gov.uk/housing/housingresearch/housingstatistics/housingstatisticsby/householdcharacteristics/livatables/>.

¹⁴³ Financial Services Authority, speech by Lynda Blackwell 20 October 2010, *The Future Landscape for Mortgage Regulation*, available at http://www.fsa.gov.uk/pages/Library/Communication/Speeches/2010/1020_lb.shtml.

¹⁴⁴ Communities and Local Government, *Housing Statistics*, available at <http://www.communities.gov.uk/housing/housingresearch/housingstatistics/housingstatisticsby/housingmarket/livatables/housepricestables/simpleaveragestables/>.

economics and culture. Denying home-ownership to financially incapable individuals is not being hard or arbitrary; it is being fair, true and prudent.¹⁴⁵ The mortgage relationship is a two way street and responsibility ought to be reciprocal. Regulation must not only determine who can realistically afford and sustain a mortgage, but also ensure that once a home is secured via a mortgage, that home is not lost unnecessarily due to non-compliance with the regulatory framework.

Micro v Macro Regulation under the New Regime

As illustrated in this article, there is an operational distance between the harms conducted on the ground and supervisory framework in place to detect and sanction those harms. The FSA's risk-based approach necessarily and justifiably neglects the individual home-owner who has been a recipient of lenders who, knowingly or unknowingly, fail to comply with the set standards of MCOB 13. This neglect does not only, as the market failure thesis, ARROW, and many of the self-regulatory control systems in place would primarily recognise, result in a vulnerable and precarious financial situation, importantly, it results in a loss of *home*. It has been argued that in legal and regulatory discourse, the concept and importance of *home* has not been properly and fairly recognised.¹⁴⁶ Approaching MCOB 13 through a market oriented framework where success and failure is measured in a numerical formula of *risk* is not only demonstrably insufficient but clearly weighs in favour of the economic rather than social interests, thus neglecting an important aspect of the housing system in the UK. More must be done. Every loss of home counts. Instead of waiting for a thematic review to indicate compliance or non-compliance of MCOB 13 or relying heavily on meta-regulation, upgrading the Protocol will ensure active compliance in every individual case brought to court. This would effectively transform static reviews of MCOB 13 compliance into an on-going process of assuring forbearance. This would also allow the mortgage lender to receive constant education of how the government expects them to behave when handling arrears. This approach falls naturally with Ayres and Braithwaite's pyramid of regulatory strategy and enforcement as we have thus far tried persuasion and self-regulation and time has come to take a more robust approach.¹⁴⁷ Enforcing compliance and sanctioning non-compliance in every individual case would dramatically increase *pD* to surpass *U*, thus giving the sub-prime lenders an economic incentive to forbear, which is particularly pertinent in regards to "amoral calculators"¹⁴⁸.

However, reliance on the Protocol to ensure forbearance in arrears management should not render the FSA obsolete in the process. Decisively, the Protocol is a case-by-case working document whereas the FSA, via the standard set out by MCOB 13, has the potential to evaluate trends within a firm or group of firms. This is an important distinction as a firm might breach MCOB 13 as the result of a holistic evaluation of cumulative and organisational behaviour which the Protocol remains insensitive to when dealing with individual cases. However, the courts can supply data to the FSA which can indicate trends amongst mortgagees and reveal where further

¹⁴⁵ See P. T. Lindberg, "Defend My Castle: Is the UK in Violation of the European Convention of Human Rights?," (2010) 22 Denning L. J. pp. 1–34.

¹⁴⁶ See L. Fox, *Conceptualising Home: Theories, Laws and Policies*, (Oxford: Hart Pub., 2007); R. Lawrence, "Deciphering Home: An Integrative Historical Perspective" in D. N. Benjamin, *The Home: Words, Interpretations, Meanings and Environments*, (Aldershot, Ashgate, 1995).

¹⁴⁷ See I. Ayres and J. Braithwaite, *Responsive regulation: transcending the deregulation debate*, (New York: Oxford University Press, 1992); see also J. Braithwaite, *To Punish or Persuade: Enforcement of Coal Mine Safety*, (State University of New York, 1985); B. Hutter, *The reasonable arm of the law?: the law enforcement procedures of environmental health officers*, (Oxford: Clarendon Press, 1988).

¹⁴⁸ R. Kagan and J. Scholtz, above n 86, at p 68.

scrutiny is required. This would fall naturally with the risk-based approach taken by the FSA as it would allow the FSA to prioritise resources on evidential grounds. For instance, in GMAC's final report the FSA had spotted that GMAC had management information showing that customer applications to postpone or dismiss evictions were often successful and GMAC was not always successful in securing the order it had applied for.¹⁴⁹ Prior to 2008, GMAC had not analysed or taken any action to why this was the case¹⁵⁰, however, if court statistics had been supplied to the FSA it could have raised a flag of potential inadequacy of GMAC's arrears management, which could have instigated an earlier investigation which ultimately would have resulted in fewer repossessions.

CONCLUSION

This article has reviewed the current status of mortgage regulation, its history and proposed reforms, and the FSA's regulatory approach in monitoring and enforcing compliance with it. Awaking out of yet another economic crisis, new light has been shed on the regulatory framework and pressure on fairer arrears practices has intensified. While the FSA's reforms of transforming guidelines and evidential provisions in MCOB 13 into rules is laudable, this article has illuminated how the FSA's risk-based approach to regulation, epitomised by the operative framework of ARROW, will hinder its potential in ensuring forbearance in mortgage arrears management. This is due to what this article has labelled the regulatory "blind spot" of the FSA in monitoring and assessing qualitative measurements, such as treating customers fairly. This has forced the FSA to rely heavily on "meta-regulation", that is regulation of self-regulation, and sporadic and selective thematic reviews in monitoring and enforcing forbearance. However, when we are facing an estimated 40,000 repossessions in 2011¹⁵¹, these are inadequate means of ensuring fair and equitable arrears management. During his Chairmanship of the Treasury Committee, John McFall reflected that "[l]osing the family home is one of the most distressing experiences a family can go through".¹⁵² In times of economic difficulties, private as well as national, it is of utmost importance that mortgagees forbear taking repossession and remain flexible and equitable to ensure a home is not lost unnecessarily. This article has argued that the only, or most prudent, way of doing this is to accept the limits of the FSA and endorse the capabilities of the Protocol by upgrading its recommendatory language into an obligatory one. Equipping the judiciary with tools of submitting the mortgage relationship to equitable considerations and making possession claims contingent upon compliance with the Protocol would ensure that mortgagors are treated fairly in every instant case. Adopting this approach in ensuring forbearance and curbing unnecessary home repossessions might also inform the government's proposals of establishing a new regulatory system where a separate body, the CPMA, will focus on consumer protection. By accepting the limitations of a regulatory body's capabilities in ensuring compliance with its code of practices, the regulatory body can invest greater resources into areas it can have a significant and effective impact, such as spotting market or firm trends. This approach would meet the

¹⁴⁹ Financial Services Authority, *Final Notice GMAC-RFC*, above n 69, para 4.15.

¹⁵⁰ *Ibid.*

¹⁵¹ See repossession statistics from Council of Mortgage Lenders, available at <http://www.cml.org.uk/cml/media/press/2836>.

¹⁵² Statement made by John McFall in a Treasury Committee *Press Notice* 8 August 2009, above n 82.

regulatory bodies' secondary objectives under the FSMA 2000, such as using its resources in the most efficient and economic way.

Successive UK governments have actively encouraged home-ownership, despite recurring tragedies of housing crises. However, for every such crisis something new is learnt. This time around, the crisis installed a Protocol and a reformed MCOB 13. However, while these might appear as answers to echoed and new cries for reform; let us not be fooled into believing this is enough.

CASE AND COMMENT

The address for the submission of material for this section is given at the beginning of this issue

SENTENCING IN CASES OF SMALL-SCALE CANNABIS PRODUCTION

Auton and Others v R [2011] EWCA Crim 76
(Hughes LJ, Eady and Rafferty JJ)

INTRODUCTION

The Court of Appeal recently heard a joint appeal from four defendants involved in small-scale production of cannabis. Having already taken the opportunity in *Xu*¹ to suggest general sentencing brackets where large-scale commercial production of the class B drug was concerned, the court here set out appropriate levels of sentencing where the cultivation fell short of industrial.²

The cultivation methods employed in such cases tend to be in line with those used in commercial production, albeit on a smaller scale. The crops are often cultivated in the defendant's own home and the use of hydroponic techniques³ and intensive artificial lighting is commonplace. Such methods allow growers to intensively cultivate the plants indoors and to strictly control the growing environment in order to maximise their yield of the high potency heads of the flowering female plant. This herbal cannabis is often colloquially referred to as 'Skunk'.

The production and cultivation of cannabis are offences contrary to sections 4(2) and 6(2) of the Misuse of Drugs Act 1971 respectively. Both offences carry a maximum sentence of 14 years imprisonment and/or an unlimited fine.⁴

THE FACTS

Auton

Auton had intensively cultivated 49 cannabis plants in his garage and loft. On analysis the estimated yield of these plants was just over one kilogram. He was additionally found in possession of 73 grams of the harvested heads of the female plants. The total street value of his crop was thought to be between £5500 and £6500. Auton pleaded guilty and indicated that he had cultivated the cannabis primarily for his own use but that he would also be likely to supply the drug to friends if he had a good crop. The

¹ *Xu* [2007] EWCA Crim 3129.

² For guidance, the cases involved in this appeal all concerned yields in the region of one kilogram.

³ Hydroponic methods involve the growing of plants in nutrient-rich solution without the use of soil.

⁴ See Schedule 4 of the Misuse of Drugs Act 1971.

Recorder sentenced him to 15 months imprisonment in respect of the cannabis cultivation.

Hindle

Hindle ran an intensive cannabis cultivation operation from his loft with a separate drying area located in his spare bedroom. He was found in possession of 37 plants and admitted that this was his second crop. While there was no estimate of the potential yield involved the court considered that this was likely to be in the region of, but slightly less than that considered for Auton. Hindle entered a plea of guilty on the basis that his crop was intended entirely for his own use. The Recorder sentenced him to 15 months imprisonment in respect of the cultivation taking account of the fact that there was no evidence that he had made any profit from his enterprise.

Vincent

Vincent was found to have cultivated 43 plants by intensive but basic methods. He operated his efforts from a bedroom in his home and the estimated yield from his crop was 1.3 kilograms with a street value in the region of £5500. Vincent entered a plea of guilty in which he accepted that whilst his intention had been to produce the cannabis solely for his own use, since becoming unemployed he would have gone on to supply the drug to people known to him in order to fund his habit. The judge sentenced him to three years imprisonment.

Willis

Willis ran an intensive cultivation operation jointly with his brother. An outbuilding was found at Willis' house that contained 12 plants and 1.9 kilograms of harvested crop that was ready for use. At his brother's house there was a separate seedling nursery containing 68 seedlings (although it was not clear how many of these would have become useable adult plants). His brother was also found in possession of £3000 in cash. Willis entered a plea of guilty and contended that the crop was intended for his personal use and that he had been surprised by the success of his operation. The judge sentenced him to 18 months imprisonment and commented that such a sentence was particularly appropriate in light of Willis' determined efforts and that his operation was sited in several locations.

THE COURT OF APPEAL'S JUDGMENT

Sentencing Ranges

The Court of Appeal made it clear that in cases such as those considered a custodial sentence would almost always be the appropriate disposal. This was the case even where there was evidence that the cannabis produced was for the sole use of the defendant. In cases where there was genuinely no issue of supply the sentence should be in the range of nine to 18 months. Where the cultivation was for the defendant's own use and was not primarily an enterprise for profit but did involve some element of supply to others, the sentence should be in the range of 18 months to three years. Where the cultivation was essentially commercial in nature the sentence should usually be below those considered in *Xu* due to the smaller scale of production but should be in the range of three to six years. The court went on to state that the unlawful

abstraction of electricity, which is the common means of powering the equipment needed in such enterprises, would normally be an aggravating factor.⁵

Determination of the appeals

On Auton's behalf it was argued that a more appropriate sentence in respect of his cultivation operation would have been in the range of six to nine months in light of the element of supply being 'social' in nature. The court dismissed this argument on the basis that such a sentence would not be commensurate with the severity of the offence bearing in mind that "the defendant would be a significant source of the drug for a circle of users".⁶ The court went on to dismiss the appeal and confirmed that the 15 month sentence was correctly within the range as set down by the court.

The court also concluded that the 15 month sentence passed down for Hindle came within the appropriate range for the same reasons as those considered for Auton.

In respect of Vincent the court concluded that the trial judge had inappropriately placed the defendant on a par with defendants involved at the lowest level in industrial cultivation operations. They went on to state that whilst sentencers should bear in mind the sentencing levels as set out in *Xu* "there is no direct analogy between a lowest role gardener in a large-scale commercial operation and a man with his own smaller scale hydroponics unit in his home".⁷ In light of this the court allowed the appeal to the extent that Vincent's sentence was reduced from three years to 27 months.

In respect of Willis the court agreed with the judge's conclusion that an 18 month custodial sentence seemed appropriate due to evidence that the operation was set up with the sale of at least some of the crops in mind. However, in light of the fact that Willis had tendered his plea on the basis that he had cultivated the cannabis for his own personal use, and that the basis for his plea had not been rejected, the court allowed his appeal to the extent that his sentence was reduced to 12 months.

COMMENTARY

It was clearly stated in *Xu* that the sentencing brackets provided were not intended to relate to non-commercial cultivation or production⁸ and so it is appropriate that the court have now taken this opportunity to offer sentencing ranges where such cultivation or production is concerned.

In their judgment the court acknowledged the role of the Sentencing Council and indicated that their suggested sentences would be subject to any further guidelines set down by that body. It should be noted that the Sentencing Council have recently conducted research on public attitudes to sentencing for drug offences⁹ and it can therefore be envisaged that further sentencing guidelines may be provided in this area.

The court's judgment is clear that a determinative factor in sentencing for cases of small-scale production of cannabis will be whether the cannabis was to be supplied to others. In order to properly assess this it is necessary to have precise indications as to the potential yield of crops and the sophistication of the production methods employed. To this end it is to be welcomed that the court recommended for estimated yields to be provided in these cases.¹⁰

⁵ *Auton and Others v R* [2011] EWCA Crim 76 at para 14.

⁶ *Ibid*, at para 18.

⁷ *Ibid*, at para 23.

⁸ *Op cit*, at para 6.

⁹ The findings from this research are due for publication in spring 2011. www.sentencingcouncil.org.uk

¹⁰ *Op cit*, at para 3.

By indicating that a custodial sentence is almost always appropriate the court is giving effect to Parliament's intention that cases of production and cultivation of cannabis be treated seriously.¹¹ Indeed research indicating that domestic cannabis cultivation is a growing issue and that nearly half of all the cannabis consumed in the UK is now domestically produced¹² would suggest that such deterrent sentences are called for in most of these cases.

However, while it is accepted that imprisonment may be appropriate in those cases where an element of supply is evident, it has to be questioned whether a custodial sentence of between nine and 18 months is acceptable where it is clear that the cannabis produced is intended for the offender's sole use. Such a sentence seems disproportionate bearing in mind that the usual disposal for those found in possession of cannabis is a police warning.¹³ Weight is added to this argument by research that suggests that were the growing of cannabis for personal use to be treated as possession rather than production or cultivation, this could have a destabilising effect on the cannabis market as more users would be encouraged to grow their own supplies rather than source these from criminal enterprises.¹⁴ Surely a finding of possession in such instances would be desirable on several counts including: the more appropriate labelling of the activity involved, the diversion of offenders away from an already over-burdened prison system, and that ultimately such an approach offers a more effective strike at the heart of the UK cannabis market.

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¹¹ The maximum custodial sentence for these offences was raised from five to 14 years by the Misuse of Drugs Act 1971 (Modification) (No. 2) Order 2003, SI 2000/3201).

¹² M Hough *et al*, *A Growing Market: The Domestic Cultivation of Cannabis* (The Joseph Rowntree Foundation, 2003), at 5.

¹³ This is the disposal suggested by the Association of Chief Police Officers in their *Reclassification of Cannabis: Guidance on Cannabis Possession for Personal Use – Revised Intervention Framework* (ACPO, 2009), at part 2.1, where the offender has been found in possession of cannabis for the first time.

¹⁴ *The Domestic Cultivation of Cannabis: Findings* (The Joseph Rowntree Foundation, 2003), at 3.

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**WHEN IS A DIRECTOR NOT A DIRECTOR?
(WHEN HE OR SHE IS A DIRECTOR OF A CORPORATE DIRECTOR
OF A COMPANY AND THEREFORE NOT A DE FACTO DIRECTOR OF
THE COMPANY ITSELF. . .)**

*Holland (Respondent) v The Commissioners for Her Majesty's Revenue and Customs
(Appellant) and another* [2010] UKSC 51
(Lord Hope, Deputy President, Lords Walker, Collins, Clarke and Saville)

THE FACTS

This was a highly complex case in which section 212 Insolvency Act 1986 (“section 212”) applications had been brought against Mr Michael Holland and his wife by Her Majesty’s Revenue and Customs (“HMRC”) on the basis that, as *de facto* directors of 42 insolvent companies, they had been guilty of misfeasance and breaches of duty in causing the payment of in excess of £13 million of unlawful dividends between 2002 and 2004 when the companies had insufficient distributable reserves to pay their creditors.¹

The 42 companies (the “composite companies”) had been set up to administer the business and tax affairs of contractors who did not want to set up and run their own companies. Each composite company had a sole, corporate director, Paycheck (Directors Services) Limited (“Paycheck Directors”). Paycheck Directors was a wholly owned subsidiary of Paycheck Services Limited (“Paycheck Services”) and was owned by Mr and Mrs Holland, each of whom held 50% of its shares. Mr and Mrs Holland were also both directors of Paycheck Directors.

Each of the composite companies had a voting share (held by another Paycheck company ultimately owned by Mr and Mrs Holland) and 50 non-voting shares which were held by the contractors who became employees of the composite companies. The services of the shareholder/employees were contracted out by the composite companies which, in return, received an income.

Each composite company paid (i) a fee to Paycheck Services for the provision of administrative services; (ii) a salary to each shareholder/employee; and (iii) after making provision for the payment of corporation tax at the small companies rate, a dividend to each shareholder employee.

Dividends were paid on a regular basis. A computer programme generated a document purporting to be a minute of a directors’ meeting of the relevant composite company which recorded that “M Holland Paycheck (Directors Services) Ltd” had been present at the meeting and that the directors of the composite company had resolved to pay a dividend of a specified amount to a be distributed to a specified shareholder/employee.

The composite companies were part of a corporate structure which had been deliberately created to be tax efficient: provided that each company kept its profits below £300,000 (which they all did) each company would, individually, pay the lower, small companies rate of corporation tax rather than higher rate corporation tax.

There was, however, a flaw in this structure which had not been spotted when it was established. As Mr Holland was in control of the companies (because he held one share in each of them and each share carried voting rights), they fell to be treated as

¹ In the matter of Paycheck Services 3 Limited to Paycheck Services 12 Limited; and Paycheck Services 14 Limited to Paycheck Services 44 Limited and PC (45) Limited and in the matter of the Insolvency Act 1986 Subnom Revenue & Customs Commissioners v (1) Michael Holland (2) Linda Holland (2008) [2008] EWHC 2200 (Ch).

“associated” companies for the purposes of the Income and Corporation Taxes Act 1988. This meant that because the collective turnover of the composite companies exceeded £300,000, each composite company was liable to pay higher rate corporation tax. Dividends had been paid after provision had been made only for corporation tax at the lower rate. This meant that there was a substantial deficiency in each composite company’s higher rate corporation tax liability. The composite companies went into administration in October 2004 and later into liquidation.

HMRC, which was the only creditor of each of the insolvent composite companies, sought orders requiring Mr and Mrs Holland to contribute over £3.5 million to the assets of the insolvent composite companies by way of compensation in respect of their misfeasance and breach of duty.

At first instance, the claims against Mrs Holland were dismissed, but Mr Holland was found to be a *de facto* director of each of the composite companies and so was answerable to HMRC’s claims under section 212. Mr Holland was found to be guilty of misfeasance for the period from 23 August to 19 October 2004, but was granted a grace period for sums due between 19 and 22 August 2004. Mr Holland’s liability was assessed to be the amount of higher rate corporation tax due to HMRC during that period. Mr Holland appealed against the orders which the deputy judge had made against him. The Court of Appeal allowed Mr Holland’s appeals and HMRC appealed to the Supreme Court against the decision of the Court of Appeal.

THE DECISION IN THE SUPREME COURT

Lord Hope considered that the main issue before the Supreme Court was whether Mr Holland was a *de facto* director of the composite companies. If he were, further issues would arise: (i) whether his liability for the payment of unlawful dividends was strict or whether it was necessary to show negligence; (ii) what was the correct remedy for Mr Holland’s breach of his duties as a director; (iii) the scope of the discretion under section 212; (iv) whether the judge had jurisdiction to grant a grace period; and (v) whether Mr Holland should have been relieved from all liability for the period after the grace period.

Section 212 applied only to persons who were or had been an officer of the company. The definition of “officer” in relation to a body corporate included a director². It was not in dispute that *de facto* directors fell within the scope of section 212, but in order for HMRC to rely on the remedy under section 212, it was necessary to show that Mr Holland was a *de facto* director of the composite companies.

The corporate structure had been created on the assumption that the composite companies could have Paycheck Directors as their sole, *de jure* director. Lord Hope did not think that Mr Holland and his advisers could be criticised for this as it was permitted by statute. The question as to whether Mr Holland was acting as *de facto* director of the composite companies so as to impose a fiduciary duty upon him had to be approached on the basis that Paycheck Directors and Mr Holland were separate legal persons.

The difficulty presented by the present case was that Mr Holland had been doing no more than discharging his duties as the director of the corporate director of the composite companies. He was the decision maker and he was the person who gave effect to those decisions.

² Insolvency Act 1986, section 251.

Lord Hope considered the principle that the Court of Appeal had drawn from the decision of Millet J in *Re Hydrodam*³. Although the facts did not precisely match *Re Hydrodam*, the correct principle identified by Rimer LJ in the Court of Appeal was that “the relevant act in relation to the affairs of the subject company is an act directed by the corporate director, not one directed by the latter company’s individual board members⁴.”

Therefore, so long as the relevant acts were done by the individual entirely within the ambit of the discharge of his duties and responsibilities as a director of the corporate director, it was to that capacity that his acts must be attributed.

The essential point was that, for a creditor of the subject company to obtain a remedy against the individual, that individual must have been shown to have been a director not just of the corporate director but of the subject company too. In his opinion, it was not shown that Mr Holland was acting as a *de facto* director of the companies themselves so as to make him responsible for the misuse of their assets.

Lord Collins observed that, until the early 1980s, the term “*de facto* director” had not been applied to anyone other than someone who had been appointed a director but whose appointment was defective or one who had been, but had ceased to be a director.

Once the concept of *de facto* director had been divorced from the unlawful holding of office, two things happened. First, there was an erosion of the distinction between *de facto* directors and shadow directors. Second, it became difficult for the courts to determine what functions were the sole responsibilities of the directors or board of directors.

In his opinion, the crucial question was whether the person assumed the duties of a director: Mr Holland was not part of the corporate governing structure of the companies and he had not assumed a role in those companies which imposed on him the fiduciary duties of a director.

The appeal was dismissed. Lord Hope agreed with the reasons that Lord Collins gave for reaching this conclusion. Lord Saville concurred with Lord Hope and Lord Collins. Lords Walker and Clarke dissented.

COMMENT

This was a knotty problem: here, an individual sat as a director of a corporate director of 42 composite companies, like a spider at the centre of a web. Yet it was not the individual’s direction of the corporate directors, but the corporate directors’ direction of the composite companies that caused the dividends to be paid unlawfully. Was it right that the individual escaped liability as a *de facto* director?

Lord Walker pointed out that “the Court’s decision will, I fear, make it easier for risk-averse individuals to use artificial corporate structures to insulate themselves against responsibility to an insolvent company’s unsecured creditors⁵”. Although this does seem a worrying possibility, it may prove to be less significant than Lord Walker thought: the law has changed since this corporate structure was put in place. As Lord Collins observed “the purpose of . . . Companies Act 2006 section 155 (1), was to

³ *Re Hydrodam (Corby) Ltd* [1994] 2 BCLC 180.

⁴ *Holland (Respondent) v The Commissioners for Her Majesty’s Revenue and Customs (Appellant) and another* [2010] UKSC 51 at para 41 (citing Rimer LJ in *Michael Holland v The Commissioners for Her Majesty’s Revenue and Customs* [2009] EWCA Civ 625 at para 68).

⁵ *Holland (Respondent) v The Commissioners for Her Majesty’s Revenue and Customs (Appellant) and another* [2010] UKSC 51 at para 101.

ensure that every company would have at least one individual who could, if necessary, be held to account for the company's actions⁶."

Lord Walker agreed with Lord Collins that section 212 was procedural and that liability could only arise if there had been a breach of some identifiable duty. He also agreed that the test was whether there was an assumption of responsibility, provided that this focused on what the individual in question did, rather than what he was called. On this basis he considered, however, that it was "putting the cart before the horse in looking for a fiduciary duty before looking at what Mr Holland did, because it is what he did that demonstrates that he was undertaking responsibility and exposing himself to a claim for breach of fiduciary duty".⁷

Clearly Mr Holland got the tax position completely wrong at the outset and paid out an awful lot of money to people when he should not have, so one's instinct is that he should be liable for something. Lord Collins was sympathetic to this view remarking that he "well [understood] the policy reasons why in such a case as this a person in the position of Mr Holland should be liable⁸". He went on to observe that the changes introduced by the Companies Act 2006 could have included a requirement that all directors be natural persons (as is required by Australian, Canadian, New York and Delaware companies legislation) but that the legislature had chosen not to take this option. It was his opinion that HMRC were effectively seeking an extension of the existing law that was a matter for the legislature and not for the court.

Although Lord Hope recognised that the other issues that he had outlined at the beginning of his opinion did not need to be decided, he did offer some comments. First, he considered the question as to whether liability for the payment of unlawful dividends should be strict or should depend upon a degree of fault being established, concluding that liability should be strict, subject to the right to claim statutory relief.

Second, he considered the correct remedy where a director has breached his or her duty in making unlawful dividend payments: should it be damages or equitable compensation for the net loss sustained by the company, or restitution or restoration of the amount of the unlawful dividends without any inquiry into the loss sustained? He concluded that the obligation was to restore the moneys wrongfully paid out and to account to the company for the full amount of those dividends (approving *Bairstow v Queens Moat Houses plc*⁹). He noted, however, that this was subject to the judge's discretion under section 212 to limit the award, if appropriate.

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⁶ *Ibid*, para 96.

⁷ *Ibid*, para 122.

⁸ *Ibid*, para 96.

⁹ [2001] EWCA Civ 712.

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PROPORTIONALITY AND POSSESSION PROCEEDINGS

Manchester City Council v Pinnock [2010] UKSC 45

(Lords Phillips, Hope, Rodger, Walker, Hale, Brown, Mance, Neuberger, Collins)

INTRODUCTION

It is rare that the highest court in the UK sits with nine judges; this only happens, it would seem, where matters of the highest constitutional importance are raised.¹ It is, perhaps, even rarer that such a court is able to speak with one voice. Interestingly, this happened in November 2010 in the case of *Pinnock v Manchester City Council*² when Lord Neuberger delivered the sole judgment of a nine judge panel of the Supreme Court, which suggests even to the casual bystander that the case must be of some importance.

It is not exactly clear why the court took the approach of leaving the judgment to one judge. One possible reason is that Lord Neuberger is probably the most eminent property lawyer amongst the Supreme Court justices and thus best suited to delivering such a judgment. The other is that there was a clear need for the Court to dispel confusion which had arisen over the conflicting decisions in *Kay and others v London Borough of Lambeth*,³ *Doherty and others v Birmingham City Council*⁴ and the subsequent European Court of Human Rights decision in *Paulic v Croatia*.⁵ All of these had wrestled with the problem of the extent to which someone who had no domestic legal right to remain in residential property could invoke the protection Article 8 of the European Convention on Human Rights to avoid eviction. *Pinnock* deals clearly with the relationship between claims for possession of land, an issue which has traditionally been unaffected by the law of non-UK jurisdictions, and European Convention law. In what is an important attempt to clarify the interaction between these, however, the Supreme Court has, perhaps, inadvertently opened up the argument as to whether that traditionally non-UK issue of proportionality should be introduced as an element to claims for possession of land which involve interference with the “home”.

BACKGROUND, FACTS AND CASE HISTORY

Mr Pinnock was previously a secure residential tenant of Manchester City Council (“Manchester”). In March 2005, Manchester began possession proceedings against him because of serious acts of anti-social behaviour committed in and around his property by members of his family. The county court in those proceedings ordered that his secure tenancy be demoted.

“Demoted tenancies” were introduced by the Anti Social Behaviour Act 2003 following the success of probationary “introductory tenancies” under the Housing Act 1996⁶. Demotion of a secure tenancy effectively removes much of the security of tenure afforded to a local authority tenant. Under a local authority secure tenancy, the court

¹ For example in *A and others v Secretary of State for Home Department* [2004] UKHL 56.

² [2010] UKSC 45.

³ [2006] UKHL 10.

⁴ [2008] UKHL 57.

⁵ App. No. 3572/06.

⁶ See s126 Housing Act 1996.

must always consider the reasonableness of making an order for possession or have an element of discretion as to whether to grant possession. Once a secure tenancy becomes a demoted tenancy, however, the statutory provisions (contained in the Housing Act 1996, sections 143E and 143F), simply require the landlord seeking possession to serve appropriate notice on the tenant and, if required by the tenant, to conduct an internal review of the decision to seek possession. If this review upholds the decision to seek possession, the landlord then applies to the court for a possession order. Under section 143D(1)(2), the court must make an order for possession unless it thinks that the statutory procedure has not been followed.

Demoted tenancies, like introductory tenancies, were introduced so that a local authority landlord could obtain possession as of right against anti-social families without the process being slowed down by arguments about whether it was reasonable or not to make an order for possession. In June 2008 Manchester served a notice under the Housing Act 1996 section 143E seeking to terminate Mr Pinnock's demoted tenancy because of the conduct of two of his sons at or near the property. Mr Pinnock requested a review of Manchester's decision, but the review panel upheld the decision to terminate the tenancy. Manchester then issued a claim for possession which the County Court granted.

Mr Pinnock appealed to the Court of Appeal on the basis that the granting of an order for possession in such circumstances infringed his rights under Article 8. In essence, his argument was that the making of an order depriving someone of their home without allowing a court to consider the substance of the claim was disproportionate and, thus, an infringement of Article 8. Such proceedings also undermined the due process protection given by Article 6.

Such arguments had already received extensive treatment, in particular, in *Kay v London Borough of Lambeth*⁷ in which the courts had held that such defences to possession proceedings would only apply either (a) where it is seriously arguable that the law that enables the court to make the possession order is incompatible with Article 8, or (b) where it is seriously arguable that the decision of a public authority to recover possession is a decision that no reasonable person would consider justifiable. In short, such defences would apply in very limited circumstances, reflecting traditional Wednesbury grounds of review.⁸ This approach had not, however, found favour in the ECtHR which held that Article 8 would be infringed if no consideration could be given to proportionality at the time an order to evict was made:

The loss of one's home is a most extreme form of interference with the right to respect for the home. Any person at risk of an interference of this magnitude should in principle be able to have the proportionality of the measure determined by an independent tribunal in the light of the relevant principles under Art.8 of the Convention, notwithstanding that, under domestic law, his right of occupation has come to an end.⁹

In the Court of Appeal, Mr Pinnock's contention was rejected on the basis that, amongst other things:

1. The County Court had considered proportionality when it was considering making the original demotion order. On a subsequent application, the County Court's power to review the panel's decision on the second occasion was limited to checking that the procedure had been followed. As the procedure

⁷ [2006] UKHL 10.

⁸ *Associated Provincial Picture Houses v Wednesbury Corp* [1947] 2 All ER 680 as refined by *R v Ministry of Defence ex p Smith* [1996] 1 All ER 257.

⁹ *Kay v United Kingdom* [2010] ECHR 1322.

had been followed, a possession order had to be made. The procedure, overall, complied with Article 6;

2. A landlord's decision to seek possession of a demoted tenant's property would satisfy Article 8(2),¹⁰ unless the decision was one which no reasonable person could consider justifiable (again, invoking the *Wednesbury* principle);
3. Even if the statutory provisions were incompatible with the Convention, a possession order would still be lawful because s.6(2)(b) Human Rights Act enabled a public body to act in such a manner;¹¹
4. In addition to the statutory review process in the County Court, the review panel's decision would be susceptible to judicial review in the High Court albeit that the applicable grounds would be the standard domestic judicial review grounds.

DECISION

The Supreme Court decided that the Court of Appeal's approach to dealing with such cases in the County Court did not adequately reflect the ECtHR's approach dealing with possession proceedings. Lord Neuberger echoed the Strasbourg court in holding that any person faced with dispossession of their home by a local authority should have the right to raise the question of the proportionality of their eviction, and to have it determined by an independent tribunal in the light of article 8. This applied even if under domestic law they had no further right to remain in their home. If a court concluded that it would be disproportionate to evict a person from their home, notwithstanding the fact that they had no domestic right to remain there, any eviction, at least by a public authority, would be unlawful.

Several points flowed from this:

1. The proportionality of the eviction under a demoted tenancy should, if raised by the tenant, be considered when the order for possession was sought, not just at the earlier stage when the demoted tenancy was imposed;
2. The County Court would have to be able to consider such matters if raised. This meant that, to be compliant with Article 8, the restrictions in the Housing Act 1996, section 143D, on the County Court's ability to review a decision to evict (which was limited to considering whether the procedure to evict had been followed) would have to be relaxed. Notably, and perhaps controversially, this would be achieved by judicial interpretation of that section using the Human Rights Act, section 3;¹²
3. The Court indicated that in the vast majority of cases where a residential occupier has no right to remain, and the local authority is entitled to possession as a matter of domestic law, there would be a very strong case for saying that making a possession order would be proportionate. Though the

¹⁰ Article 8(2) states: There shall be no interference by a public authority with the exercise of [the right to privacy]. . . in accordance with the law and is necessary in a democratic society in the interests of national security, public safety or the economic well-being of the country, for the prevention of disorder or crime, for the protection of health or morals, or for the protection of the rights and freedoms of others.

¹¹ Section 6 states:

(1) It is unlawful for a public authority to act in a way which is incompatible with a Convention right.

(2) Subsection (1) does not apply to an act if –

(a) as the result of one or more provisions of primary legislation, the authority could not have acted differently; or

(b) in the case of one or more provisions of, or made under, primary legislation which cannot be read or given effect in a way which is compatible with the Convention rights, the authority was acting so as to give effect to or enforce those provisions.

¹² The obligation to read and give effect to legislation in a way which is compatible with the Convention Rights.

Court avoided characterising these as “exceptional cases” (avoiding the pitfall on the basis that “exceptionality is an outcome not a guide”¹³), it clearly anticipated that local authorities would not be required to routinely justify their actions in such cases. Similarly, the proportionality of the eviction would normally be justified by considering the local authorities’ duties in relation to the distribution and management of housing stock.¹⁴

IMPACT OF THE DECISION

On a practical level, the decision clearly attempts to steer a mid course between giving County Courts the ability to consider human rights arguments on evictions with a desire not “to open the floodgates” to Article 8 challenges. While upholding the principle previously expressed that local authorities should not be required to routinely plead an Article 8 justification, there is clearly scope for proportionality challenges to be brought, especially in cases where the tenant suffers a mental illness, physical or learning disabilities, poor health or frailty, and/or the local authority are not providing alternative accommodation. While there is much in the judgment which stresses that this is likely to be an issue which courts can deal with summarily, importantly, the judgment shied away from imposing a blanket “exceptionality” test to Article 8 arguments. This should be seen as a welcome extension of the use of Convention rights arguments in the County Court.

Given that the decision applies to public authorities, following the Court of Appeal’s reasoning in *R (Weaver) v London & Quadrant Housing Trust*,¹⁵ this must mean that, unless the Supreme Court overrules *Weaver*, these principles will apply to housing association¹⁶ proceedings in cases where a court has no discretion as to ordering possession (such as in assured and assured shorthold tenancies).

The Supreme Court was keen to emphasise that the principle does not apply when proceedings are brought by a purely private landlord, though the ECtHR in *Zehentner v Austria*¹⁷ did not seem to draw a distinction between cases brought by public and private landlords. It remains to be seen whether this approach will be further challenged through the process of a continuing dialogue between Strasbourg and the UK Supreme Court (a dialogue emphasised in *R v Horncastle and others*).¹⁸

The Supreme Court also gave some useful guidance as to the way in which the Human Rights Act 1998 section 2 should operate. Whilst reiterating the principle behind section 2 that Strasbourg caselaw does not “bind” UK courts, Lord Neuberger stated that where:

“there is a clear and constant line of decisions whose effect is not inconsistent with some fundamental substantive or procedural aspect of our law, and whose reasoning does not appear to overlook or misunderstand some argument or point of principle, we consider that it would be wrong for this Court not to follow that line”¹⁹.

Finally, the Supreme Court offered some useful guidance on the Human Rights Act 1998, section 6(2)(b) and narrowly interpreted the exception in section 6 which allowed

¹³ Paragraph 51.

¹⁴ Paragraph 52.

¹⁵ [2009] EWCA Civ 587.

¹⁶ Housing associations are Registered Providers of Social Housing.

¹⁷ (App no 20082/02).

¹⁸ [2009] UKSC 14.

¹⁹ Paragraph 48.

public authorities to act in a non-compliant way, limiting its application to those cases where the public authority was mandated to act.

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CARE QUALITY COMMISSION GUIDANCE TO REGISTERED PROVIDERS

INTRODUCTION

In October 2010, Care Quality Commission (CQC) published Guidance for registered providers of care, treatment and support services (for example, care homes) on how the Mental Capacity Act 2005 (MCA 2005) affects the way they make decisions on behalf of adults who lack capacity to make decisions for themselves.¹

CQC is the independent regulator of health and adult social care services in England. The Guidance is part guidance, part “soft” compliance, and should be read in conjunction with CQC’s Essential Standards of Quality and Service (essential Standards), which provides for a series of compliance outcomes that have to be met.²

WHY DO IT?

Health and social care professionals who work with adults who lack or have reduced capacity are under a duty to have regard to the Code of Practice that accompanies the MCA 2005 (MCA Code). It is vital that staff comply with it as a failure to do so can be used as evidence in civil or criminal proceedings before a court of tribunal.

In fact, very recently, a public authority was ordered to pick up a substantial bill for legal costs for failing to ensure that its own staff were aware of their obligations under the Act.³

GUIDANCE OUTCOMES

The Guidance has a series of outcomes (a different set of outcomes to those described in the Essential Standards, of which more below). Among these are that people who use registered care, treatment and support services will be encouraged to make their own decisions wherever possible (and if not possible, will be included in best interests decision making); services and their staff are aware of their duties and responsibilities under the Act and that human rights will be respected.

There is a strong theme of compliance in the Guidance and, in this sense, puts the guidance contained in the MCA Code on a strong practical footing. It tells registered providers what they need to make sure they are doing, and what evidence CQC can ask for to make sure that providers are complying with those obligations.

To illustrate this, the Guidance describes the process for assessing an adult’s capacity to make a particular decision at the time it needs to be made, but then goes on to state that services need to:

- have a copy of the MCA Code available for staff to use;
- make sure that staff induction includes learning about how the MCA Code and the Deprivation of Liberty Code of Practice (DoLS Code) affect their work; and

¹ Available at: http://www.cqc.org.uk/_db/_documents/RP_PoC1B2B_100563_20100825_v3_00_Guidance_for_providers_MCA_FOR_EXTERNAL_PUBLICATION.pdf

² Available at: http://www.cqc.org.uk/_db/_documents/Essential_standards_of_quality_and_safety_FINAL_081209.pdf

³ G v E (2010) EWHC 3385 (Fam) – Judgment of Baker, J.

- make sure that assessments of capacity using the two stage test are being properly recorded.

In some way, CQC Guidance goes further than the MCA Code. It sets out how detailed assessments of capacity should be, and tackles the difficult issue of when circumstances might suggest that a formal, recorded assessment of capacity may be needed (for example, when the significance of the decision increases for the individual concerned, or where the decision is likely to be challenged). It is a shorter document than the MCA Code and, as a result, is more likely to be accessible to staff who need to consult something on a frequent basis, or as part of their reflective learning.

CQC's Essential Standards must be read alongside the Guidance, and this is where we put the Guidance in context. CQC's new registration system for health and adult social care is designed to make sure that services meet key standards of quality and safety that are designed to protect the dignity and rights of service users.

Taking some examples that dovetail with the obligations under the MCA 2005 and the guidance in the MCA Code, and which illustrate CQC's approach:

if people are not being involved in decisions about their care and treatment, CQC can take action in relation to failure to comply with regulation 17 (outcome 1).

if people are not being properly supported to consent to the care, treatment and support they receive, CQC can take action in relation to failure to comply with regulation 18 (outcome 2).

if assessments of capacity and decision-making are not being undertaken in a way that complies with the MCA 2005 Code of Practice, CQC will consider whether regulation 9 (outcome 4) is being met and can set compliance and improvement actions about aspects of people's care and treatment.

CQC will monitor registered providers for evidence of compliance, using available information and intelligence, seeking evidence of compliance and information from patients and representative groups (a multi-dimensional approach to regulation and patient experience). If concerned, CQC can work with commissioners of services and use its powers of enforcement if necessary.

The message for providers is to comply, and make sure there is evidence to show that they are complying. CQC has teeth.

ANDREW ALONZI*

OUTCOMES FOCUSED REGULATION: RISK OF A CULTURE SHOCK?

This is the calm before the storm. With the release of the Solicitors' Regulation Authority's final pronouncement on its new outcomes focused approach to regulation draws near, solicitors will increase their focus on the four letter word at the heart of the regime: risk. In the past, the SRA have been very clear in stating that the advent of Outcomes Focused Regulation ("OFR") will require firms to take responsibility for identifying and managing risk. Those firms that are able to demonstrate that they can do so effectively will be "left alone" to some extent, with resources being targeted at firms that are unable to do so. The devil is in the detail, or the lack of it.

Firstly, it is a mistake to consider risk management as simply a synonym for "claims avoidance". This new approach is evident in the inclusion of four new core principles within the proposed new Code of Conduct: legal and regulatory compliance, business and financial governance and risk, the promotion of equality and diversity and the safeguarding of client assets. Indeed, the drafting of one "core principle" that firms must run the business effectively and in accordance with proper governance and sound financial and risk management principles is a prime example. Risk management, in all its forms, will be a much more pervasive issue. It will encompass both questions of basic operational risk and "file work" and also strategic and financial issues. However, most of the training in relation to risk management in the UK focuses on claims avoidance rather than other aspects of risk analysis used in other businesses and professions such as concepts of risk tolerance, probability and impact.

Secondly, it is still an open question, as to just how much information firms will have to provide in their Annual Information Report to enable the regulator to make a risk assessment. Thirdly, what type of evidence should the firm collect to enable it to make an informed decision as to whether it is achieving the right outcomes? For instance, it is assumed that it will be possible to collect client satisfaction data via a questionnaire. A client satisfaction questionnaire seems to be an appropriate research tool. Clients are well versed in filling them after seemingly almost every consumer purchase. However, how effective will such a mechanism be in practice in a law firm? Law can be a "stress purchase" and the relationship may well be fraught with difficulties. A lawyer often has to give advice to client that they may well find to be unpalatable, albeit that it is necessary and in their best interests. In such circumstances, the wording of client questionnaire will have to be considered very carefully. A badly drafted questionnaire could elicit a false positive or a false negative response from the client which may say more about their own predicament rather than the service that they have received from their lawyer. This problem of questionnaire bias and drafting is one which besets the professional researcher but not necessarily the lawyer in past. Will some firms opt for a questionnaire and a structured interview in order to collect the relevant data and intelligence together with an analysis of their complaints data? Will questionnaire modelling be something that is done "in house" or outsourced to others to draft and analyse the results? Will such a response be weighted for a particular firm type or client population?

Whilst the issue of client satisfaction seems straightforward, at least on the surface, it could result in unforeseen consequences. How will the firm stress test other aspects of the core principles, especially the new four, such as equality and diversity and issues of sound business and financial governance and risk management? How will the data be collected, interpreted and presented to the regulator to enable it to risk assess the firm on the basis of a "desk based" study?

OFR should provide greater flexibility and innovation. There is no real doubt that the current Code of Conduct 2007 may be too prescriptive and responsible for a

“compliance blizzard” of paper regulating almost every aspect of the client relationship. Whilst greater flexibility should be welcomed, many may consider OFR to be too permissive in style, at least at first. There will, inevitably, be a cultural shift in attitudes to compliance and many firms will have initial concerns as to whether they have done enough to evidence that they have achieved the relevant outcomes: will the compliance ball fall on the right side of the baseline or whether in the fullness of time their efforts at compliance will be greeted with a resounding “out”? The devil really will be in the detail.

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BOOK REVIEW

*Book reviews and books for reviewing should be sent to
the address given at the beginning of this issue*

A RATIONAL APPROACH TO EXCITING DEVELOPMENTS IN SPACE LAW

Space Law A Treatise by FRANCIS LYALL and PAUL B. LARSEN,
Ashgate Publishing Ltd, Surrey, 2009, 1st Edition, 596 pp, Hardcover, £80,
ISBN: 978 07546 4390 6, eISBN 978 0 7546 9242 3 (ebook)

Space has revolutionized telecommunication services, climate and weather forecasting, commerce, environmental management, security, banking, navigation and TV broadcasting. Consequently, in the lead up to the creation of the United Kingdom Space Agency (UKSA) on 1 April 2011 the publication of a space law monograph is timely. The authors of this book, Professor Francis Lyall and Adjunct Professor Paul Larsen, are recognised experts in the developing body of space law. In the Preface they advise that they met several decades ago in 1963–64 as students in a Space Law class run by Ivan Vlasic in the Institute of Air and Space Law at McGill University. Their enthusiasm for the subject and enduring friendship has clearly grown in the intervening years. Indeed their careers over the past forty-five years can be said to match the actual development of space law. Lyall is a distinguished retired academic, although he remains active in teaching and scholarship, and holds the position of Emeritus Professor of Public Law at the University of Aberdeen in Scotland. He is a Board Member of the European Centre for Space Law and a Director of the International Institute of Space Law. He is also a member of the INTELSAT Panel of Legal Experts and sits on the ITU Reform group. He has previously written a monograph on space law entitled, *Law and Space Law Telecommunications* (1989) as well as numerous journal articles and curiously has so far published five crime novels! His co-author, Larsen, is an Adjunct Professor at the Georgetown University Law School in the United States where he has taught Aviation Law, International Law and a Space Law Seminar. He studied at the Institute of Air and Space Law at Cologne University and Yale University. He is the author of several books on aviation and space law and practised law from 1970–1998 in the US Department of Transportation.

A collaborative effort, the book is a companion to a collection of essays the pair edited in 2007¹. The authors state that they “sought to present the bulk of space law as it stands in the 2000s” and that the book “is more akin to a mural than to an etching”. This monograph builds on the seminal work of *Space Law* (1965) by J W Jenks and Vlasic’s monumental treatise *Law and Public Order in Space* (1963) and later works in the French language *Droit des activités spatiales* (1992) by P-M Martin and

¹ Lyall, F and Larsen, P B *Space Law* in *The Library of Essays in International Law* (Aldershot and Burlington, VT; Ashgate Publishing, 2007).

the Italian *Il Regime Internazionale dello Spazio* (1993) by F Pocar. It obviously adopts an international perspective and the authors clearly draw on their extensive experience in the field within the United Kingdom and the United States respectively. The authors are of the opinion that radical solutions have evolved for the problem of control of space relating to such issues as: (1) the basic principles of equality of access to space, (2) freedom of its exploration and use, (3) the prohibition of national sovereignty and finally (4) the lawfulness of only peaceful uses of space. Legal developments up to 1 January 2008 are explored in detail in the book. A clear advantage of the book is that there is certainly little competition in this highly specialised area of law. Further, although in hard cover it runs to a reasonable 596 pages in total, being reasonably competitively priced for a law book at £80.

The book helpfully provides a list of abbreviations and acronyms as the space world is rife with acronyms that are not as familiar as NASA or ESA. There is also a succinct list of the space law Major Treaties. The Table of Contents organises the book into 18 chapters. Chapter 1 is an Introduction to the Actors, History and Fora of space law and culminates with Chapter 17 The Search for Extraterrestrial Intelligence and Chapter 18 The Future. The chapters in between cover a variety of topics including sources of space law (Ch 2), the Outer Space Treaty (1967) (Ch 3), the law of space objects (Ch 4), astronauts (Ch 5), the air/space boundary question (Ch 6), the moon and other celestial bodies (Ch 7), radio and international telecommunication (Ch 8), orbits, broadcasting and solar power (Ch 9), environmental regulation (Ch 10), telecommunication organisations (Ch 11), satellite systems (Ch 12), remote sensing (Ch 13), space activities and international trade (Ch 14), commercial activities (Ch 15) and military activities (Ch 16). The book is organised topically as well as in a sense, chronologically.

The writing style is very engaging especially for a law book. By way of example, Chapter 1 begins as follows:

The launch of the Sputnik I on 4 October 1957 took the attention of the world. In his non-fiction book *Danse Macabre* (1981) the horror writer Stephen King tells how the screening of a film in a small-town New England cinema was interrupted. The cinema manager told the audience what had happened, and the screening was abandoned. People went out in a fruitless attempt to try to see the satellite.² Nearly fifty years later on 31 May 2007 fourteen space agencies announced the adoption of a mechanism through which their efforts may be co-ordinated in the future exploration and use of outer space.

A law book that is also readable! Such imagery drives the reader to read and devour the more formally written substantive law material that unfolds in the remainder of the chapter. The book is not aimed specifically at lawyers, but to anyone with an interest in space law. In other words, although the authors do not expressly say so, the book will appeal to a fairly wide readership, although having a specialist legal background in public international law is an advantage.

Each chapter ranges between twenty to thirty pages long and is peppered with headings to signpost the subject in issue. Extensively referenced, there are voluminous footnotes which although useful for providing additional information, can be a major distraction – I am a fan of short footnotes or endnotes. In my view, endnotes would be more appropriate for this book.

How well is the law explained? How are the author's ideas developed? As a non-specialist with a developing interest in the field of space law and intellectual property rights I found the explanations of the law and concepts described and

² Sputnik I was only 58 cm/25 inches in diameter.

explained succinctly and unambiguously. I was so pleased to find that pages 124–127 deal with intellectual property rights in relation to space: discoveries, inventions and patents. I also learned about the innovative *Patents in Space Act 1990 (US)* and how inventions on board the International Space Station are governed.

The vivid imagery and language used in Chapter 1 reoccurs with regularity to assist the reader to digest the more dry and black letter law topics. How I do wish that the book had some inspiring photographs of beautiful space images, objects and space craft, or even a few illustrations. Some images from the NASA National Space Science Data Center are public domain, as long as one acknowledges NASA and NSSDC as the supplier of the images/data.³ The sole photograph of space is on the hard cover. Although increasing the production costs, photographs and illustrations would make for a more visually appealing book. Some traditionalist lawyers would argue that the book would not appear as authoritative to serious lawyers as of course it is.

Coverage of how space law concepts and principles are applied in practice also features in the body of the text with reference to decided cases from a variety of countries to illustrate the application of the law.

Chapter 17 The Search for Extraterrestrial Intelligence (SETI) is illuminating. The authors are not lunatics, the debate as to whether this world is the only home of intelligence in the Universe has gone on for millennia. Further, there are specific laws to deal with SETI. The possible detection of any form of extraterrestrial life is the reason why there are international legal obligations as to the avoidance of harmful contamination of the Moon and other celestial bodies in Article IX of the Outer Space Treaty. There is also a duty under Article 5.3 of the Moon Agreement to report any finding of evidence of organic life.

Chapter 18 charts the future development of the maturing field of space law. It has been half a century since the launch of Sputnik I and forty years since the Outer Space Treaty was agreed. The most pressing issue identified by the authors is the need to regulate emerging commercial uses of space, whether national or international. A high profile example of such commercial use is Sir Richard Branson's Virgin Galactic enterprise which aims to provide passenger space travel, in other words, space tourism and the distinction between astronauts, space flight participants, space crew and space hotels. In 2005, Virgin Galactic and the State of New Mexico agreed to build a state funded \$200 million (USD) spaceport from which the company would establish a headquarters and operate space flights from Spaceport America, the world's first purpose built commercial spaceport. Flowing from space travel is the problem of regulating space traffic and the eventual exploitation of celestial bodies such as the moon or even our neighbouring planet Mars. Another issue is when it will be opportune to establish a World Space Authority or something similar to facilitate international cooperation. The authors do not think this will happen in the near future but is perhaps a goal in the medium to long term. Nor do the authors share the view that moves to revise and codify the outer space treaties is likely in the short term. The reality is that it is not in the interest of the major space-active nations to surrender the certainty of certain advantages they think they possess. Environmental concerns are pressing given the increasing problem of space debris and the need to strengthen legal obligations in this regard. Finally, the future modalities of governing space bases and space stations will have to be determined. All these issues are incredible food for thought. The role of the United Kingdom as a player on the international space law

³ <http://www.freeimages.co.uk/galleries/spce/index.htm>.

stage will only improve given the creation UKSA together with the UK's thriving space sector which contributes £7.5b a year to the UK economy.

In conclusion, *Space Law A Treatise* is a comprehensive, authoritative yet straightforward and rare book covering the key topics in the field of space law. To achieve this aim, Lyall and Larsen focus on providing plain English, clear non-technical explanations of the current state of space law. The book is not a light read, but the authors do succeed in making it a highly interesting one that without a shadow of a doubt increases the reader's understanding of space law. A non-specialist lawyer faced with a space law problem could hardly do better than start with this. This excellent book will no doubt inspire a new generation of space lawyers. Even an experienced space lawyer would do well to orient himself by reading Lyall and Larsen's book. Ian Shield of the UK Ministry of Defence states that it is the best and most complete explanation of space and its uses that any would require and deserves a wider audience. I concur.

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