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Foreword

It gives me great pleasure to introduce this second issue of the LSE Law Review, following the successful publication of the first last year. ‘Second book syndrome’, in which the challenge of writing a second novel turns out to much harder than completing a first one, so commonplace amongst creative writers, has clearly not affected the Editors of the Review. Readers can look forward in this issue to a remarkably rich diversity of offerings; although there is a broad underlying theme. This is the importance of maintaining a steadfast and unwavering commitment to human rights and the rule of law, and the importance of challenge to the ever-increasingly elastic demands of those exercising authority in the name of public order.

Professor Jeremy Horder
Head of the Department of Law
The London School of Economics and Political Science
March 2017
Letter from the Editor

It is with great pride and honour that we present you with the second volume of the LSE Law Review.

Our publication was founded in October 2015 by a small group of law students at the LSE. Our vision was to create a fully independent student-led law journal that would serve as a forum for students and academics to express their thoughts on some of the most important legal issues around the world. During our first year, we reached a number of milestones: setting up our website, publishing our first letter-to-the-editor, watching our first issue go to print… all of these were the fruits of much deliberation and teamwork. On 23 March 2016, our first volume was finally released at our Launch Night event. That evening, we invited Cherie Booth CBE QC to be our guest-of-honour, and we were joined by numerous legal representatives, academics, authors, students and members of the public in celebration.

Building upon last year’s achievements, we continue to grow as a team this year. In addition to expanding the editorial board with a few additional positions, one particular change that we implemented this year was to institutionalise the roles of “Junior Editors”. The goal was to allow these first and second year undergraduate students to work among and learn from the more seasoned editors on the board so that they can carry on the vision next year. Otherwise, we are also publishing more articles this year, and we have revised the book’s format. All these were done in order to establish a sustainable infrastructure that would hopefully help the journal to grow into what we want it to become over time.

We owe a great debt to a number of people, without whom this journal would not have come into existence. First and foremost, we thank all writers who have shared their works with us. Our journal is but a concert hall, and you are the soloists. Your works bring new music to this world, and we hope we have done justice to the labour that you have put into the articles. Secondly, we want to thank Prof. Jeremy Horder, Prof. Andrew Murray, Ms. Sarah Lee and the entire LSE Law Department. They had been tremendously supportive of our project since the beginning, and we will be eternally grateful. Thirdly, we want to thank all of our financial sponsors. This year we have been
tremendously blessed by two grants from the LSE Annual Fund and the Law Department. In addition, we have also received generous donations from five external sponsors, including 7KBW (Mr. Brian Lee), Norton Rose Fulbright (Ms. Bethany Foote), Francis Taylor Building (Ms. Deirdre Mahon), 11KBW (Ms. Clair Halas) and 3VB (Mr. Robin Jackson). Your support means a lot to us in terms of sustaining our publication in the long run, and we salute to you.

Finally, I would like to personally thank the founding editorial board from last year and, most importantly, my fellow editors this year: Charlotte, Clara, Daniel, Grady, Karen, Lubaba, Lucas, Max, Shukri, Svetlana, Vandana and Zoe. Having served on this board for two years, I have enjoyed our time working together, and have learnt a great deal from each of you. You are all beautiful, courageous and truly amazing. I am very proud of the work that you guys have achieved.

We remain faithful that the LSE Law Review will become something great over the years, and we look forward to seeing its growth in the future.

Wilson Tang
Editor-in-Chief 2016-17
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The Case for a Human Rights Act Based Approach to Unfair Dismissals Engaging Convention Rights: Challenging Judicial Attitudes and Assessing Potential

Alex Shellum*

ABSTRACT

The protection which the law of unfair dismissal offers to those dismissed in circumstances which engage their rights under the European Convention on Human Rights is anaemic. In such circumstances, judges continue to take a deferential approach to managerial discretion. This paper seeks to make the argument that judges should apply the same rigorous standards in unfair dismissal cases as they do in public law under the Human Rights Act. In doing so, the author challenges prevailing judicial attitudes in labour law, including a critical treatment of the judgment in Turner v East Midlands Trains, and assesses the impact that a genuine Human Rights Act based approach would have on this area.

INTRODUCTION

The law of unfair dismissal, legislated for in Part X, Employment Rights Act 1996 (ERA), favours the employer. It does so by restricting access to claims through a narrow personal scope;¹ through judges taking a laissez-faire approach to the reasons for, and reasonableness of, employers’ decisions to dismiss;² and

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The Case for a Human Rights Act Based Approach

through an anaemic remedial regime. These three principal imbalances in the law of unfair dismissal are shown at their most egregious when the dismissal in question is one that engages a dismissed employee’s Convention rights. This is the species of dismissal with which this essay is concerned – its purpose is to present the case for a Human Rights Act 1998 (HRA) based approach to dismissals engaging employees’ Convention rights.

The case has been made by Collins that compulsory protection of job security, and the correlative ability to claim unfair dismissal – underpinned by the two values of dignity and autonomy – constitutes a right in and of itself. The theory of dismissal law is beyond the scope of this essay, but the analysis within is written taking Collins’ characterisation of the value of just dismissal law as sound. The principles of dignity and autonomy, which underlie many of the Convention rights upon which this paper’s case for a more robust dismissal regime will be built, are familiar terms to labour and human rights law scholarship alike.

The reasons for advocating the present approach based on the HRA are threefold: firstly, it is more grounded in the plausible than a call for legislative intervention to a government which has orchestrated a drastic decline in the number of cases brought before employment tribunals; secondly, as will be demonstrated below, there is no current statutory impediment to interpreting the law on unfair dismissal in light of the HRA where appropriate; and, thirdly, legislative intervention without challenging judicial attitudes, which have proven thus far to be resilient to legislative coaxing, may fail to effect any real change. As ACL Davies puts it, ‘it seems to be quite difficult for Parliament to alter the judges’ perception of their proper place in employment law’.

This third reason alludes to the greatest obstacle to a HRA based approach to dismissals, and Part I of this essay will attempt to overcome it. This is the non-interventionist, deferential, and contractual view that judges have through an anaemic remedial regime. 

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6 Pretty v United Kingdom (2002) 35 EHRR 1 [65].  
historically adopted with regards to labour law.\textsuperscript{10} This judicial attitude may be challenged on two fronts: firstly, by distinguishing labour law from public law; and, secondly, by analogising labour law with public law (the challenge from analogy). The former is convincingly articulated by Davies – the constitutional constraints upon the judiciary in public law cases, which triggers judicial self-restraint and deference, are largely inapplicable to labour law cases.\textsuperscript{11} In the interests of space, this essay takes Davies’ view to be correct and will refrain from further exposition. The challenge from analogy retrofits Gearty’s analysis of judicial restraint and deference where Convention rights are engaged, paradigmatically in the public context, and applies it to Convention rights sensitive dismissals.\textsuperscript{12} It will be claimed that cases involving Gearty’s three principles of respect for human dignity, legality, and civil liberties – each of which he shows induce courts to robust engagement as opposed to restraint or deference – should give rise to similar levels of scrutiny and intervention in dismissals where those same principles are engaged.

In seeking to make the case for a HRA based approach to dismissals engaging Convention rights, this essay proceeds in three parts: Part I assesses the applicability of the HRA to unfair dismissal law and launches the challenge from analogy to propose a revised judicial methodology. Part II applies the HRA in conjunction with this revised methodology to problem areas in the current law of unfair dismissal – personal scope; the reasons for, and reasonableness of, decisions to dismiss; and, remedies. Part III offers concluding thoughts on the value to be gained from a HRA based approach to dismissals engaging Convention rights and suggests some areas for further fruitful research.

\textbf{I. DISMISSALS ENGAGING THE HUMAN RIGHTS ACT 1998}

\textbf{The Horizontal Hurdle}

‘The horizontal hurdle’ refers to the HRA’s lack of explicit provision for horizontal effect between employer and employee. On its face, the HRA is merely vertically effective between state and individual. The hurdle, however, is low – ‘There can be no doubt that the HRA is fully capable of application to

\textsuperscript{10} Davies, Judicial Self-Restraint (n 9) 278, 287.
\textsuperscript{11} Ibid 289-290.
\textsuperscript{12} Conor Gearty, \textit{Principles of Human Rights Adjudication} (OUP 2005).
employment law'. The combination of the s 3 HRA interpretative obligation on courts, to read and give effect to legislation compatibly with Convention rights 'so far as it is possible to do so', and the s 6 HRA duty on courts and tribunals to act in a manner compatible with Convention rights, generates horizontal effect. Consequently, the HRA applies to unfair dismissal when Convention rights are engaged. Indeed, the fact that unfair dismissal is defined by flexible concepts of 'reasonableness' render it well-suited to interpretation under the HRA.

This analysis is uncontroversial and enjoys explicit judicial approval in X v Y. In X, the applicant, who was employed by a charity working with young offenders, was dismissed following discovery by a police officer of his engaging in consensual sex with another adult male in a public lavatory – a criminal offence. He complained that the dismissal involved a breach of his rights under Articles 8 and 14 of the European Convention on Human Rights (ECHR), scheduled to the HRA. On the facts, the Court of Appeal found no breach of the applicant’s rights due to the public nature of the lavatory – an approach which has received criticism. What is important for present purposes, however, is that Mummery LJ accepted that the s 6(1) HRA duty requires courts and tribunals, as public authorities, to interpret existing employment legislation compatibly with the Convention rights.

The effect of X, therefore, is to vault 'the horizontal hurdle' and demonstrate that there is no statutory impediment to interpreting the law on unfair dismissal in light of the HRA in appropriate cases – those with a 'human rights hook'.

**Human Rights Hooks**

The purpose of this section is to demonstrate:

A. The types of dismissal which engage Convention rights.

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14 Ibid 350.
18 X (n 15) [49], [58], [64].
B. The challenge from analogy, which applies Gearty’s methodological framework in *Principles of Human Rights Adjudication*, to dismissals engaging Convention rights.19

Types of Dismissal Engaging Convention Rights

In order for a dismissal to attract a HRA analysis the dismissal must engage the employee’s Convention rights as provided for in the Act under Schedule 1. This is problematic as the HRA does not incorporate into domestic law the European Social Charter – the document which contains the right to protection in cases of termination of employment.20 Moreover, the position that jobs constitute property rights does not enjoy significant support within the literature.21 To contest otherwise would be to either unjustifiably tip the balance of the law in favour of the employee, or to corrupt the strength that characterises property rights by allowing for non-consensual deprivation in cases of rational dismissal. Consequently, a job does not come within the scope of the ‘right to property’ in the Convention.22 This precludes a universal HRA based review in cases of unfair dismissal. There are, however, a number of instances in which Convention rights will be engaged by a dismissal.

The most relevant ‘human rights hook’ is the right to privacy under Article 8 ECHR, which extends to the workplace.23 The right has, however, thus far alluded definition as to scope.24 However, Strasbourg has clearly adopted an expansive approach to privacy. The right to privacy includes the maintenance of relationships with others and the ability to develop new relationships.25 Given the amount of time spent at work during one’s lifetime, it is clear that such a conception of privacy lends itself to engagement in dismissal. Moreover, Article 8 has been applied in cases where an employer has dismissed an employee owing to matters in the employee’s private life outside of work, particularly in the context of sexual orientation.26 The reputational element of privacy,

19 Gearty, *Principles* (n 12).
21 Collins, *Justice in Dismissal* (n 5) 9-12.
22 ECHR, art 1 First Protocol.
24 *Niemitz v Germany* (1992) EHRR 97 [29].
25 ibid; *Connors v United Kingdom* (2005) 40 EHRR 9 [82]; *Sidabras v Lithuania* [2006] 42 EHRR 6 [48].
established in *Pfeifer*, also has application to the employment context.\(^{27}\) This may be seen by the judgment in *R (Wright)* where the stigma of the dismissal in the circumstances was a contributory factor to the breach of the right to privacy in that case.\(^{28}\)

Although tangential to the present enquiry, it is noteworthy that domestic courts have, however, been reluctant to find the right to privacy engaged in certain circumstances.\(^{29}\) For present purposes, it suffices to say that the Strasbourg court has subsequently offered clarification on the position in *Pay v UK* – acts need not necessarily take place in a private environment in order to be protected by the right to privacy.\(^{30}\)

Article 10 ECHR, the right to freedom of expression, presents a further ‘human rights hook’. Dismissals for political speech and affiliation, in particular, have consistently been deemed to engage the right to freedom of expression at the Strasbourg level.\(^{31}\) Dismissals relating to dress code are another scenario in which the right to freedom of expression may be engaged.\(^{32}\) Although collective labour law is beyond the scope of this paper, it is also relevant that dismissals relating to trade union membership will engage Article 11 ECHR, the right to freedom of association, and are therefore susceptible to a HRA based approach.\(^{33}\)

The example rights and scenarios given are by no means exhaustive.

**The Challenge From Analogy**

The scenarios in the previous sub-section may also act as examples upon which the challenge from analogy with public law to judicial attitudes in dismissal cases, introduced above, may be built. Gearty presents a vision of the judiciary which sees judges more willing to engage in scrutinising public decisions under the HRA where any one of three principles are in play: ‘These are the principle

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27 *Pfeifer v Austria* (2009) 48 EHRR 8 [35].
29 X (n 15); *Pay v Lancashire Probation Service* [2004] ICR 187 (EAT); for criticism, see Mantouvalou (n 17).
33 *Young, James & Webster v United Kingdom* (1982) 4 EHRR 38.
of respect for civil liberties; the principle of legality; and the principle of respect for human dignity’. 34

This is not only because these are important principles in their own right, but also because they are principles which the judiciary feel empowered to adjudicate upon. To explain this, Gearty uses the metaphor of a swimming pool with the shallow end marked ‘legal principle’ and the deep end marked ‘public policy’. 35 In the shallow end, dealing with legal principle, is where the judges are most at home. Conversely, in the deep end, adjudicating on public policy, the judges are out of their depth. When any one of these three principles are engaged, however, judges consider themselves to be in the shallow end.

This sub-section seeks to demonstrate that these three principles are sufficiently engaged in the dismissal scenarios in the previous sub-section and should therefore induce a similar response from judges in dismissal as they do in review of public action. Judges should consider themselves in the shallow end of the pool when analysing dismissals which engage Convention rights.

In fact, there is a case to be made that the lack of constitutional constraints on judges in labour law should lead to even greater intervention than in public law. 36 Consequently, the three principles are able to do more work in dismissals than in the vertical arena as the countervailing interest of managerial prerogative is not as weighty as the constitutional concern of ensuring proportionate intrusion into government business. 37 By presenting this challenge from analogy to judicial attitudes, the way is cleared for an analysis of what a HRA based approach to dismissal law has to add to the status quo.

**Legality**

Gearty gives his definition of legality as “one that requires all official action in a democratic state to be positively authorized by law”. 38 The principle of legality involves fair play and due process. 39 Legality in this sense is already found in the regime of unfair dismissal.

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34 Gearty, *Principles* (n 11) 4.
35 ibid 121.
36 Davies, ‘Judicial self-Restraint’ (n 9).
38 Gearty, *Principles* (n 11) 60.
39 ibid 128.
An employer’s failure to follow a fair procedure is by far the most likely ground for a successful unfair dismissal claim … The willingness to impose procedural standards has several explanations … it may of course simply be that in addressing questions of procedural fairness the courts are dealing with familiar judicial principles of ‘natural justice’ or ‘procedural due process’.40

The emphasis on due process is best shown by Polkey v AE Dayton Services Ltd – procedures must be complied with regardless of whether the eventual outcome will be identical.41 The remedial inadequacy of Polkey from a human rights perspective is noted below under ‘Remedies’. The fact that judges already robustly protect the principle of legality in dismissal cases, requiring that dismissals comply with positively authorised and fair procedures, adds credence to the challenge from analogy. What it shows is a judicial confidence to uphold the principle of legality wherever it is engaged. It is also reminiscent of the ‘prescribed by law’ requirement to be found in justifications for infringing Convention rights. The judicial propensity to protect due process in dismissal cases demonstrates that the judges feel comfortably in the shallow end of the pool.

**Dignity**

Dignity is a notoriously slippery concept. Gearty describes it as ‘a core sentiment that lies behind and explains much of the language actually deployed in the Convention’ and as ‘the notion that each person matters in view of his or her humanity’.42 Dignity, as a quality innate to all humans, is a term also discussed in labour law scholarship.43 Regardless of the term’s precise definition, it is clearly considered relevant in both legal areas.

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42 Gearty, *Principles* (n 11) 84.
In unfair dismissal, dignity is most engaged in cases concerning the right to privacy. Many of these cases involve elements of control or domination, with the employer seeking to control an employee’s conduct outside of work, which fails to treat employees as autonomous individuals deserving of being treated with dignity.\textsuperscript{44} On a more basic level, the idea that ‘labour is not a commodity’ underlies much of the rationale behind controls on dismissal.\textsuperscript{45} In that sense, and according to Collins, all regulation of dismissal is justified by dignity and autonomy.\textsuperscript{46} Interestingly, it may be argued that the current regime already acknowledges the role that dignity plays in cases of unfair dismissals. An entitlement of an employee to a written statement of reasons for their dismissal, thereby acknowledging the employee’s agency, acts as evidence for this.\textsuperscript{47} Consequently, especially in cases engaging Convention rights, there is a strong case to be made that the stakes for dignity may be as high in dismissal as they are in public law. Similar levels of review, therefore, should be conducted in both circumstances.

\textit{Civil Liberties}

Basing his definition on the work of Feldman, Gearty states that ‘The subject of civil liberties is best viewed as being concerned with those freedoms which are essential to the maintenance and fostering of our representative system of government’.\textsuperscript{48}

In unfair dismissal, civil liberties are most engaged in dismissals touching upon Articles 10 and 11 ECHR, where an employee is dismissed pursuant to their political affiliation, speech, or membership of a trade union.\textsuperscript{49} Dismissals in these circumstances have a clear chilling effect on civil liberties and detract from the quality of the UK’s democracy. The fear of losing one’s livelihood is a strong disincentive to engaging in political speech and association. It is clear to see how such dismissals engage the principle of respect for civil liberties. As with dignity, therefore, similar levels of review should be conducted in dismissal.

\textsuperscript{44} Mantouvalou, ‘Human Rights and unfair dismissal’ (n 17).
\textsuperscript{45} Declaration concerning the Aims and Purposes of the International Labour Organisation, adopted at the 26th session of the ILO, Philadelphia, 10 May 1944.
\textsuperscript{46} Collins, \textit{Justice in Dismissal} (n 5).
\textsuperscript{47} ERA 1996, s 92.
\textsuperscript{49} \textit{Vogt} (n 31); \textit{Aslef} (n 31); \textit{Redfearn v UK} (n 31); \textit{Young} (n 33).
cases impacting upon political activity covered by the HRA as in equivalent public law cases.

The challenge from analogy has sought to show that the principles that lead judges to intervene more robustly in public law cases under the HRA, rather than exercise restraint or deference, are also engaged where a dismissal involves Convention rights. In doing so, given the lack of constitutional constraints on judges in dismissals, the claim is made that judges should abandon their deference to managerial prerogative in Convention rights sensitive dismissals\(^{50}\) and instead adopt a HRA based approach – the value of which is assessed in Part II.

II. APPLYING THE HRA TO UNFAIR DISMISSALS

Personal Scope

Universality is a key tenet of human rights law, reflected at Article 1 ECHR and in the HRA by virtue of the s 3 interpretative obligation and duty under s 6. Therefore, the first problematic aspect of the unfair dismissal regime from a human rights perspective is its lack of universality. There are two principal ways in which access to a claim for unfair dismissal is restricted: first, the inability of ‘workers’ to claim unfair dismissal;\(^{51}\) and, second, the qualifying period requiring two years’ continuous service before an employee is eligible to claim.\(^{52}\)

Workers

Access to the right to claim unfair dismissal is limited to ‘employees’ – meaning those engaged under a contract of employment.\(^{53}\) Collins has described this state of affairs as “as unjustifiable as it is inexplicable” and the extension of protection from unfair dismissal to workers is one of his nine proposed reforms to the law on unfair dismissal.\(^{54}\) Davies characterises this as a ‘radical’ position.\(^{55}\)

\(^{50}\) Davies, Judicial Self-Restraint (n 9).
\(^{51}\) ERA 1996, s 94.
\(^{52}\) ERA 1996, s 108
\(^{53}\) ERA 1996, s 230(1).
\(^{54}\) Collins, Nine Proposals (n 40) 9.
\(^{55}\) ACL Davies, Perspectives on Labour Law (2nd edn, CUP 2009) 83.
However the present case is that workers should enjoy protection from unfair dismissal where their Convention rights are engaged. Thus, the position is consonant with Davies’ view that protection of fundamental rights should be extended to all workers.\(^{56}\)

The inadequacy of the distinction is exemplified by *O’Kelly v Trusthouse Forte Plc.*\(^{57}\) In this case, casual wine waiters were for all intents and purposes dismissed pursuant to their attempts to organise with the help of a union. Their claim for unfair dismissal, however, failed without any consideration of the employer’s motives due to their status as workers. *O’Kelly* is an extreme example but demonstrates how the distinction fails to adequately protect Convention rights in relevant cases.

Applying a HRA based approach to unfair dismissal law would alleviate this issue significantly. Section 3 HRA might be used so as to read and give effect to the following reading of s 94 ERA as follows: ‘An employee, and a worker where their Convention rights are engaged, has the right not to be unfairly dismissed by his employer.’ Such a reading would not go against the overriding statutory regime.\(^{58}\) Moreover, the fact that workers enjoy the protection of many other employment rights, such as discrimination, allows the courts to infer Parliamentary intent on this matter thereby avoiding any Parliamentary sovereignty criticisms.

*The Qualifying Period*

The qualifying period, at s 108 ERA, denies access to a claim for unfair dismissal to employees who do not possess two years of continuous service. Generally, the existence of a qualifying period is within a state’s margin of appreciation.\(^{59}\) However, in *Redfearn*, it was ruled that the satisfaction of a qualifying period in cases where a dismissal may be in breach of Convention rights constitutes a disproportionate exclusion.\(^{60}\) Therefore, for the dismissals with which this paper is concerned, the dilemma of the qualifying period has already been largely solved.

The dilemma does, however, remain for dismissed individuals who are unable to hang their claim on a ‘human rights hook’. This, *inter alia*, has

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56 Ibid.
57 [1984] QB 90 (CA).
60 *Redfearn* (n 31).
precipitated calls for an ‘integrated approach’ to labour rights in interpreting the ECHR.\footnote{V. Mantouvalou, 'Labour Rights in the European Convention on Human Rights: An Intellectual Justification for an Integrated Approach to Interpretation' (2013) 13(3) Human Rights Law Review 529.} Failing this, there may also be a case to be made that an ‘integrated approach’ to labour rights is possible under the HRA. Indeed, the case may be stronger as the margin of appreciation, which currently protects the general qualifying period, is afforded to states, not to governments, and therefore as a branch of the state the judiciary is not limited by it. It is now acknowledged that the HRA creates domestic rights and the judiciary are currently riding on a wave of support for common law constitutional rights.\footnote{E.g. Kennedy v Charity Commission [2014] UKSC 20, [2015] AC 455.} Therefore, although unlikely, there is nothing in principle precluding the judiciary from integrating the right to unfair dismissal, so labelled at s 94 ERA, in the HRA. In that sense, the HRA may be partially informed by the ERA in a similar way to how the ESC helps give content to the rights in the ECHR.

In any event, for present purposes, what is of note is that the qualifying period is no longer an issue for dismissals engaging an individual’s Convention rights. Indeed, ensuring robust scrutiny of dismissals in such circumstances is a prudent step to be taken before seeking to extend that scrutiny in all cases.

Therefore, it may be seen that a HRA based approach to relevant dismissals either has the capacity to grant greater protection to Convention rights, or has already managed to do so, following Strasbourg case law, without need for legislative modification of the statutory qualifying period.

**Reasons For Dismissal**

There are three categories of reasons for dismissal: automatically fair,\footnote{ERA 1996, s 10(4); Trade Union and Labour Relations (Consolidation) Act 1992, s 237.} automatically unfair,\footnote{ERA 1996, ss 99 - 105.} and potentially fair.\footnote{ERA 1996, ss 98(1)(b) and 98(2).} The latter two are most relevant to the present enquiry.

**Automatically Unfair Reasons**
In the interests of space, the list of automatically unfair reasons will not be given here. Collins lists three types of reason for dismissal that are treated as automatically unfair: protection of social rights, protection of worker representatives in performing their functions, and victimisation for asserting a statutory right enforceable in an employment tribunal.66 Dismissals for these reasons will result in an automatic finding of unfair dismissal and entitle the individual to a remedy.

As a product of legislation, the contents of the list of automatically unfair reasons are a political choice. There are some omissions which commentators have been critical of such as dismissals relating to political expression or religion.67 Collins has called for the rights in the Charter of Fundamental Rights of the European Union to be included in the list.68

A HRA based approach to dismissals will not give rise to these developments. That is not, however, a shortcoming of the approach. Automatic unfair dismissals allow no room for justification – therefore, it is difficult to see why qualified rights should enjoy absolute protection upon engagement. A more balanced approach, which the HRA allows for, would necessitate a discussion as to the proportionality of the dismissal, including whether the dismissal pursued a legitimate aim. It is the failure at present of the courts to apply a true proportionality analysis in these cases, which has in part induced calls for a wider category of automatically unfair reasons. A true proportionality analysis would swiftly consider unmeritorious reasons unfair.

Therefore, although a HRA based approach to dismissals engaging Convention rights would be unable to widen the list of automatically unfair reasons for dismissal, this is no great disadvantage.

Potentially Fair Reasons

Two elements make up a potentially fair dismissal: firstly, the actual reason relied upon;69 secondly, the reasonableness of the employer’s action in dismissing the employee for that reason.70

66 Collins, Nine Proposals (n 40) 75.
67 Deakin, The Utility of Rights Talk (n 43) 366.
68 Collins, Nine Proposals (n 40) 78.
69 ERA 1996, ss 98(1)(b) and 98 (2).
70 ERA 1996, s 98(4).
The first step is to identify which of the four potentially fair reasons the employer had for the dismissal. They are conduct, capability, redundancy, and ‘some other substantial reason’.\(^{71}\) These reasons are largely in line with international standards and reflect Article 4 ILO Convention 158, Termination of Employment, 1982 – a treaty not ratified by the UK. Despite this fact, the reasons are not without controversy, and Deakin has labelled their width as one of the problems with unfair dismissal from a rights-based perspective.\(^{72}\) For example, the category of ‘some other substantial reason’ has been found to include dismissals as a result of an employee’s difficult personality, and dismissals arising from pressures to dismiss.\(^{73}\)

These flaws are, however, endemic of the unfair dismissal regime generally. It is the reasonableness element that is more relevant to the enquiry of what a HRA based approach to unfair dismissal can add to dismissals engaging an individual’s Convention rights. It is the reasonableness element also which has most robustly repelled a genuine HRA interpretation to such dismissals. Moreover, remedying the deficiency of the reasonableness element, by applying a proportionality analysis in cases engaging Convention rights, would alleviate the worst symptoms of the breadth of the potentially fair reasons in the statute.

**Reasonableness**

*‘The Band of Reasonable Responses’*

In order to assess whether an employer acted ‘reasonably’ in the circumstances by dismissing the employee, the courts have adopted the notorious ‘band of reasonable responses’ test (BORR) set out in *Iceland Frozen Foods v Jones*:\(^{74}\)

> [T]he function of the industrial tribunal, as an industrial jury, is to determine whether in the particular circumstance of each case the decision to dismiss the employee fell within the band of reasonable responses which a reasonable employer might have adopted. If the dismissal falls within the band the dismissal is fair: if the dismissal falls outside the band it is unfair.\(^{75}\)

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\(^{71}\) ERA 1996, ss 98(1)(b) and 98(2).

\(^{72}\) Deakin, The Utility of Rights Talk (n 43) 364.


\(^{74}\) Iceland (n 2).

\(^{75}\) ibid.
This test, after some judicial criticism,\(^{76}\) has been reaffirmed and remains law.\(^{77}\) The test instructs tribunals to assess the reasonableness of the decision to dismiss from the perspective of the hypothetical reasonable employer – it must not substitute its own view as to the reasonableness of the decision. The breadth of the BORR, and the weight given to managerial prerogative under the test, is exhibited by Ackner LJ in *British Leyland UK Ltd v Swift*:

> As has been frequently said in these cases, there may well be circumstances in which reasonable employers might react differently. An employer might reasonably take the view, if the circumstances so justified, that his attitude must be a firm and definite one and must involve dismissal in order to deter other employees from like conduct. Another employer might quite reasonably on compassionate grounds treat the case as a special case.\(^{78}\)

Under this test it is clear that, as Collins puts it, ‘considerations of respect for the civil liberties [and human rights] of employees rarely surface in the reasoning of the courts and tribunals’.\(^{79}\) Consequently, the test has been heavily criticised in a vast academic literature – it has been likened to a perversity test and the *Wednesbury* test in administrative law,\(^{80}\) described as an ‘unwarranted gloss on the statute’,\(^{81}\) and as switching the emphasis from requiring an employer to act reasonably to requiring that an employer does not act unreasonably.\(^{82}\)

\(^{76}\) *Haddon v Van den Bergh Foods* [1999] ICR 1150 (EAT).
\(^{78}\) *British Leyland UK Ltd v Swift* [1981] IRLR 91 (CA).
\(^{79}\) Collins, *Justice in Dismissal* (n 5) 185-86.
\(^{81}\) Collins, *Nine Proposals* (n 40) 36.
The UK courts have stated that the BORR is not a perversity or *Wednesbury* test – most recently by Elias LJ in *Turner*. This is unconvincing – given the breadth of the test, it is difficult to envisage an instance in which an employer’s decision falls outside the BORR and cannot be characterised as perverse.

Given that *Wednesbury* and its variants have been explicitly rejected by Strasbourg, it is of concern that the BORR remains the standard of review in dismissal cases engaging Convention rights. What a HRA based approach, built out of the challenge from analogy, has the capacity to contribute to this area of dismissal is the imposition of proportionality to the reasonableness element of potentially fair dismissals.

There has been, however, a spate of domestic decisions paying lip service to protecting Convention rights and intensifying the standard of review whilst failing to apply a genuine proportionality analysis. This line of authority has culminated in the ruling in *Turner* that the BORR is compatible as a justificatory test under the Convention – a decision that requires refuting in order to make the claim that a HRA based approach can inject proportionality into the reasonableness test.

*Turner v East Midlands Trains Ltd*

In *Turner*, the claimant employee was dismissed from her job as a senior train conductor due to allegations of misconduct. The employer alleged that the employee had deliberately manipulated the ticket machine so as to sell fraudulent tickets and retain the proceeds. There was no direct evidence and the employee denied the allegations. The employer based their case on statistics and inferences which could be drawn from the data – an approach that the employee accepted as adequate by the standards of domestic unfair dismissal law. However, most importantly for present purposes, the employee alleged that the dismissal engaged her Article 8 rights due to the damage to her reputation flowing from the dismissal. In these circumstances, the employee alleged that the domestic BORR did not meet the requirements of Article 8, necessitating the application of a proportionality analysis.

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83 *Turner* (n 2) [18].
84 *Smith* (n 26).
86 McGowan v Scottish Water [2005] IRLR 167 (EAT); X (n 15); Pay (n 29); Copsey v WWB Devon Clays Ltd [2005] EWCA Civ 932, [2005] IRLR 81.
Rejecting the claimant employee’s submissions, Elias LJ held that the BORR applies to all aspects of the dismissal process, including whether adequate procedures were adopted, and that the test provided a sufficiently robust analysis of the decision to ensure compliance with Article 8. Moreover, Elias LJ stated that the domestic test may protect human rights more effectively than the Strasbourg proportionality test.

*Turner* is an unfortunate judgment. Elias LJ’s analysis is incoherent in respect of both its finding of equivalence between the BORR and proportionality, and its characterisation of Strasbourg authority.

**Proportionality and the ‘band of reasonable responses’ test – structural differences**

Conventional wisdom under the HRA and in Strasbourg case law necessitates that infringements on Convention rights are assessed by proportionality – *Wednesbury* and its variants are incompatible. This is relevant, as Elias LJ’s defence of the variable nature of the BORR, when Convention rights are engaged, appears very similar to the rejected super-*Wednesbury* test.

Lord Reed in *Bank Mellat* provides the most recent and authoritative formulation of the proportionality test under the HRA. Paraphrasing, there are four limbs:

1. the limitation on the right must pursue a legitimate aim;
2. the measure taken must be rationally connected to that legitimate aim;
3. there must be no less restrictive measure available; and
4. on balance, is the impact of the rights infringement disproportionate to the likely benefit of the impugned measure.

The BORR falls well below this standard. By virtue of the very fact that it allows for a ‘band’ or ‘range’ of responses, it is clear that it permits for dismissals which may not necessarily be the least restrictive measure to achieve the employer’s legitimate aim. Moreover, proportionality by its nature requires the

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87 *Whitbread plc v Hall* [2001] IRLR 275 (CA); *Sainsbury’s Supermarkets v Hitt* [2003] IRLR 23 (CA).
88 *Turner* (n 2) [56].
89 *Smith* (n 26).
90 *Turner* (n 2) [52]; *A v B* [2003] IRLR 405 (EAT); *Salford Royal NHS Foundation Trust v Roldan* [2010] EWCA Civ 522, [2010] ICR 1457.
court/tribunal to make its own independent assessment as to whether there has been a violation of a Convention right.\textsuperscript{92} Contrastingly, the BORR, as seen above, actively deters tribunals from forming their own view of the reasonableness of the employer’s decision to dismiss. The assertion by Elias LJ that the BORR may more effectively protect Convention rights is highly flawed. This is especially the case in the context of domestic dismissal cases where courts and tribunals need not consider the ‘Margin of Appreciation’ or the aspiration of institutional preservation that drives some of the Strasbourg jurisprudence.

Incoherent and partial view of authority

In seeking to establish the BORR as Article 8 compliant, Elias LJ offered an incoherent and partial view of Strasbourg authority.

Due to the employee’s case centring on the incompatibility of the procedure adopted, Elias LJ was required first to jump the preliminary hurdle of demonstrating that Article 8 does not require a proportionality analysis in respect of procedural fairness. In jumping this hurdle, Elias LJ cited a number of Strasbourg authorities.\textsuperscript{93} However, it is difficult to conclude from the passages cited that the authorities disavow a proportionality analysis. In \textit{McMichael}, the required standard of procedure was ‘to a degree sufficient to provide… the requisite protection of… interests’.\textsuperscript{94} This begs the question of what is ‘sufficient’ and ‘requisite’ – usually answered through an assessment of proportionality. Similarly, in \textit{Buckley}, it is stated that interfering measures must be ‘fair’ and afford ‘due respect’ to Article 8 interests.\textsuperscript{95} What is ‘fair’ and affords ‘due respect’ is typically determined by proportionality. Finally, in \textit{Turek}, the standard of procedural protection is said to be one which offers ‘practical’ and ‘effective’ protection of Article 8 rights – two metrics usually distilled, again, through proportionality. In this context, it is difficult to see how the weight of findings of fair dismissal, pursuant to the BORR, may be claimed to amount to ‘effective’ protection. Indeed, conventional Strasbourg wisdom dictates that insufficient procedural safeguards may result in a violation of Article 8.\textsuperscript{96} Therefore, the conclusion Elias LJ draws from these cases, which fall short of


\textsuperscript{94}\textit{McMichael} (n 93).

\textsuperscript{95}\textit{Buckley} (n 93).

\textsuperscript{96}\textit{Connors} (n 25).
an explicit rejection of proportionality, represent a partial and incoherent view of authority.

A further, more egregious example of Elias LJ’s partial presentation of the Strasbourg case law is found in his reliance on Palomo Sanchez. Elias LJ cites Palomo Sanchez as authority for the position that, due to the leeway afforded to employers in dismissal cases, the BORR is Article 8 compliant. Implicit in that position is the finding that no proportionality analysis is required. However, at paragraph 30, it is stated that ‘the proportionality of a measure of dismissal in relation to the conduct of the employee concerned underlies all the legislation analysed.’ Indeed, an explicit proportionality analysis, within which account is taken of the employer’s discretion, is conducted at paragraphs 69 – 77 of Palomo Sanchez.

A final note on the incoherence and partiality of Elias LJ’s analysis of the authorities concerns those relevant cases which were omitted. The judgment makes no references to the cases of Pay v UK, Vogt v Germany or Obst v Germany – all of which address infringements with Article 8 rights in employment contexts through the lens of proportionality. Particularly in Pay, the Strasbourg court ‘did not ask whether the employer acted “reasonably” or “within a range of reasonable responses”’, and therefore it would appear that ‘the test of justification under Article 8(2) differs from the normal test of reasonableness for unfair dismissal’. Moreover, the Strasbourg court continues to assess such infringements on a proportionality basis. Such cases, therefore, point strongly in the direction that Article 8 requires that any infringements be assessed as a matter of proportionality, contrary to the decision in Turner.

Turner – conclusions

In light of the above, there is a strong case to be made that the judgment in Turner v East Midlands Trains requires revisiting, and that the BORR does not satisfy the requirements of Article 8. Ultimately, Turner is a judgment symptomatic of the judicial view challenged in Part I. Therefore, suspending

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98 Turner (n 2) [53].
99 Pay v United Kingdom (2009) 48 EHRR SE2; Vogt (n 31); Obst v Germany App no 425/03 (ECtHR, September 23, 2010); Schuth v Germany (2011) 52 EHRR 32.
disbelief and assuming that the judiciary take a more reflective institutional view of self as suggested, there is a strong case that a HRA based approach to relevant dismissals would yield a different result.

Indeed, a HRA based approach coupled with a shift in judicial attitudes, is capable of offering a proportionality analysis in dismissals engaging Convention rights. This would bring unfair dismissal in line with HRA analyses in other areas and with the direction of travel in Strasbourg.\(^\text{102}\)

**Remedies**

There are three possible remedies for unfair dismissal: reinstatement, reengagement, and compensation.\(^\text{103}\) The compensatory award has two elements: a basic award and a compensatory award. The basic award is calculated by statutory formula. The compensatory award is calculated by what the tribunal considers just and equitable.\(^\text{104}\)

The practice of this remedial scheme has a number of deficiencies: firstly, a negligible number of unfair dismissals result in orders of reinstatement or reengagement. Only 5 of 5,100 upheld cases in 2011-2012 made such orders.\(^\text{105}\) Secondly, the damages awarded in unfair dismissal cases are low – the median award in 2011-2012 being £4,560.\(^\text{106}\) Thirdly, there is a statutory cap on the amount of damages available for an unfair dismissal which is currently set at £72,300.\(^\text{107}\) Fourthly, in a finding of unfair dismissal for a failure to follow correct procedures, an award of damages may be reduced by up to 50% if the employer shows that the employee would have been dismissed in any event - the *Polkey* deduction.\(^\text{108}\) Fifthly, awards may be reduced for contributory negligence or subsequent proof of good cause for summary dismissal to zero.\(^\text{109}\) Sixthly,

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\(^{103}\) ERA 1996, ss 112-127B.

\(^{104}\) ERA 1996, s 123.


\(^{106}\) ibid table 5.

\(^{107}\) ERA 1996, s 124.

\(^{108}\) *Polkey* (n 41).

\(^{109}\) ERA 1996, s 123(6); *W Devis & Sons v Atkins* [1977] ICR 662 (HL); *Nelson v BBC (No 2)* [1980] ICR 110 (CA).
and problematically from a rights perspective, no damages may be awarded for non-pecuniary loss.\textsuperscript{110}

At present, it would appear that a HRA based approach to dismissals engaging Convention rights would be of limited use in bolstering the remedial regime.\textsuperscript{111} The reason for this is that damages under the HRA have thus far been subject to Lord Bingham’s ‘mirror’ principle.\textsuperscript{112} The ‘mirror’ principle holds that courts and tribunals must look exclusively to Strasbourg jurisprudence for guidance on the award of damages and as to quantum. This is problematic for unfair dismissal as Strasbourg, under Article 41, recognises only ‘just satisfaction’.\textsuperscript{113} The effect has been to preclude, \textit{inter alia}, awards of punitive damages under the HRA – a key recommendation of Collins, alongside injunctions, for the reform of unfair dismissal.\textsuperscript{114} Moreover, remedies for breaches of human rights may also be purely declaratory. Space precludes a full discussion of the flaws of this approach, but there have been calls for a tort-based approach to HRA damages.\textsuperscript{115}

It is worth noting that there since the development of the principle of judicial ‘dialogue’ there may be some light on the horizon for damages under the HRA.\textsuperscript{116} However, at present, a HRA based approach to dismissals engaging Convention rights would be of limited efficacy in respect of improving the remedial regime for unfair dismissal.

CONCLUSION

The purpose of this paper has been to make the case for a HRA based approach to dismissals engaging Convention rights. In making the case, two interconnected exercises have been conducted. Firstly, it was necessary to pave the way for a HRA based approach to

\begin{enumerate}
\item Oliver (n 13) 358-9.
\item HRA 1998, s 8; R (Ullah) \textit{v} Special Adjudicator [2004] UKHL 26, [2004] 2 AC 323 [20]; R (Greenfield) \textit{v} Secretary of State for the Home Department [2005] 1 WLR 673 [18-19].
\item ECHR Art. 41.
\end{enumerate}
dismissals. This was done through demonstrating horizontality and, more importantly, introducing the ‘challenge from analogy’ to the judicial institutional view of self in dismissal cases. Secondly, the potential of such an approach was assessed. It is clear from the preceding analysis that a HRA based approach has the potential to vastly improve the protection of Convention rights in dismissal by widening the personal scope of the action, and by injecting a proportionality analysis into the assessment of the reasonableness of decisions to dismiss.

There are, however, limitations to a HRA based approach: firstly, in order to benefit from the increased protection, an individual must be able to hang their claim on a ‘human rights hook’; secondly, it is unlikely to positively affect remedies for unfair dismissal; and, thirdly, to be applied at its height it requires that the ‘challenge from analogy’ to judicial attitudes be accepted. On this last point, however, the contemporary judicial willingness to engage with matters previously thought beyond their competence, such as the bedroom tax litigation, may indicate a climate of judicial intervention in which the ‘challenge from analogy’ may be more readily accepted.\textsuperscript{117}

Space has precluded a full analysis of the literature on the underlying theory of dismissal law.\textsuperscript{118} Considering what Collins would add to a second edition of \textit{Justice in Dismissal} would be a fruitful area of further research. Since his monograph, the HRA has been passed and the UK courts have developed a healthy rights jurisprudence. Better distilling the underlying theoretical importance of protection from dismissal, in this context, could offer an intellectual architecture from which the courts, accepting the ‘challenge from analogy’, could build a stronger unfair dismissal regime for all workers.

A necessary first step, however, is ensuring that sufficient protection is offered in instances of dismissal engaging rights which the law already recognises as important – Convention rights. This paper hopes to contribute towards taking that first step.

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\textsuperscript{118} Collins, Justice in Dismissal (n 5); Gwyneth Pitt, 'Justice in dismissal: A reply to Hugh Collins' (1993) 22(4) Industrial Law Journal 251.
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Order, Authority, and Law:
On the Development of Modern Conceptions of Political Order, Legitimate Rule, and Law and How They are Challenged

Nico Schröter*

ABSTRACT

This essay examines the development of the Western conception of political order, which has changed considerably since its medieval origins. It has undergone a process of abstraction, secularisation, positivisation, and legalisation. In particular, the contemporary conception of political order, which I term Legalised Political Constructivism, emphasises the role of law as a means to structure political and social life. This essay shows that Legalised Political Constructivism is the result of historical attempts to justify political developments or to induce change, which leaves it open to challenge on empirical grounds. It concludes that normative political thought must engage with the social sciences in order to better understand the role that positive law can (and should) play as a constructive element in society.

INTRODUCTION

Since its medieval origins, the conception of political order has on its way to modernity changed considerably. It has undergone a process of abstraction, secularisation, positivisation, and legalisation. In particular, in its modern form it emphasises the role of positive law as a means to structure political and social life.

This contemporary conception of political order, which I term Legalised Political Constructivism, can be explained as the result of historical attempts either to justify political developments on normative grounds, or to actively
induce political change. In particular, philosophical conceptions of political order were often used instrumentally to legitimise or entrench transitions between papal or monarchical authority and popular sovereignty. It is unsurprising, then, that some of its core assumptions and concepts – for example, the notion that political associations are the product of rational choices to protect individual and collective welfare or the role of positive law in political order – are inconsistent with what we nowadays know about political behaviour. This leaves Legalised Political Constructivism, with its insistence on the role of law to circumscribe political structures, open to criticism on empirical grounds. This prompts the challenge to reconcile normative political thought with theories of social behaviour propounded by the social sciences.

I. MEDIEVAL ORIGINS: CATHOLIC ORDER AND THEOCRATIC GOVERNMENT

Many concepts underlying modern political thought emerged during the medieval period and must be seen against this background. Until the High Middle Ages, political philosophy was considerably shaped by the cosmovision and doctrines of Christianity, which had attained influence by its establishment as the official church of the late Roman Empire by Theodosius I in 380 AD and – following the Western Empire’s decline – by the rise of the papacy to become a political player. Its underlying rationale of a divinely created world, structured in a natural and strictly hierarchical order (a ‘Great Chain of Being’),¹ remained prevalent throughout much of the Middle Ages.²

The Structuring Force of Christian Theology

The main consequences of Christian theology for political thought were threefold. Firstly, political order was considered ancillary to heteronomous, transcendental objectives. Early Christian philosophers like St Augustine of Hippo (354–430), in his text City of God, suggested that government was made

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² Michael White, Political Philosophy (2nd edn, OUP 2012) 124.
necessary only by the Fall of Man.\textsuperscript{3} Hence, its main purpose was the achievement of salvation (and the suppression of forces working to the contrary).\textsuperscript{4} This general rationale for political order was contrary to earlier Roman and Greek political thought, most prominently Aristotle (384–22 BC), who considered political life in the \textit{polis} to be natural (and god-willed) human behaviour.\textsuperscript{5}

Linking political order primarily to transcendental objectives meant that, secondly, any rightful political authority had to be divinely bestowed (see, for example, \textit{Romans} 13:1–7).\textsuperscript{6} Earthly authorities were therefore understood to be ‘vicegerents of God’ and to act in the exercise of His will.\textsuperscript{7} This idea of delegated authority allowed for a certain abstraction of political power, as opposed to earlier pagan theories of kings as unchallengeable quasi-gods. At the same time, it contradicted those traditions which perceived political authority not as divinely bestowed, but rather derived from a compact between the ruler and his people, as for example in ancient Germania.\textsuperscript{8}

Thirdly, the structure of government – being part of a greater, inherently consistent order – was considered to be (at least in part) divinely predetermined, an idea encapsulated by the later ‘Divine Right of Kings’ theory.

\textbf{Medieval Theory and Practice}

In conformity with Christian theology and Germanic as well as late Roman governmental practice, ideas of theocratic kingship emerged in Western Europe in the Early Middle Ages.\textsuperscript{9} One consequence of this development was that whereas God was considered to be the sole and omnipotent (or to put it in

\begin{itemize}
\item \textsuperscript{3} John McClelland, \textit{A History of Western Political Thought} (Routledge 1996) 111.
\item \textsuperscript{4} White (n 2) 158ff.
\item \textsuperscript{5} Aristotle, \textit{Politics} [4th c BC] bk. I.2, 1252b, 1253a, reprinted in Richard McKeon (tr), \textit{The Basic Works of Aristotle} (Random House 1941). See further McClelland (n 3) 111; White (n 2) 79ff.
\item \textsuperscript{6} ‘Let every person be subject to the governing authorities. For there is no authority except from God, and those that exist have been instituted by God. […]’ (ESV). See also White (n 2) 119ff.
\item \textsuperscript{7} Martin Loughlin, \textit{Foundations of Public Law} (OUP 2010) 21ff.
\item \textsuperscript{8} See Ken Pennington, ‘Law, Legislative Authority, and Theories of Government, 1150–1300’ in James Burns (ed), \textit{The Cambridge History of Medieval Political Thought} c.350–c.1450 (online edn, CUP 2008) 426.
\item \textsuperscript{9} More precisely, this has been dated back to the 7th and 8th century: Loughlin, \textit{Foundations} (n 7) 25; or even further to the 5th century: PD King, ‘The Barbarian Kingdoms’ in Burns (n 8) 127ff.
\end{itemize}
modern terms, ‘sovereign’) transcendental authority, on earth such authority was shared with the monarch. The Church retained its position as both the mediator and the ultimate interpreter of an all-ordering divine will from which royal power was derived and to which it was subject. The result of this form of theocratic kingship was a dualistic structure of authority, figuratively expressed in the ‘Theory of the Two Swords’, according to which both the papacy and the royalty were divinely authorised to exercise spiritual and temporal authority, respectively.

This intertwining of Christian theology and politics found its most elaborate application in the structure of the Holy Roman Empire. In practice, however, there was no neat hierarchy in medieval politics. Rather, society was shaped by overlapping and competing jurisdictions, as well as by the interdependencies and power struggles between the main political actors: the Church, monarchs and local princes. Tensions arising from and attempts to stabilise this volatile framework would drive many of the developments of modern political thought.

**Medieval Notions of Law**

10 The German jurist Carl Schmitt would hence consider the modern concept of sovereignty to be a secularised version of this omnipotent power: *Political Theology* (first published 1922, Georg Schwab tr, University of Chicago Press 2010) 36.

11 This mediating function found its symbolic explication in meticulous coronation ceremonies in which a dignitary would formally invest the king with regal power: Loughlin, *Foundations* (n 7) 26f. See also János Bak (ed), *Coronations: Medieval and Early Modern Monarchic Ritual* (University of California Press 1990).

12 This distinction between a ‘spiritual sword’ and a (subordinate) ‘temporal sword’ was first formulated by Pope Gelasius (492–496?): McClelland (n 3) 132f, and has famously been invoked eg by Boniface VIII (1294–1303) in his bull *Unam Sanctam* [1302], issued during his conflict with Philip IV of France. See Walter Ullmann, ‘A Medieval Document on Papal Theories of Government’ (1946) 61 The English Historical Review 180.

13 The exact relationship between spiritual and temporal powers, however, was subject to constant dispute: HJA Watt in Burns (n 8) 367ff.


15 McClelland (n 3) 131-32. Kings had long relied on the Church’s prestige and institutions to govern effectively, while exercising considerable factual authority over it within their own realms, see ibid 131, 135. At the same time, for the exercise of actual (military) power, they relied on local princes, who owed them only limited allegiance, see ibid 278-79.
Since medieval thought considered God to be the supreme legislator, any
temporal law had to emulate or at least comply with His will.\(^{16}\) Hence, Thomas
Aquinas (1225–74) could claim that compliance with temporal laws also meant
obedience to divine law, since every (rightful) temporal law at least partly
embodied it.\(^ {17}\) Yet for a long time there was no clear conception of what ‘law’
actually was, or who made it.\(^ {18}\) During the Early and High Middle Ages legal
propositions were mainly drawn from customary or adopted sources, and the
exercise of legal authority amounted to little more than casuistically applying
these propositions. Those sitting in judgment faced a mixture of overlapping
and competing systems and sources of law, including traditional (for example,
Germanic) practices, Christian Canon Law, and – following the rediscovery of
Justinian’s *Digests* in 1135 – Roman Law. In addition, the rediscovery of
Aristotle’s *Politics* in the thirteenth century led to a revival of natural law
theories.\(^ {19}\) The cardinal ‘project’ of medieval legal scholarship was to reconcile
these conflicting systems.\(^ {20}\)

It is not clear when people began to conceptualise that they could actually
‘make’ new law in the form of abstract rules. Terminologically, it was not before
the late twelfth century that Canonists coined the term *ius positivum* to designate
law promulgated by a human legislator.\(^ {21}\) However, even Civilians at that time
were divided about the relationship between deliberately drafted and existing
customary law.\(^ {22}\) And while Thomas Aquinas already clearly distinguished
between divine and man-made law,\(^ {23}\) definitions by Marsilius of Padua (circa
1275–1342) only roughly resemble the modern categories of natural and
positive law.\(^ {24}\) In actual fact, for much of the Middle Ages even promulgated
legislation was considered merely a representation of divine will.\(^ {25}\) Before ideas
of genuinely ‘positive’ law took hold, the concept of law hence retained a
‘passive’ role in both political thought and practice. Firstly, it was regarded to be
an emanation of a divinely predetermined order rather than a product of

\(^ {16}\) McClelland (n 3) 133.
\(^ {17}\) ibid 118.
\(^ {18}\) ibid 133, 140.
\(^ {19}\) Loughlin, *Foundations* (n 7) 34.
\(^ {20}\) Pennington (n 8) 425ff.
\(^ {21}\) ibid 425.
\(^ {22}\) ibid.
\(^ {23}\) White (n 2) 183ff.
\(^ {24}\) McClelland (n 3) 140-41.
\(^ {25}\) ibid 140.
political will. It could therefore, secondly, play only a limited role as a means of governance.26

In the High Middle Ages, however, disputes about political power and its limits started to be expressed in legal terms. Canonists were among the first to make law central to their political theory.27 For instance, Thomas Aquinas expressed the relationship between God-given, natural laws and promulgated laws – that is, the limits of governmental power – in terms of legal hierarchy: in the case of conflict, promulgated law would be invalidated as leges corruptio.28 The exercise of political power was therefore subject to what would become known as ‘fundamental laws’ (leges fundamentalis). A similar use of legal terminology to express the limits to regal power can be seen in the writings of Henry de Bracton (1210–68).29 This trend towards legalisation provided the language for subsequent debates about political right and order. While in medieval times law had not yet become the ‘building blocks’ of political order, it already supplied the terminology in which the contours of political power were described.

II. TRANSITION TO MODERNITY: AUTONOMISATION AND SECULARISATION OF THE POLITICAL

The transition from medieval to modern political thought is closely linked to changes in the political landscape occurring towards the Late Middle Ages. These developments questioned existing doctrines and set off a re-conceptualisation of both political order and law.

Decentralisation and Consolidation of Political Power

26 Certainly, apart from theoretical constraints, low levels of literacy and limited means of communication set very practical limits to the rule-making capacity of early medieval kings.
27 Pennington (n 8) 427.
28 Thomas Aquinas, Treatise on Law Q 95, quoted in J Budziszewski, Commentary on Thomas Aquinas’s Treatise on Law (CUP 2014) 316.
From the mid-thirteenth century onwards, regional principalities and republics successfully began to claim political autonomy.\textsuperscript{30} Notably the French and English royalty – declaring themselves to be ‘emperors within their own kingdom’ (imperator in regno suo) – opposed both papal and imperial authority.\textsuperscript{31} As was foreshadowed by the eleventh and twelfth century Investiture Controversy between the papacy and royalty over the power to appoint Church officials, monarchs increasingly attempted to control the Church within their own realms.\textsuperscript{32} These power struggles overlapped with and were closely related to the Protestant Reformation.\textsuperscript{33} The Reformation and subsequent religious wars led to increased political fragmentation (especially among the German principalities), and this decentralisation further impaired papal authority.\textsuperscript{34} The overall effect of these developments was a gradual dispersion of political power towards the regional polities and a concomitant increase in royal over religious authority. At the same time, within a given territory, governmental power was consolidated more and more in the royalty, at the expense of inferior feudal lords.\textsuperscript{35}

The political authority exercised by an increasingly independent royalty found its conceptual expression as ‘sovereignty’. The term – formerly synonymous with suzerainty\textsuperscript{36} – was used to describe a consolidated and independent political power, in contrast to the patchwork of competing authorities and jurisdictions that had shaped feudal systems.\textsuperscript{37} This modern notion of sovereignty is mainly attributed to Jean Bodin (1530–96), who defined sovereign power, held by the king, as ‘the absolute and perpetual power vested in a commonwealth’.\textsuperscript{38} Many commentators consider this idea of sovereignty to

\textsuperscript{30} With a focus on northern Italy, Quentin Skinner, \textit{The Foundations of Modern Political Thought Vol. 1} (CUP 1978) ch 1; further Chris Thornhill, \textit{A Sociology of Constitutions} (CUP 2011) 40ff.

\textsuperscript{31} Martin Loughlin, \textit{The Idea of Public Law} (OUP 2004) 74.

\textsuperscript{32} McClelland (n 3) 131.

\textsuperscript{33} This is perhaps most evident in the case of Henry VIII’s disengagement from the Catholic Church in the 1530s. On the Reformation’s political implications, see Quentin Skinner, \textit{The Foundations of Modern Political Thought Vol. 2} (CUP 1978).

\textsuperscript{34} This loss of authority was explained by the principle “Whose realm, his religion” (cuius regio, eius religio) in the Peace of Augsburg in 1555 as well as the Peace of Westphalia in 1648.

\textsuperscript{35} Loughlin, \textit{Idea} (n 31) 74. See also Skinner, \textit{Foundations Vol. 2} (n 33) ch 4 on the connection of Lutheran thought and absolutism.

\textsuperscript{36} Loughlin (n 31) 73ff.

\textsuperscript{37} See generally ibid ch 5; Loughlin, \textit{Foundations} (n 7) 184ff.

\textsuperscript{38} Bodin, \textit{Six Books of the Commonwealth} bk I ch 8 (first published 1576, MJ Tooley tr, Blackwell 1955) 25. However, he recognized certain ‘fundamental laws’ (eg the \textit{Lex Salica}, natural law and self-constraints), ibid 28ff; Loughlin, \textit{Foundations} (n 7) 67ff.
be a linking element between medieval and modern political thought. Indeed, since it is agnostic as to where such authority was derived from, the concept paved the way for an abstract description of and theorising about political power.

The decentralisation and consolidation of political power in the Early Modern Age also saw the emergence of the ‘state’ as a new form of political entity and object of theoretical discourse. As a type of political entity, it marked a scholarly shift of focus from a universal Christian ecclesia towards the individual polity and by the early seventeenth century had become the major object of political philosophy. This shift led to the re-emergence of comparative inquiry and the development of relative theories of political right. As a concept, the ‘state’ was the result of an abstraction and institutionalisation of sovereign political power. As can be seen, for example, in Thomas Hobbes’ *Leviathan*, the state is conceived as an entity independent both from the people who established it and from the person(s) ruling it.

**Explaining Political Order Anew**

The idea of sovereign states, independent especially from papal authority, could hardly be reconciled with existing Christian theology and feudal doctrines of political philosophy. Hence, new answers were needed as to (1) how political authority was legitimised; (2) what the rationale or function of political order was; and (3) where the principles of political order could be derived from.

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39 Notably Figgis (n 14) 258.  
40 ‘Sovereign’ authority could be conceived as divinely bestowed, as by Bodin (n 38) bk I ch 10 (p 40), or derived from a ‘social contract’ as by Hobbes, *Leviathan* (first published 1651, CB Maepherson ed, 58th edn, Penguin Books 1985) pt II ch 18.  
41 On the concept of ‘state’ see Loughlin, *Foundations* (n 7) 183ff; Oliver Beaud, ‘Conceptions of the State’ in Michael Rosenfeld and András Sajó (eds), *The Oxford Handbook of Comparative Constitutional Law* (OUP 2012) 269, 278ff. See also McClelland (n 3) 280ff on the historical development of the concept. On the peculiarities in the Anglo-American tradition see Beaud 280-81.  
43 See eg Bodin (n 38) bk II. See also the works of the French Legists (see n 73) and Niccolò Machiavelli, *The Prince* (first published 1532, Peter Bondanella tr, OUP 2005) 7ff or Niccolò Machiavelli *Discourses on Livy* (first published 1531, Julia Bondanella and Peter Bondanella trs, OUP 1997).  
44 Hobbes (n 40) pt II ch 17.
From Descending to Ascending Delegation of Power

Within the power struggles between the royalty and papacy, the question of how to legitimise political authority gained new significance. For the king to achieve substantive independence from the papacy, it was necessary to displace the notion that the Church was the medium through which divinely authorised authority was bestowed. While the Divine Right of Kings theorists reconciled theocracy with the idea of a sovereign monarch, the idea that would ultimately prevail in Western political thought and pave the way to a positive conception of political order was that of ‘popular sovereignty’.45

The Divine Right of Kings theory subordinated clerical power to the king, who claimed supreme authority (*pletitudo potestatis*) in both political and spiritual matters.46 While the theory has its origins in Bodin’s idea of the monarch being divinely bestowed with sovereign power,47 it was discussed most extensively in England, where the theory was first explicitly set out by James VI and I (1566–1625).48 Although it was a post-Reformation theory – defending increased royal power against the papacy and the Presbyterians49 – it drew on the medieval notion of an inherently consistent and hierarchical natural order to justify the monarchy as the God-willed form of government.50 The theory sparked fierce debate in England: it was opposed amongst others by John Locke,51 and defended by Edward Forsett and Robert Filmer.52 Yet its influence in this

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45 In this essay, the term ‘popular’ sovereignty will denote legitimisation of political authority ‘from below’ instead of by way of an external authority. For a discussion of the term’s conceptual ambiguities, see Loughlin (n 7) 186.

46 According to Figgis, the claim for consolidated and independent power expressed in the Divine Right of Kings was a transition towards the modern conception of sovereignty, (n 14) 237ff; contra Gless Burgess, ‘The Divine Right of Kings Reconsidered’ (1992) 107 The English Historical Review 838ff.

47 Bodin (n 38) bk I ch 10 (p 40).


49 Burgess (n 46) 837.

50 W Greenleaf, ‘The Divine Right of Kings’ (1964) 14 History Today 642, 646. A similar methodology is already underlying Bodin’s argument for monarchy, see his (n 38) bk V ch 1.


country came to an effective end with the Glorious Revolution of 1688-89, after which supreme authority shifted from the king to Parliament.\(^{53}\) On the continent, however, it would be adopted by divine-right absolutists like Louis XIV (1638–1715).

Instead of conceiving of political authority as being divinely bestowed, theories of popular sovereignty – emerging in the sixteenth and seventeenth centuries – see it as originating from the uniting of a people under a commonwealth and subsequently commissioned by the populace to the ruler. Similar ideas of ascending delegation of authority existed since antiquity\(^ {54}\) and had frequently been invoked in medieval practice, both to bolster a king’s authority (in elective or popular monarchies) or to oppose royal claims to absolutism.\(^ {55}\) The modern idea of popular sovereignty is primarily attributed to the work of social contract theorists – notably Hobbes, Lock and Jean-Jacques Rousseau – which dominated political thought from the Reformation up until the mid-eighteenth century.\(^ {56}\) Contractual language had been used before to describe governmental arrangements, either between political authorities\(^ {57}\) or between a ruler and his subjects.\(^ {58}\) However, such covenants were generally made within an existing political order.\(^ {59}\) In contrast, modern contractual theories depict the very existence of political order as the product of a (hypothetical) contractual arrangement. Hence, despite considerable differences in their political thought,\(^ {60}\) all contract theorists posit a pre-contractual, apolitical ‘state of nature’.\(^ {61}\) The establishment of government, marking the transition to

\(^{53}\) See Burgess (n 46) 842ff on the theory’s development in England.

\(^{54}\) Including in Germanic theories of kingship (see n 8).

\(^{55}\) McClelland (n 3) 134; Greenleaf (n 50) 643 on the invocation of medieval notions of popular sovereignty by the Church to oppose the Divine Right of Kings doctrine in England. Similarly, on the continent, Protestant Monarchomachs like François Hotman and Juan de Mariana invoked popular sovereignty, exercised by the Estates General, to oppose claims to absolute royal power.

\(^{56}\) McClelland (n 3) 172.

\(^{57}\) E.g. royal coronation in exchange for military protection, ibid 172.

\(^{58}\) See n 54; McClelland (n 3) 172.

\(^{59}\) ibid 173. One notable exception is the Jewish narrative of the Israelites contracting with Yahweh to obey His will in exchange for habitable land: ibid 174f. However, here the content of the laws in question was not subject to bargaining: ibid 175.

\(^{60}\) ibid ch 10–13 for an exhaustive comparison of the theories of Hobbes, Locke and Rousseau.

\(^{61}\) Hobbes (n 40) pt I ch 13; Locke, Second Treatise (n 51) ch 2; Jean-Jacques Rousseau, The Social Contract (first published 1762, Maurice Cranston tr, 25th edn, Penguin Books 2004) bk I ch 8. Yet, these theorists differ on how human life in such a state of nature would look. Notably Hobbes depicted life in the state of nature to be ‘solitary, poore, nasty, brutish, and short’, (n 40) pt I ch 13. Later writers were more optimistic, including Jean
the ‘civil state’, is achieved through a multilateral agreement between the people.\textsuperscript{62} As the institutors of political order, any political authority has to stem from the people and is either conferred or commissioned ‘upwards’ to the governmental entity. Therefore, social contract theories break with the assumption that political authority is derived from an external authority (God). It should be noted, however, that such theories are not necessarily secular: religion and divine law (or natural law) still played a role in some versions of the model, but only as a constraint on political power and not as its foundation.\textsuperscript{63}

**An Immanent Rationale for Politics**

As discussed above, both the Reformation and the religious wars called into question the notion that government exists to serve transcendental aims. The tendency of governments in the Early Modern period to regulate subjects’ everyday lives further undermined the perceived connection between government and religion.\textsuperscript{64} At the same time, the consolidation of political power in governments and an increase in their regulatory capacity meant that claims at that time for a centralised (and often absolutist) government were at least partially catalysed by actual existential threats to the political order. For example, Bodin’s *Six Books* were written following the French Wars of Religion, Forset’s *Defence of the Right of Kings* in the aftermath of the ‘Gunpowder Plot’ of 1605, and Hobbes’ *Leviathan* as a reaction to the English Civil War (1642–51).\textsuperscript{65}

Calls for a particular political order were thus framed not as a means of achieving salvation but as a means of offering protection against internal and external threats. While it might be argued that the desire for protection has always accounted for the emergence of governmental structures, social contract theorists were the first to declare the protection of citizens to be not only a government’s duty but the very reason for its establishment. They conceived of political association neither as an inevitable human impulse\textsuperscript{66} nor as divinely

Jacques Rousseau in his *Discourse on Inequality* (first published 1755, Maurice Cranston tr, Penguin 1984).

\textsuperscript{62} See Hobbes (n 40) pt II ch 17; Locke, *Second Treatise* (n 51) ch 8; Rousseau, *Social Contract* (n 61) bk I ch 6. These writers differ however, as to whether the governmental institution created is also a party to this contract and hence subject to its conditions.

\textsuperscript{63} Locke, *Second Treatise* (n 51) ch 11.

\textsuperscript{64} Loughlin, *Foundations* (n 7) 63.

\textsuperscript{65} ibid 64; Greenleaf (n 50) 646; McClelland (n 3) 193. Likewise, texts written during times of relative peace exhibit more sympathy for limited government, eg Locke’s *Second Treatise* (n 51), written after the Glorious Revolution.

\textsuperscript{66} Contra eg Aristotle, see n 5.
prescribed, but as an act of deliberate, self-interested choice in order to secure individual rights, liberty, and property.\textsuperscript{67} In order to recognise such rights antecedent to the state, social contract theorists had recourse to natural law theories, which had become increasingly prominent ever since the rediscovery of Aristotle’s writings. Political order thus became orientated towards serving the individual as a bearer of rights.\textsuperscript{68} This marked a shift from an heteronomous and transcendental rationale for political order towards one which was endogenous and immanent, subservient to individual members and to the furtherance of the general good (\textit{salus populi}).\textsuperscript{69}

\textbf{Inherited and Designed Constitutions}

The emergence of individual polities further raised questions as to how – and by reference to which discourses – to derive principles according to which the polities were governed. After all, acceptance of a general notion of ‘public sovereignty’ neither prescribes a certain political structure nor necessitates that such a structure is open to deliberate design.\textsuperscript{70} Further, social contract theories, starting from a (hypothetical) ‘state of nature’, may be interpreted as merely describing social evolution or be disregarded as a purely theoretical construct.\textsuperscript{71} In the eighteenth and nineteenth centuries, the word ‘constitution’ was revived to refer to the political order of a given polity,\textsuperscript{72} and was used instrumentally, as a means of deriving the ‘proper’ principles of political order.

One such attempt to reveal principles of political order by reference to the concept of a constitution was that of the sixteenth century school of the French ‘Legists’. The Legists proposed that these principles should be drawn not from a

\begin{footnotesize}
\begin{enumerate}
\item White (n 2) 231. See eg Hobbes (n 40) pt II ch 30; Locke, \textit{Second Treatise} (n 51) ch 9; Rousseau, \textit{Social Contract} (n 61) bk I ch 8.
\item Loughlin, \textit{Idea} (n 31) 86; White (n 2) 230f.
\item eg Locke’s use of the phrase ‘\textit{salus populi suprema lex esto}’ as an epigraph for his \textit{Second Treatise}. Immanuel Kant went even further and elevated the good of the state to being an end in itself in \textit{The Metaphysics of Morals} (first published 1797) pt II sec 49 in HB Nisbet (tr) and Hans Reiss (ed), \textit{Kant: Political Writings} (2nd edn, CUP 1991) 142: ‘\textit{Salus republicae suprema lex}’.
\item McClelland (n 3) 146, 172.
\item White (n 2) 228; McClelland (n 3) 180f. Kant, for instance, considered the ‘social contract’ as a hypothetical construct of reason (while accepting its normative propositions): \textit{Theory and Praxis} (first published 1792) in Reiss and Nisbet (n 69) 79.
\end{enumerate}
\end{footnotesize}
close interpretation of Roman Law, but from examining existing legal and political practices. Such an approach gave normative priority to custom and tradition over a priori reasoning about political right and order. It led to the emergence of lex terrae – a systemised ‘law of the land’ (rather than fragmented legal customs) elucidated through historical inquiry – alongside Roman and Canon Law. This historiographic methodology led to the development of the concept of ‘ancient constitution’— a set of traditional laws to which all governmental power was subject. Being derived from human customs and traditions, the idea of an ancient constitution positions political order as something essentially positive and man-made, thereby stripping it of its ‘theological colouring’. However, the governmental arrangements so derived were not open to deliberate design but seen as the immutable product of (potentially immemorial) custom. Due to its inherently conservative attitude, the ancient constitution has often been invoked by writers in opposition to revolutionary developments, including Edmund Burke and Joseph de Maistre. The concept took root in England especially, where similar historiographic methods had already been used to challenge the power of the Crown by invoking the (myth of an) ancient Anglo-Saxon constitution preceding Norman government. It would ultimately be superseded by the concept of parliamentary sovereignty, which retained the primacy of customary common law, but subjected it to Parliament’s power to amend. However, the notion of an ancient constitution survives in contemporary discussions regarding a ‘common law constitution’.

73 See eg François Hotman, in his Anti-Tribonian (first published Jeremie Perier ed 1603, Universite de Saint-Etienne ed 1980).
74 Loughlin, Foundations (n 7) 53.
75 ibid 53.
76 ibid 54.
77 ibid 53.
79 Loughlin, Foundations (n 7) 61f. See also the reasoning of Edward Coke in Dr. Bonham’s Case [1610] 8 Co. Rep. 107, according to whom the common law may ‘controul acts of parliament when they are against common right and reason.’
Others claimed that a polity’s constitution did not need to be derived from custom, but could be deliberately designed by (or on behalf of) the sovereign populace. The (revolutionary) thinking was that popular sovereignty could be exercised in one deliberate act of ‘constitution-making’. In doing so, the sovereign people would both constitute a political order and authorise political power. A constitution thus established would not be a bundle of habits and customs but a very concrete set of rules, often codified in a single constitutional document which derives its binding force not from metaphysical or historical authority but from being the product of a rational act of self-determination. This (capital-C) ‘Constitution’ would gain the status of fundamental law against which the legality of all governmental activity was to be measured.82 This notion – driven by political liberalism – became a tenet of eighteenth century ‘constitutionalism’.83 The claim of a deliberately drafted Constitution to be supreme law, regulating a state’s political order and constraining even legislative authority, was first put into practice in 1789 in the United States’ Constitution.84 It lay at the heart of the European revolutions of the eighteenth and nineteenth century, in the course of which numerous further constitutional documents were drafted. Furthered by their success, constitution-drafting became, for all intents and purposes, a necessity whenever political order was meant to undergo considerable change. It resulted in several ‘waves’ of constitutionalisation over the last centuries, making it the predominant model of political order at least in Europe.

These ideas were closely connected with theories about legitimate resistance against established governments.85 The people’s prerogative to disobey a government acting illegitimately was not a necessary incident of theories such as popular sovereignty or of the social contract. According to Hobbes, for example, sovereign power is permanently alienated from the people and is identical with (absolute) governmental power.86 The social contract is thus

84 Additionally, the normative priority of the Constitution was safeguarded by the power of the United States Supreme Court to engage in constitutional review, claimed in Marbury v Madison, 5 US 137 (1803).
85 Raffaele Laudani, Disobedience in Western Political Thought: A Genealogy (CUP 2013).
86 Hobbes (n 40) pt II ch 17; Loughlin, Foundations (n 7) 189.
irreversible and creates an unchallengeable sovereign.\textsuperscript{87} The notion of legitimate resistance to government, on the other hand, requires a conceptual distinction between government and sovereignty. Locke, for example, understood sovereign power to remain with the people, who merely delegate political authority but reserve the right to reclaim it if a government becomes corrupted\textsuperscript{88}. Similarly, Rousseau makes it clear that sovereignty is ‘inalienable’ and remains at all times with the people.\textsuperscript{89} This distinction was later elaborated by Emmanuel Joseph Sieyès, who distinguished between constituent power (\textit{pouvoir constituent}) residing with the people and constituted power (\textit{pouvoir constitu	extit{e}}) exercised by government.\textsuperscript{90}

**Positive Law and the Activation of Legal Discourse**

The changes which led to a re-conceptualisation of political order also impacted on the conception of law. This resulted in law’s positivisation and in what can be called an ‘activation’ of law and legal discourse.

**Positivisation of Law**

The decline of religion as a source of political authority meant that ‘divine law’ ceased, without more, to be automatically binding. Kings were now able to promulgate rules that were the products of political will as opposed to simply emulations of divine law or a codification of existing customary rules. This separation of political will from divine revelation could already be seen in the writings of Marsilius of Padua, who distinguished ‘law’ (man-made commands) from ‘justice’ (according to divine law).\textsuperscript{91} By the Late Middle Ages, promulgated law had generally become recognised as a source of law distinct from theological rules.\textsuperscript{92} The social contract theorists, for example, advocated a positive

\textsuperscript{87} Hobbes (n 40) pt II ch 18. Though he acknowledges an individual and inalienable right to self-defence, ibid ch 21 (pp 268ff). See also Susanne Sreedhar, \textit{Hobbes on Resistance: Defying the Leviathan} (CUP 2010) ch 1.
\textsuperscript{88} Locke, \textit{Second Treatise} (n 51) ch 11, 19.
\textsuperscript{89} Rousseau, \textit{Social Contract} (n 61) bk I ch 6; bk II ch 1.
\textsuperscript{90} Emmanuel Joseph Sieyes, \textit{What is the Third Estate?} (first published 1789, Samuel Finer tr, Pall Mall 1963) ch 5. See also Loughlin, \textit{Idea} (n 31) ch 6.
\textsuperscript{91} McClelland (n 3) 141.
\textsuperscript{92} See eg Bodin (n 38) bk I ch 8 pointing out that ‘laws of a sovereign prince, even when founded on truth and right reason, proceed simply from his own free will.’
conception of law, promulgated either by the populace\textsuperscript{93} or the government.\textsuperscript{94} While ideas of divine law survived in the form of natural law theories,\textsuperscript{95} such laws were no longer considered to impede the validity of temporal laws. The case for the normative priority of promulgated law was especially strong once these laws were seen as expressions of popular sovereignty; a sentiment captured in Rousseau’s assertion that ‘the general will is always rightful and always tends to the public good.’\textsuperscript{96}

With positivisation, law became employable as an instrument of government.\textsuperscript{97} The ability to proclaim law that was independent from both external authority and material constraints marked an important step towards the autonomisation of the political. Michael Oakeshott therefore considers both the supremacy of positive law and its employment as an element of government to be essential characteristics of the modern European state.\textsuperscript{98} Simultaneously, since the legitimacy of positive law was no longer assessed by reference to its conformity with an external standard provided by divine or natural law, but by its quality as an expression of political will,\textsuperscript{99} rules of competence and procedure gained crucial importance.\textsuperscript{100}

**Activation of Legal Discourse**

As discussed above, legal terminology had played a role in political discourse since the High Middle Ages. Hence, political changes were closely linked with developments in legal scholarship, which was deployed to provide theoretical justification for conflicting claims to power. Jurisprudence went from being a passive and descriptive discipline to one which was employed instrumentally to

\textsuperscript{93} Rousseau, *Social Contract* (n 61) bk II ch 12 referring to ‘civil’ and ‘criminal laws’.
\textsuperscript{94} Hobbes, *Leviathan* (n 40) ch XVIII and Locke, *Second Treatise* (n 51) ch 11.
\textsuperscript{95} Rainer Grote, ‘Rule of Law, Rechtsstaat and “Etat de droit”’ in C Starck (ed), *Constitutionalism, Universalism and Democracy: A Comparative Analysis* (Nomos 1999) 272; McClelland (n 3) 177. See also Bodin (n 38) bk I ch 8 defining ‘sovereignty as a power to override positive law … [but not to] set aside divine and natural law’; Locke, *Second Treatise* (n 51) ch 11.
\textsuperscript{96} Rousseau, *Social Contract* (n 61) bk II ch 3.
\textsuperscript{99} White (n 2) 229.
\textsuperscript{100} McClelland (n 3) 176f. See eg the emphasis put on process by Locke, *Second Treatise* (n 51) ch 12.
buttress assertions of political authority. In doing so, legal scholarship would initially still draw on customary and inherited sources and not tamper with the overall premise of divine authorisation. For instance, during conflicts in the fourteenth century between the Empire and Northern Italian cities, the *Codex Iuris Civilis* was relied on by the Emperor’s jurists to justify imperial supremacy over the papacy. At the same time, ‘post-Glossators’ challenged the literal interpretation and intellectual authority of the *Codex Iuris Civilis* and clerical scholars invoked customary authorities to oppose royal claims to absolute power.

As the importance of religion and customary law faded and the authority of positive law became acknowledged, political and legal scholarship adopted a truly prescriptive role, making claims for political order based on a priori reasoning. Accordingly, discussions now turned towards questions of governmental structure, revolving around (*inter alia*) the merits and detriments of elective and hereditary monarchy, limited and unlimited government and democratisation.

### III. MODERN CONSTRUCTIVISM AND ITS CRITIQUE

As can be seen, the evolution of political theory from the medieval period through to modernity comprised a gradual process of secularisation, positivisation, abstraction, and legalisation. Initially, the decline of religious authority led to political order becoming perceived as a temporal as opposed to transcendental matter, detached from theological prescriptions and conceptualised in the institution of a sovereign state. Secularised rationalism and ideas of popular sovereignty – both of which were encapsulated in the concept of a social contract – led to a complete secularisation of political thought. Hence, by the eighteenth century religion was no longer a structuring force for political order. This allowed for a positive conception of the political. Due to the normative priority ascribed to rules which were deliberately drafted as opposed to gleaned from custom and tradition, formal ‘constitutional law’ (at least on the continent) was regarded as the essential constructive element of political order and a means to ‘elevate the [political] consensus … above the

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101 Loughlin, *Idea* (n 31) 75.
102 Loughlin, *Foundations* (n 7) 52.
103 Greenleaf (n 50) 643.
104 ibid 188.
fleetingness of the moment’. This concurred with a general trend towards positivism in European philosophy, which gave normative priority to rational deliberation over tradition and to deductive over inductive reasoning. This normative priority also found expression in an increased trust in positive law as a constructive force for society. Not only were ideas of political order expressed in terms of formal constitutional law: under a constructivist influence and equipped with enhanced rulemaking capacities, modern European states engaged in projects of comprehensive legal codification aimed at governing ever more aspects of their citizens’ lives.

Four Tenets of Legalised Political Constructivism

The trajectory of Western conceptions of political order has culminated in a contemporary political philosophy which exhibits four main characteristics. Firstly, it is understood that political associations are founded on a rational choice to protect and enhance individual and collective welfare. Secondly, political authority is derived from the people (that is, through constituent power) and delegated from them to an instituted government. Thirdly, the emanations of government – its bureaucracy and institutions – are understood to be the product of deliberate design by or on behalf of the people. Lastly, positive (constitutional) law is employed as the primary means to create the political order and to regulate social affairs. Combined, these traits form an understanding of political power which I term Legalised Political Constructivism.

Criticism of Legalised Political Constructivism


107 A trend which Friedrich Hayek labelled ‘Cartesian Constructivism’, see ‘Rules and Order’, vol I of his Law, Legislation and Liberty (Routledge 2013) ch 1 (pp 10f).

108 See e.g. (anecdotally) the stipulations in pt II ss 2, §§ 67, 68 of the 1794 General State Laws for the Prussian States regulating a mother’s obligation to breastfeed, reprinted in Hermann Rehbein and Otto Reincke (eds), Allgemeines Landrecht für die Preussischen Staaten (5th edn, Berlin 1894).
While Legalised Political Constructivism is today widely endorsed, its four tenets do not reflect one coherent theory. For one thing, they are a mix of both normative and descriptive features. This is unsurprising, given that the tenets are the result of multiple philosophical and jurisprudential ‘projects’ which may or may not tessellate. For another, since most of these projects were aimed at providing theories on how political order and authority can be legitimised, they cannot be expected to have exhaustive explanatory value. Disciplines such as sociology, political science and social psychology, whose focus is the empirical study of human behaviour, are more suited to explain political developments.

Consequently, the tenets of Legalised Political Constructivism have been criticised on the ground that they fail to adequately explain actual political behaviour. In particular, the notion that political association is an act of reason, an idea which each of the tenets presupposes, was challenged by David Hume in the eighteenth century. Hume, an empiricist, dismissed the ideas of divine creation and a social contract, doubting the latter’s explanatory value due to a lack of empirical substantiation. Since apolitical ‘states of nature’, from which people consciously proceed to establish polities, have existed (if at all) since prehistoric times, Hume considers the concept irrelevant for the study of modern societies. Similarly, Immanuel Kant conceived of the social contract as a mere hypothetical construct of reason. As opposed to the contractualists, Hume considered self-interest to be a mere ‘secondary … principle of government’, holding that political power could never rest entirely on consent. In fact, modern social sciences have shown that human beings are naturally sociable beings who band together not in a deliberate act of pure reason but more or less impulsively. Hume’s scepticism about human rationality also leads him to question the assumption that the structure and institutions of government are completely open to deliberate design. He adopts instead the view that government structures evolve more or less naturally, in an

109 This is the critique that I will focus on. On challenges to the concept of sovereignty and esp Carl Schmitt’s reworking of the concept see eg Lars Vinx, in David Dyzenhaus and Thomas Poole (eds), Law, Liberty and State: Oakeshott, Hayek and Schmitt on the Rule of Law (CUP 2015) ch 5.
111 Kant, Theory and Praxis (n 71) pt II (p 79).
112 David Hume, ‘Of the First Principles of Government’ (n 110) 34.
113 David Hume, ‘Of the Original Contract’ (n 110) 474.
iterative process, over time, which leads him to once again assign normative value to evolved structures of government.115

The most comprehensive critique of modern positivism, however, was formulated by Friedrich Hayek, based on the behavioural insight that human rationality is limited and that people rely instead on cultural rules of conduct.116 In accordance with his general distinction between spontaneous (cosmos) and made order (taxis),117 he develops a conception of law and political order in which human behaviour is not predominantly guided by positive norms (‘legislation’, thesis) but instead by evolved cultural rules (‘law’, nomos).118 As such, the potential for positive constitution-making is limited, since structural constraints on governmental power are ineffective unless they are backed by cultural rules.119 At best, formal constitutional laws describe a ‘superstructure’ erected over an already existing legal system.120 Like Hume, Hayek’s critique gives primacy to evolved over positive rules.121 While the latter may interact with evolved rules,122 culturally evolved norms ultimately determine the contours of political order.123

CONCLUSION: CONSTRUCTIVISM CHALLENGED?

Starting from a medieval conception of divine prescription, the perception of political order has undergone a process of secularisation, positivisation, abstraction, and legalisation. In modernity, political order is conceived as a positive and legalised concept, detached from metaphysical influence and embodied in the institution of the state.

115 ‘Let us cherish and improve our ancient government as much as possible, without encouraging a passion for such dangerous novelties.’ Hume, ‘Of the First Principles of Government’ (n 112) 36.
116 See Hayek, ‘Rules and Order’ (n 107) ch 1 (pp 10f).
117 ibid ch 2 (pp 34ff).
118 ibid ch 1 (pp 12, 18ff). Hence his general criticism of legal positivism: ‘Law is older than legislation’, ibid ch 4 (p 69).
120 Hayek, ‘Rules and Order’ (n 107) ch 6 (pp 127ff).
122 Hayek (n 121) ch 17 (pp 441ff).
123 Boykin (n 119) 19.
This abstraction, however, has led to a partial alienation of the political from the social. Since many of the assumptions underlying modern political thought were originally aimed at providing normative foundations for actual political events, they suffer from a moralistic fallacy: they purport to be descriptive when they are in fact normative. As such, they cannot adequately explain actual political behaviour. The critique offered by Hume and Hayek suggests that cultural rules have a profound impact on political behaviour and order. By way of example, the relevance of cultural codes of behaviour might go some way towards explaining the problems faced by projects which aim to promote the ‘rule of law’ by emulating Western institutional structures.\textsuperscript{124} The current authoritarian ‘backlash’ witnessed in some Central and Eastern European Countries\textsuperscript{125} further shows the limits of formal (constitutional) law for structuring political and social processes. While these insights are not overly surprising, they may – as it is most clearly expressed by Hayek – impact on existing assumptions about the relationship between positive law and political order. This is also true if one does not in reverse fall for a naturalistic fallacy by elevating actual political behaviour to a normative standard.

Such tensions between established normative assumptions and modern empirical insights, however, are not unique to political philosophy. Similar challenges are faced by normative economics, which is to a great extent equally based on rationalist assumptions.\textsuperscript{126} At times, scholars’ attempts to construct governmental systems without paying due attention to existing social structures risks overlooking what Karl Polanyi describes, in an economic context, as ‘embeddedness’. This is the notion that conventional economic activity is secondary to, and embedded within the confines of, existing social behaviour.\textsuperscript{127} In the same way, in the political sphere, normative conceptions of political order may be subsumed by social codes of behaviour. When attempting to determine the role that positive law can (and should) play as a constructive element in politics and society, we might therefore be encouraged to look ‘over the rim of the tea cup’ and engage in an exchange with other disciplines.

\textsuperscript{127} Karl Polanyi, \textit{The Great Transformation} (Gower Beacon Press 1957).
7 King’s Bench Walk (7KBW) has a pre-eminent reputation for excellence and intellectual rigour in all areas of commercial law. The members of 7KBW are at the cutting edge of developments in commercial law. They pride themselves on adapting matters of intellect to practical and commercial priorities, yielding a modern approach to advocacy and advice.

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Liability for Complicity: State Responsibility for Torture

Case Note - Belhaj v Straw, Rahmatullah v Ministry of Defence

Jing Tao (Nathan) Qin*

INTRODUCTION

This case note considers the recent joint judgment in Belhaj & Anor v Straw & Ors and Rahmatullah (No 1) v Ministry of Defence, delivered by the Supreme Court in its opening session of 2017. Both cases concern the liability of British authorities and officials for their complicity in torture, unlawful rendition, false imprisonment, and other rights-violating torts committed by foreign authorities in overseas jurisdictions. In a comprehensive judgment, the court held that neither the rules of State immunity, nor the foreign act of State doctrine, would prevent a civil claim from being brought against the United Kingdom (UK) for its responsibility in rights-violating torts committed by foreign States. Belhaj and Rahmatullah establishes a significant precedent, defining boundaries to the applicability of State immunity, and affirming the primacy of fundamental rights over the rules of foreign act of State.

Analysis of the judgment and its impacts will be split across the two doctrines. The court’s rejection of State immunity claims, based on a narrow construction of ‘indirect impleading’ circumstances, will be considered in light of the principle of sovereign equality. As for foreign act of State, the structural divergences between Lord Mance, Lord Neuberger, and Lord Sumption’s interpretations will be highlighted, alongside an explanation of why Lord Mance’s ought to be favoured as a matter of conceptual clarity.

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I would like to express my gratitude to Professor David Kershaw, Professor Andrew Lang, Eunice Lee, and Gabriele Watts for providing wonderfully thorough feedback throughout various drafts of this case note. All errors remain my own.
1 [2017] UKSC 3.
2 The sovereign equality of States is a foundational principle of the international community, as enshrined in Article 2(1) of the Charter of the United Nations, 24 October 1945, 1 UNTS XVI.
I. CONTEXT

State Immunity

The immunity of States from foreign municipal courts is a well-established rule of customary international law. As most recently reaffirmed by the International Court of Justice in the Jurisdictional Immunities case, State immunity is ‘one of the fundamental principles of the international legal order’,\(^3\) based upon the principle of sovereign equality of all States. The rule has been recognised as part of the common law since the late 19th century,\(^4\) and has been placed on statutory footing within the UK since 1978.\(^5\)

Foreign Act of State

The doctrine of foreign act of State encompasses a range of situations, where English courts will not adjudicate upon the lawfulness or validity of an action taken by another State. The precise scope and rationale of the doctrine is unclear, thus the significance of Belhaj and Rahmatullah in part lays with the Supreme Court’s clarification of what is meant by an invocation of foreign act of State. Although it shares a similar function with State immunity, foreign act of State is a separate doctrine – a purely domestic creation with roots in the common law that can be traced back to the 17th century.\(^6\) Whereas State immunity precludes an action from being brought against foreign States in domestic courts, the rules of foreign act of State are engaged whenever an enquiry into the validity of a foreign State’s actions constitutes a necessary element of the adjudication.

II. THE CASE

\(^3\) Jurisdictional Immunities of the State (Germany v Italy: Greece Intervening) (Judgement) [2012] ICJ Rep 99 [57].
\(^4\) The Parlement Belge [1880] 5 PD 197.
\(^6\) Blad v Bamfield [1674] 36 ER 992.
Facts of Belhaj

In early 2004, Mr Belhaj, a Libyan citizen and political opponent of Libyan dictator Colonel Gaddafi, was detained in Malaysia alongside his wife, Mrs Boudchar. UK intelligence services became aware of the situation and shared this information with Libyan authorities, as part of an alleged strategy to secure diplomatic and intelligence advantages with Colonel Gaddafi. Mr Belhaj and Mrs Boudchar were then delivered to US agents in Thailand, who flew them to Libya, where Mr Belhaj was imprisoned for six years, whilst his wife was held in prison for three months.

During this period, it is alleged that they were subject to torture and other serious mistreatment at the hands of US officials throughout the illegal rendition and by Libyan officials during their false imprisonment in Libya. It is not alleged that UK officials were directly involved in the torture, rendition, or other serious mistreatment; rather, the action is being brought for the UK officials’ complicity (secondary responsibility) in designing, arranging, assisting, and encouraging the alleged torts committed by US and Libyan officials (the prime actors).

Facts of Rahmatullah

Mr Rahmatullah, a Pakistani citizen, was detained by British armed forces in February 2004 during the UK and US occupation of Iraq. Initially detained on suspicions of being a member of a terrorist group with links to Al-Qaeda, Mr Rahmatullah was later passed onto the custody of US forces under a memorandum of understanding (MoU). Mr Rahmatullah was transferred to the infamous Bagram Airbase in Afghanistan, where he was subsequently kept in US detention for over ten years without trial or charge.

Mr Rahmatullah alleges that he was subject to serious mistreatment amounting to torture during his unlawful detention by US and UK forces. The
direct liability of UK officials and the availability of the Crown act of State
defence are dealt with by the Supreme Court in a concurrent judgment. The
case discussed herein concerns the UK’s complicity to the alleged torts
committed by US personnel whilst he was in US custody.

Legal Issue

Both cases are actions brought directly against the UK for its complicity in the
tortious actions of the prime actor States. There is no claim pursued against the
prime actor States themselves.

The appellants, various UK officials and authorities in Belhaj and the
Ministry of Defence in Rahmatullah, assert that both cases are inadmissible or
non-justiciable by reason of State immunity and/or the rules of foreign act of
State. The claim is that their secondary responsibility cannot be established
without determining the validity or legality of the alleged torts by the prime
actor States. Such an investigation is precluded by the fact that the prime actor
States themselves would have had State immunity from the proceedings, and in
any case an assessment of their actions is barred by the doctrine of foreign act
of State.

III. THE JUDGMENT

A seven-strong panel of the Supreme Court unanimously rejected the appellants’
claims, holding that neither State immunity nor the doctrine of foreign act of
State would be a procedural bar to the claims made in Belhaj and Rahmatullah.

State Immunity

On the claim of State immunity, Lord Mance and Lord Sumption analysed the
matter in depth, with the rest of the court concurring with the conclusions.
Their Lordships were in agreement that the appellants’ claim of State immunity

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15 Rahmatullah (No 2) v Ministry of Defence & Ors [2017] UKSC 1.
16 Belhaj and Rahmatullah (n 1) [6].
17 ibid [7].
was an argument of ‘indirect impleading’.\textsuperscript{18} Indirect impleading refers to a situation when a foreign State would be affected by the outcome of the case despite not being a named party.\textsuperscript{19} Where it can be established that a foreign State would be indirectly impleaded, that foreign State’s immunity bars progression of the case onto the merits stage.

Lord Mance viewed that State immunity would only be applicable in situations of indirect impleading if the outcome creates second-order legal consequences upon the foreign State’s property rights.\textsuperscript{20} The appellants’ argument that indirect impleading should be given a broader understanding, in order to be inclusive of circumstances where the action would affect the ‘interests’ of the foreign State, was firmly rejected.\textsuperscript{21}

Lord Sumption, on the other hand, was receptive to a wider reading of indirect impleading, as encompassing situations where legal interests beyond property were affected.\textsuperscript{22} However, the operative factor is that a legal interest needs to be impacted upon. Since no potential outcome in the present cases would alter any rights or liabilities of foreign States, the situation did not amount to indirect impleading and State immunity would not be applicable as a procedural bar.\textsuperscript{23}

**Foreign Act of State**

A large portion of the judgments delivered by Lord Mance, Lord Neuberger, and Lord Sumption focused on ‘foreign act of State’, in recognition that the scope and the principles underlying the doctrine have become rather vague and obscure.\textsuperscript{24} All three judges concur that ‘foreign act of State’ would not apply in the present cases. However, the reasoning and the understanding exhibited by Lord Mance and Lord Neuberger (with whom Lady Hale, Lord Wilson, and Lord Clarke agree) contrasts with that of Lord Sumption (with whom Lord Hughes agrees).

\textsuperscript{18} ibid [15] (Lord Mance SCJ), [186] (Lord Sumption SCJ).
\textsuperscript{20} \textit{Belhaj} and \textit{Rahmatullah} (n 1) [31].
\textsuperscript{21} ibid [29].
\textsuperscript{22} ibid [196].
\textsuperscript{23} ibid [197].
\textsuperscript{24} ibid [119].
Lord Mance identifies three types of claims made under the foreign act of State doctrine in English law:

1) The first type is an established rule of private international law, according to which English courts will recognise and accept as valid foreign State legislation relating to property within that foreign State’s jurisdiction.25

2) The second type is likewise a rule of private international law, that English courts will not question the validity of foreign governmental action in respect of property within that foreign government’s territory.26

3) The third type applies to situations where, due to the subject matter, domestic courts will treat the case as non-justiciable and abstain from adjudication.27

Within this framework, Lord Mance rejected the appellant’s argument that the second type of foreign act of State, properly understood, expands to foreign government action against persons.28 Lord Mance was also of the opinion that the third type of ‘foreign act of State’ was not applicable to the present cases.29

The third type is an act of judicial abstention – it is an exception to the ordinary course of judicial proceedings; thus, an invocation of ‘foreign act of State’ requires a high level of justification.30 Since the alleged torts amount to violations of fundamental rights recognised in English law, an invocation of foreign act of State could not be justified in the present cases.31

Lord Neuberger’s judgment broadly agrees with the tripartite outline of the doctrine presented by Lord Mance,32 albeit with a different understanding of the operative reasoning behind the third principle.33

Contrary to the approach taken by Lord Mance and Lord Neuberger, Lord Sumption presents a more expansive view of foreign act of State. For Lord Sumption, there are two main principles underlying the doctrine:

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25 ibid [35].
26 ibid [38].
27 ibid [38].
28 ibid [83].
29 ibid [101] – [102].
30 ibid [91].
31 ibid [99].
32 ibid [121] – [123].
33 ibid [147].
1) The principle of municipal law act of State: English courts will not question the validity of foreign legislative and governmental action within that foreign State’s territory.34

2) The principle of international law act of State: English courts will not adjudicate upon the lawfulness of extraterritorial acts by foreign States.35

Where the subject matter cannot be resolved without determining the validity of a foreign State action, the doctrine is engaged as a matter of default.36 However, both principles are subject to a public policy exception.37 Since the alleged torts in Belbaj and Rahmatullah amount to a transgression of fundamental domestic rights and jus cogens norms of international law, the public policy exception is engaged, suspending the application of foreign act of State.38

IV. ANALYSIS

Limits to the Applicability of State Immunity

Belbaj and Rahmatullah represents a significant precedent in establishing the liability of the UK for its complicity vis-à-vis the actions of foreign States. Rather than eroding the principle of State immunity, the court limited the circumstances of its relevancy. By rejecting an expansive view of what amounts to a situation of indirect impleading, the court ensured State immunity could not be utilised as an oblique defence to prevent actions against the UK for its secondary responsibility. It is exclusively when the property rights (Lord Mance)39 or legal interests (Lord Sumption)40 of a non-named party State are affected, would that State be considered to be indirectly impleaded and State immunity would prevent the case from proceeding to merits. The government cannot rely on State immunity as a carte blanche to preclude its accessory liability for torture, rendition, arbitrary detention, and other rights-violating torts committed by foreign States.

34 ibid [228].
35 ibid [234].
36 ibid.
37 ibid [248].
38 ibid [268], [272], [278], [280].
39 ibid [29].
40 ibid [196].
Basis of State Immunity

The court aptly rejected the appellants’ argument that indirect impleading should incorporate a broader concept of interests, as such an argument misconstrues the basis of State immunity. The core principle underlying the doctrine of State immunity is the sovereign equality between all States, as enshrined in Article 2(1) of the UN Charter. The corollary to the sovereign equality of States is that no State is in a position of superiority over another. For one State to be subjected to obligations and liabilities in the court of another State, means to present the latter in a position of authority over the former, ergo the principle of State immunity from the jurisdiction of foreign municipal courts.41

As Lord Mance recognises, adjudication upon the merits of the present cases may cause ‘reputational or like disadvantages’42 upon the prime actor States; however, this does not mean that foreign States are being subjected to the jurisdiction of an English municipal court. Jurisdiction is the power to create binding legal decisions; causing reputational or like disadvantages is a far cry from the imposition of obligations or liabilities over a foreign State. Taken to its logical conclusion, the appellants’ claim is effectively that jurisdiction of domestic courts is precluded whenever the mere trial, not even the outcome, would cause embarrassment to another State. This argument incorrectly equates respecting the interests of foreign States with respecting the sovereign equality of foreign States. If the infringement upon the interests of a foreign State represented a failure to respect sovereign equality, every State would be in transgression of the UN Charter. Border taxes on imports, regional co-operation agreements, strategic positioning of military bases – these actions are all examples of standard State behaviour that involve a certain degree of violating another State’s interest. The inherent chess-like nature of international diplomacy invariably entails States treading upon each other’s interests, however this does not mean the sovereign equality of States has been in any way compromised.

Clarification of the Doctrine of Foreign Act of State

41 In so far as the State is acting in a sovereign capacity (acta jure imperii), State immunity does not extend to acts of a private nature (acta jure gestionis).
42 Belhaj and Rabmatullah (n 1) [29].
Liability for Complicity

Belhaj and Rahmatullah represents an important attempt by English courts to coalesce the range of disjointed authorities that invoke the notion of foreign act of State.\(^{43}\) Although there is substantial common ground between them, Lord Mance, Lord Neuberger, and Lord Sumption present subtly different understandings of the doctrine.

Lord Mance and Lord Neuberger on Foreign Act of State

Lord Neuberger’s framework resembles Lord Mance’s tripartite outline.\(^{44}\) However, Lord Neuberger differs on the rationale for judicial abstention in the aforementioned third type of foreign act of State. Both agree that its application to legal proceedings is the exception rather than the norm. The mere fact that proceedings may involve assessment of foreign State actions does not result in the doctrine being engaged as a matter of default. Rather, it is an extraordinary act of ‘judicial abstention’\(^{45}\) for Lord Mance, or an exercise of ‘judicial self-restraint’\(^{46}\) for Lord Neuberger. Thus the operative question for their Lordships was what circumstances justified the doctrine’s application.

For Lord Mance, English courts will abstain from adjudication if the matter is better addressed at the international level.\(^{47}\) The present cases concern, \textit{inter alia}, the alleged infliction of torture and arbitrary detention, which constitute violations of fundamental rights recognised in English law.\(^{48}\) These are matters manageable within domestic law and thus, there is no reason why English courts ought not to preside over the present cases. In fact, for the courts to shy away from adjudicating, would represent a failure by the judiciary to perform its constitutional role as the guarantor of rights.

On the contrary, for Lord Neuberger, the basis of judicial self-restraint is where the subject matter involves the presence of a ‘comparatively formal, relatively high level agreement or treaty’ between States.\(^{49}\) This criterion was not met in Belhaj, where, at best, there was an informal agreement of cooperation.

\(^{43}\) \textit{ibid} [119].
\(^{44}\) \textit{ibid} [121]-[123].
\(^{45}\) \textit{ibid} [89].
\(^{46}\) \textit{ibid} [151].
\(^{47}\) \textit{ibid} [95]. Examples of such subject matter include the legality of a declaration of war and the recognition of a claim to statehood.
\(^{48}\) The right against arbitrary detention dates back to the Magna Carta 1225, whilst the common law right against torture has been most recently affirmed in \textit{A v Secretary of State for the Home Department (No 2)} [2005] UKHL 71.
\(^{49}\) Belhaj and Rahmatullah (n 1) [147].
between UK and Libyan intelligence services. The same applies to *Rahmatullah*, where the MoU between UK and US forces did not provide for unlawful detention or torture. Both cases fell beyond the remit of circumstances that justify invoking the third type of foreign act of State. Lord Neuberger’s reasoning appears to be grounded in a separation of powers point, requiring judicial deference whenever the case’s subject matter intersects with foreign affairs of a certain import or significance.

Between their differing understandings, Lord Mance’s conception seems to better capture the essence of the third type of foreign act of State. It is a more accurate reflection of the reasoning invoked in past authorities, such as *Buttes Gas* and *Noor Khan*, where the doctrine has been applied. In *Buttes Gas*, adjudication upon merits would have positioned the court to establish the disputed maritime boundaries between four sovereign States. In *Noor Khan*, resolution of the case would have required the court to determine if there was a situation of armed conflict in Pakistan and/or Afghanistan. The exercise of judicial restraint, where the subject matter is better addressed at the international level, seems to be a truer reading of *Buttes Gas* and *Noor Khan* than Lord Neuberger’s understanding. There is nothing within the facts of either case which suggests that his ‘agreement or treaty’ criterion would have been met. Furthermore, the threshold of a ‘comparatively formal, relatively high level agreement or treaty’ itself is problematic, as it remains ambiguous what exactly would satisfy such a standard. This difficulty was evinced within Lord Neuberger’s own doubts as to whether the MoU between the US and the UK forces in *Rahmatullah* constituted a sufficiently high level agreement. When contrasted to the simpler query proposed by Lord Mance – whether the matter is better resolved at the international legal level, Lord Mance’s understanding seems favourable as a matter of practical application.

*Lord Sumption on Foreign Act of State*

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50 ibid [167].
51 ibid [171].
52 *Buttes Gas and Oil Co v Hammer (No 3)* [1982] AC 188 (HL).
53 *R (Noor Khan) v Secretary of State for Foreign and Commonwealth Affairs* [2014] 1 WLR 872 (CA).
54 *Buttes Gas* (n 52) 938.
55 *Noor Khan* (n 53) [34]-[35].
56 *Belhaj and Rahmatullah* (n 1) [171].
Although Lord Sumption’s first principle roughly corresponds with the first and second types of foreign act of State under Lord Mance’s conception, Lord Sumption’s notion of municipal act of State is far more expansive in scope. It covers all legislative and executive action (rather than just actions that pertain to property) within that foreign State’s territory, as a logical derivation from the territorial principle of sovereignty. Lord Sumption’s second principle, international law act of State, correlates with the third type of foreign act of State as identified by Lord Mance. The two seem to be grounded in similar roots – matters concerning the international plane are better dealt with at the international level. However, the application of Lord Sumption’s doctrine is an inversion of Lord Mance’s judicial abstention: where it is relevant, foreign act of State is engaged as a matter of default, requiring a public policy justification for the doctrine’s inapplicability.

Lord Sumption presents an understanding of the foreign act of State doctrine that is structurally different to Lord Mance’s. It captures a wider range of actions within its two principles, and the doctrine is automatically applied once it is established that the merits of the case would involve an assessment of a foreign act of State. Although initially wider, the scope of foreign act of State is cut back by giving a larger role to the public policy exception, which precludes the doctrine’s application. Thus, despite their divergence in structure, it is unlikely that Lord Mance and Lord Sumption would reach different conclusions in any given case.

The essential difference between Lord Sumption and Lord Mance is the scope given to the public policy exception. Lord Sumption’s view of this exception is wider, as it incorporates the international law notion of *jus cogens* norms, whereas Lord Mance strictly focuses on rights recognised as a matter of domestic law. Lord Sumption’s intuitive pull towards international legal norms, where the case concerns an international context, ought to be resisted. It loses sight of the fact that foreign act of State is essentially a domestic doctrine, whose bounds are defined by the common law. To intertwine foreign act of State with the notion of *jus cogens* is an open invitation for confusion. As recognised by Lord Mance, there is little agreement and much uncertainty in regard to what amounts to a *jus cogens* norm. Aside from a small irreducible

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57 ibid [229].
58 ibid [234].
59 ibid [250].
60 ibid [107].
61 ibid [257].
62 ibid [99].
63 ibid [107].
core, there is no consensus as to what norms of international law have obtained this peremptory status. This problem was demonstrated within Lord Sumption’s judgment, as he attempted to establish the dubious existence of a *jus cogens* prohibition against rendition and enforced disappearances. There is a risk involved when the concept of *jus cogens* is enveloped within foreign act of State; it introduces an uncertain and unnecessarily complex layer of assessment into the doctrine. The public policy exception should be delinked from *jus cogens* norms and purely assessed on the basis of domestic rights considerations. In this regard, Lord Mance’s outline of foreign act of State ought to be preferred for its conceptual clarity.

**CONCLUSION**

The judgement in *Belhaj* and *Rahmatullah* represents an affirmation by the judiciary of their constitutional role as the supreme protector of rights within the UK. Through a restrictive construction of what amounts to indirect impleading, circumstances where the UK government may invoke the State immunity of foreign States as an oblique defence has been strictly limited. Likewise, the application of foreign act of State has been caved by a public policy exception when fundamental rights are at stake. Carrying this significant precedent onwards into the future, Lord Mance’s understanding should be preferred due to its conceptual clarity and ease of application.

Although 13 years have elapsed since the initial facts, Mr Belhaj, Mrs Boudchar, and Mr Rahmatullah’s ordeals are far from unique. As a 2009 Parliamentary Report into the matter suggests, instances where the UK has been alleged to design, arrange, assist, and encourage rights-violating torts by foreign States are far more common than one might hope to expect. Where previously all means of compensation were shut, the Supreme Court has now opened the door to legal redress for those victims. Post *Belhaj* and *Rahmatullah*, UK authorities and officials who are complicit in torture and other rights-violating torts will be held legally liable; their impunity has been superseded by accountability.

64 Examples of uncontroversial *jus cogens* include the right to self-determination, the prohibition of genocide, torture, slavery, and unlawful use of force.
66 *Belhaj* and *Rahmatullah* (n 1) [273]-[278].
Dear Editor,

The principle of complementarity, which governs the admissibility of cases to the International Criminal Court (ICC), has recently been getting a lot of attention. The discussion may have been sparked by the capture of Saif Gaddafi by Libyan militias in 2011.\(^1\) Detained without access to legal advice and eventually convicted in absentia,\(^2\) his trial prompted questions as to whether national judicial proceedings which blatantly violate human rights standards should be able to preclude the jurisdiction of the ICC.

The complementarity debate has largely been concerned with the proper interpretation of Article 17(1)(b) of the Rome Statute.\(^3\) This Article provides that a matter is inadmissible before the ICC if a state has investigated the person

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concerned but decided not to prosecute, unless that decision ‘resulted from the unwillingness or inability of the State genuinely to prosecute.’ In this letter I would like to approach the topic from a different angle. Instead of concentrating on the text of Article 17, I argue that - adopting the positon of Kevin Jon Heller\(^4\) - an amendment should be made to the Rome Statute to provide that states wishing to retain control over cases which concern international criminal law, must show that their trials adhere to the international standards of due process.\(^5\) As long as states are able to oust ICC jurisdiction with trials which are, for example, predetermined or procedurally unfair, the crisis of legitimacy which currently besets the ICC will persist.

It is true that some scholars argue that Article 17 already contains a minimum standard of trial.\(^6\) The thought is that the collocation in Article 17(2) that a state’s unwillingness to prosecute must be evaluated ‘having regard to the principles of due process recognised by international law’, means that investigations must meet certain standards if they are to preclude ICC admissibility. However, this view is not widely held.\(^7\) The consensus rather is that, as the former Chief Prosecutor of the ICC, Luis Moreno-Ocamp, put it in 2012, ‘we [the Court] are not a system to monitor fair trials ... we are a system to ensure no impunity’.\(^8\) Thus, it is generally understood that a failure to live up to international human rights standards will not give rise to the Court’s jurisdiction.

I think there is a strong case for extending the scope of ICC jurisdiction. Firstly, it will serve to improve the legitimacy of the ICC in the eyes of those who believe it lacks impartiality. Leaders from Africa, especially, have criticised the work of the Court, claiming that it has focused disproportionately on that continent at the expense of international crime elsewhere.\(^9\) While the evidentiary basis for such allegations is weak,\(^10\) they have nonetheless compromised the Court’s reputation. As Luban argues, the ICC cannot operate in a vacuum outside the ‘political’ because the fulfilment of its functions are heavily dependent on the support of States Parties.\(^11\) For example, the ICC has no

\(^5\) ibid.
\(^7\) See Heller (n 4).
\(^8\) Quoted in Teitel (n 3).
\(^9\) See Richard Steinberg (ed), Contemporary Issues Facing the International Criminal Court (Brill Nijhoff 2016) pt VII.
\(^10\) ibid.
policing mechanisms of its own and the enforcement of its arrest warrants relies on the willingness of States Parties to perform their obligations in good faith. South Africa’s decision not to arrest the visiting Sudanese President al-Bashir\(^\text{12}\) and the intimidation of witnesses in the prosecution of the Kenyan President leading the ICC to drop the case,\(^\text{13}\) illustrate the extent to which the functioning of the Court is affected by political concerns.

By inserting a due process clause into the Rome Statute, the geographic scope of ICC prosecutions might increase. Jurisdictions which may seek to shield individuals from ICC jurisdiction by putting them on trial while lowering or eliminating standards of due process would no longer be immune from ICC scrutiny. And if such individuals were released by the relevant domestic authority, a modified rule of complementarity would enable the ICC to take jurisdiction immediately on the ground that the trial was not conducted in conformity with international human rights standards. This may enable the ICC to investigate or prosecute higher profile cases, such as those which relate to the UK’s involvement in Iraq.\(^\text{14}\)

It might be argued that an amendment to Article 17 to include a due process requirement would result in increased uncertainty when it comes to the functioning of the Court. After all, the ICC was originally set up for a narrow and specific purpose: to prevent impunity for international crimes, the corollary of which is that if a wrongdoer is being tried in a domestic context then there is no additional role for the Court. Any expansions of the Court’s jurisdiction will depart from States Parties’ understanding of how the ICC was to function when they submitted to its jurisdiction. However, it should be noted that Article 121 explicitly authorises amendments to be made, and by virtue of ratifying the Rome Statute, States Parties have accepted the possibility of future changes to its provisions. Further, an amendment of the Rome Statute made in accordance with Article 121 requires the consent of two-thirds of the States Parties. This will provide a fresh mandate for the Court to exercise its additional function.


In any case, privileging the original intent of the Rome Statute risks undermining the whole purpose of the international law project. As Luban persuasively argues, international law is about moral projection and transformation; the radical restructuring of how ‘ordinary men and women regard political violence against civilians’. In particular, the creation of various international courts and tribunals has been marked by a transformation of the rhetoric used to describe the nature of war, moving from a discourse of sacred sacrifice towards one of moral stigma, violence and criminality.

In other words, the ICC has an instrumental function as well as simply a judicial one: it is involved in a process of norm projection. Implicit in its mission is the deployment of law to project an alternative vision of politics. Empowering the ICC to scrutinise the fairness of national judicial proceedings, so that due process violations can no longer be regarded as justifiable or permissible in the international community, would go a long way towards achieving this vision.

Yours faithfully,

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15 Luban (n 11) 509.
16 Luban (n 11) 510.
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Enforceability of OECD Linking Rules in the Light of EU Law

Bruno Vanden Berghe*

ABSTRACT

To counter tax arbitrage resulting from the use of hybrid financial instruments, the Organization for Economic Co-operation and Development (OECD) suggested the implementation of anti-hybrid mismatch rules, which align the domestic tax treatment of hybrid financial instruments with their tax treatment in foreign countries. This paper assesses the enforceability of these so-called “linking rules” in the light of European Union (EU) law. Since the European Court of Justice (ECJ) has yet to rule on their relation to EU law, considerable weight is assigned to legal literature and comparable ECJ case law. Following the various steps of the analytical framework adopted by the ECJ, the author concludes that OECD linking rules are enforceable in the light of EU law, provided that the Member States implementing these rules domestically complement them with additional conditions.

INTRODUCTION

Background

Benjamin Franklin once famously said: “In this world nothing can be said to be certain, except death and taxes”\(^1\). Nevertheless, in today’s globalized world, these words seem to be rather meaningless. Multinational corporations such as

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\(^1\) Benjamin Franklin, *The Private Correspondence of Benjamin Franklin* (2nd edn, H Colburn 1817) 266.
Enforceability of OECD Linking Rules

Google, Amazon, and Starbucks avoid paying taxes by constituting all kinds of international tax planning schemes. According to Van Rompuy, former European Council President, an estimate of €1 trillion revenue is annually lost in the EU due to tax avoidance practices. Recent policy papers have indicated that a considerable amount of this figure could result from cross-border tax arbitrage. This avoidance technique can be defined as “the act of taking advantage of the inconsistencies of more than one country’s tax rules to realize a more favourable result than that provided for by a transaction in a single jurisdiction.” Hybrid financial instruments are commonly used to achieve this outcome. They can be described as financial instruments that “combine typical characteristics of equity and borrowed capital, thereby being economically positioned between these two forms of capital.” Depending on their qualification as either equity or debt, the tax treatment of such instruments may differ. Indeed, dividends as compensation for equity are usually not deductible by the payer, while the recipients are typically entitled to an exemption. Interests as compensation for debt, on the other hand, are deductible by the payer, but are taxed in the hands of the recipient.

Due to the current lack of harmonization in tax classification among jurisdictions, the use of hybrid financial instruments in cross border-transactions

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5 Hans van den Hurk, ‘Starbucks versus the People’ (2014) 68(1) BFIT 27, 27.
8 Rafael Bispo, ‘Cross-Border Intra-Group Hybrid Finance: A Comparative Analysis of the Legal Approach Adopted by Brazil, the United Kingdom and the United States’ (2013) 67(7) BFIT 365, 367.
9 Other techniques include hybrid entities and hybrid transfers.
may give rise to double tax benefits ("double dip").\textsuperscript{11} This occurs when compensations for hybrid instruments are deductible in the country of the payer without being taxed in the country of the recipient.\textsuperscript{12} These so-called "mismatch arrangements" negatively affect "tax revenue, competition, economic efficiency, transparency and fairness".\textsuperscript{13} Therefore, in its latest report named "Neutralising the Effects of Hybrid Mismatch Arrangements", the OECD suggested that Member States implement rules linking the domestic tax classification of hybrid financial instruments to their tax classification in foreign countries.\textsuperscript{14}

Under these "OECD linking rules", one State could successfully eliminate potential mismatches by allowing the deduction of interest payments to foreign entities on the condition that the other State does not provide dividend exemptions. Analogously, the former State could condition dividend exemptions on the refusal of interest deductions by the latter State.\textsuperscript{15} However, since potential mismatches can only arise in cross-border situations, linking rules promote a tax treatment of cross-border cases that is heavier than the taxation of similar domestic situations. Indeed, regarding domestic transactions, dividends are exempt and interests are deductible. Meanwhile, depending on the tax outcome in the foreign jurisdiction, the application of linking rules could result in the denial of these tax benefits in a cross-border context.

\textbf{Purpose and approach}

According to the case law of the European Court of Justice (ECJ), supranational EU law prevails over domestic law. Hence, for tax rules to be enforceable domestically, Member States need to respect EU law. Against this background, however, one could question the enforceability of linking rules. Indeed, according to the fundamental freedoms of the EU incorporated in the Treaty on the Functioning of the European Union (TFEU),\textsuperscript{16} payments made to non-residents must receive the same tax treatment as payments made to residents, unless a different treatment can be justified on grounds of an overriding public

\begin{itemize}
  \item \textsuperscript{11} Niels Johannesen, "Tax avoidance with cross-border hybrid instruments" (2014) 112 Journal of Public Economics 40, 40.
  \item \textsuperscript{12} ibid.
  \item \textsuperscript{13} ibid.
  \item \textsuperscript{14} OECD, \textit{Action 2: Neutralising the Effects of Hybrid Mismatch Arrangements} (Paris, OECD Publishing 2015) 27.
  \item \textsuperscript{15} ibid.
  \item \textsuperscript{16} Consolidated Version of the Treaty on the Functioning of the European Union [2010] OJ C83/47 (TFEU). See text to n 60 below.
\end{itemize}
interest. Following the analytical framework of the ECJ, this paper will analyse these concepts and determine whether the more onerous tax treatment of non-residents, resulting from the application of linking rules, violates the EU fundamental freedoms. It will also tackle the extent to which such potential violation could be justified.

The aim of this paper is to answer the following research question: “Are the OECD linking rules proposed in Action 2 to address tax arbitrage enforceable in the light of EU law?” However, before doing so, this paper examines the following preliminary issues:

- (1) What are hybrid financial instruments? (2) How are these instruments treated in the Netherlands and the United States (US)?
- What initiatives did the OECD undertake to tackle tax arbitrage?
- Do linking rules discriminate against non-residents who are in a similar situation as residents?
- Can a potential discrimination be justified on grounds of public interest, while, likewise, passing the proportionality test?

**Methodology**

This paper applies a combination of different research methods.\(^{17}\) Firstly, a comparative legal method is used to determine the risk of hybrid mismatches between the Netherlands and the US. Hence, the tax treatment practices of hybrid financial instruments in both countries are compared to each other.\(^{18}\) In this regard, the *PepsiCo* case will be used as a case study.

Furthermore, a traditional legal method is applied in analysing the relevant materials regarding OECD linking rules. Thus, different sources of law are evaluated throughout this paper including domestic legislation, OECD recommendations, as well as sources of both primary and secondary EU law. Moreover, since no judgment of the ECJ exists regarding the relationship between OECD linking rules and EU fundamental freedoms, this study assigns considerable weight to legal literature and comparable case law of the ECJ, together with the relevant opinions of the Advocate-Generals (AG).

\(^{17}\) Qunfang Jiang and Yifan Yuan, ‘Legal Research in International and EU Tax Law’ (2014) 54(10) European Taxation 470, 470.

Delimitation

In addition to hybrid financial instruments, mismatches can emerge from hybrid entities. Those are single business entities that are treated as transparent in one State and as opaque in another, likewise resulting in double non-taxation.¹⁹ A detailed analysis of such arrangements, however, falls outside the scope of this work.

This paper exclusively studies the relationship between linking rules and EU fundamental freedoms. Hence, the issue of compatibility with the non-discrimination principle regarding the deductibility of interests incorporated in Article 24(4) OECD Model Convention will be ignored.

Despite their affiliation with the topic, transfer pricing and thin capitalization fall beyond the scope of this paper.

Outline

The introduction sets out the background and the purpose, together with the relevant research questions addressed in this paper. The first part describes what hybrid financial instruments are and how they operate in a cross-border context. The second part covers linking rules, the solution to tax arbitrage proposed by the OECD in BEPS Action 2, and elaborates on how these would work in practice. The third and central part outlines the various steps of the analytical framework adopted by the ECJ. Following these steps, the enforceability of OECD linking rules is, subsequently, analysed in the light of EU law. The final part summarizes the essential findings, and provides an answer to the main research question.

I. HYBRID FINANCIAL INSTRUMENTS: A TECHNIQUE FOR TAX ARBITRAGE

Concept

Hybrid financial instruments present elements that may characterize them as equity as much as debt. Hence, they can be described as “a combined face of equity and debt”. Several forms of hybrid financing exist. Examples not only include traditional instruments, such as redeemable shares which grant their holder a claim on a preferred dividend, but also more innovative instruments, such as profit participating loans which, unlike conventional loans, provide interest rates that are performance linked.21

Because they can differ in numerous dimensions including maturity, voting rights and return, a wide variety of hybrid instruments exists, ranging from pure equity (no maturity, no fixed return, right to vote) to pure debt (fix maturity, fix return, no right to vote).22

From an economic perspective, hybrid financial instruments are often used, because they can adapt accurately to the needs of investors and issuers.23 For example, profit participating loans are particularly advantageous in circumstances where the risk of the investment (for example, country risk) can provoke the need to divest or reduce the capital commitment as soon as possible.24 In addition to economic reasons, tax motives also play a significant role in adopting hybrid financing. Indeed, in a cross-border context qualification, conflicts between two countries can lead to tax advantages.25 In the remainder of this paper, the emphasis is placed on the tax consequences of hybrid financing.

21 Kahlenberg (n 10) 265.
22 Johannesen (n 11) 41.
23 Bispo (n 8) 365.
24 Russo (n 20) 30.
25 Bispo (n 8) 365.
Classification issue

In most tax systems, dividends as compensation for equity are taxed in the hands of the payer, while interests as compensation for debt are taxed in the hands of the recipient since they are deductible by the payer. Thus, from a tax perspective, the distinction between debt and equity is relevant.

Corporate tax systems classify financial instruments as either debt or equity. However, since hybrid financial instruments combine elements of both, their qualification for tax purposes can be challenging. Moreover, this classification issue is a matter of domestic law which may differ between jurisdictions.

For example, in the Netherlands, the tax treatment of a financial instrument as either debt or equity depends, in principle, on its civil law classification. However, following the case law of De Hoge Raad (the Dutch Supreme Court), loans can be qualified, in exceptional circumstances, as equity for tax purposes and, thus, the interest is regarded as a non-deductible dividend payment. Such a “recharacterisation” may occur regarding sham loans, loss financing loans and participating loans, provided that the following conditions are met:

- The height of the interest depends on the profit of the borrower; and
- The principal amount is subordinated to ordinary creditors; and
- The principal amount has no maturity or is perpetual.

In the US, courts look beyond the legal form of a transaction to determine its substance. This so-called “substance-over-form” principle has been upheld by US case law for decades. According to this principle, the tax treatment of a transaction is determined by its economic substance. Therefore, the Internal

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31 ibid.
32 Michiel van der Breggen, ‘Chapter 13: Netherlands’ in Bakker (n 20) 429.
Revenue Code provides a list of characteristics which courts can consider when assigning a hybrid instrument to either the debt or equity group.\textsuperscript{34}

**Tax arbitrage**

Due to the lack of coordination between jurisdictions regarding their qualification (for example, the Netherlands and the US), hybrid financing can be used for tax arbitrage purposes.\textsuperscript{35} As mentioned above, this concept refers to the act of taking advantage of differences between tax systems to minimize taxes.\textsuperscript{36} Indeed, for multinationals, hybrid financing leads to tax planning opportunities, because qualification conflicts may result in double non-taxation. For instance, a hybrid financial instrument is considered debt in the country of the payer while regarded as equity in the country of the recipient. Consequently, no taxation is due, since the payment is deductible in the hands of the payer while being exempt in the hands of the recipient.\textsuperscript{37} The OECD provides the following example regarding these so-called “deduction/non-inclusion schemes”:\textsuperscript{38}

\textsuperscript{34} Internal Revenue Code (IRC), § 385(b).
\textsuperscript{35} OECD (n 7) 5.
\textsuperscript{36} Bispo (n 8) 367.
\textsuperscript{37} Johannesen (n 11) 40.
B Co (resident in Country B) issues a hybrid financial instrument to A Co (resident in Country A). The instrument is regarded as debt for the purposes of Country B's law and Country B provides a deduction for interest payments made under the instrument, while Country A's law grants an exemption regarding the same payments. Hence, no taxes are due on the financial compensation from B Co. to A Co.

The aforementioned example provided by the OECD is reasonably straightforward. In practice, however, more elaborate schemes are used to explain the same outcome. In this regard, the PepsiCo case can be used as a case study.

**Case study: PepsiCo**

In the PepsiCo case, the US Tax Court examined the characterization of Pepsi's advance agreements for tax purposes. The group structure of the soft drink multinational can be structured as follows:

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39 ibid 34, para 53.
In the mid-1990s, the US company PepsiCo wanted to establish its brand in Asia and Eastern Europe. Instead of moving funds from the US directly to its overseas investments, which would create withholding tax liability, PepsiCo restructured its international operations so that the overseas investments were financed by Dutch holding companies (PGI). The latter, in turn, were funded by PepsiCo Puerto Rico (PPR) who provided notes in exchange for advanced agreements. The Dutch authorities perceived this cross-border transaction between the US and the Netherlands as debt. PepsiCo assumed that the payments received from its Dutch subsidiaries pursuant to the advance agreements would be treated as dividends in the US and, as a result, be exempt from taxation. The Internal Revenue Service, however, disagreed and claimed $363 million of PepsiCo and PPR in unpaid taxes for years between 1998 and 2002.

The case was brought before the US Tax Court which ruled in favour of PepsiCo. Indeed, after identifying 13 factors to consider in characterising the instrument, the court argued that several factors, including the long maturity

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dates and the subordination of payments to debt, established uncertainty of repayment. This, in turn, allows the court to label the advance agreements as equity.\textsuperscript{42}

The PepsiCo case clearly illustrates how hybrid financial instruments can successfully be used for tax planning purposes. Indeed, due to the lack of coordination between the Netherlands and the US regarding the tax treatment of the advance agreements, PepsiCo was able to reduce its tax liability significantly. A more detailed description of the debt-equity analysis of the court in the PepsiCo case, however, falls outside the scope of this paper. The next chapter examines the solution suggested by the OECD to cope with this issue of tax arbitrage.

\section*{II. SOLUTION PROPOSED BY THE OECD}

In response to tax arbitrage, the OECD proposed rules that make the qualification of a particular payment conditional on its qualification in the other state. These so-called “linking rules” first appeared in the “Hybrid Mismatch Arrangements: Tax Policy and Compliance Issues” report published by the OECD in 2012.\textsuperscript{43} In this report, changes to domestic law were suggested to counter “hybrid mismatch arrangements” which were defined by the OECD as “arrangements exploiting differences in the tax treatment of instruments, entities or transfers between two or more countries”.\textsuperscript{44}

Following the release of the report named “Addressing Base Erosion and Profit Shifting” (BEPS),\textsuperscript{45} the OECD continued its work on hybrid mismatch arrangements. Indeed, among the other proposed actions, BEPS Action 2 of BEPS addressed the issue of hybrid mismatches.\textsuperscript{46} In addition to two Public Discussion Drafts,\textsuperscript{47} the OECD launched another report in 2014 suggesting

\begin{footnotesize}
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\begin{enumerate}
\item OECD (n 7) 11.
\item ibid 5.
\item OECD, \textit{Discussion Draft BEPS Action 2: Neutralise the Effects of Hybrid Mismatch Arrangements} (Recommendations for Domestic Laws) International Organizations (Paris, OECD
\end{enumerate}
\end{footnotesize}
potential solutions to different types of hybrid mismatches including those resulting from hybrid financial instruments.\textsuperscript{48} However, it was not until October 2015 that the OECD published its final report on Action 2 entitled “Neutralising the Effects of Hybrid Mismatch Arrangements”.\textsuperscript{49}

The first part of this report provides an overview of the OECD recommendations for domestic law. Regarding the deduction/non-inclusion schemes resulting from the utilization of hybrid financial instruments, the OECD suggested the implementation of domestic linking rules. Such rules aim to connect the domestic tax qualification of a cross-border hybrid financial instrument with the tax treatment in another jurisdiction.\textsuperscript{50}

The rules suggested by the OECD consist of a “primary rule” and a “defensive rule”.\textsuperscript{51} The primary rule allows a Member State to deny the payer a deduction for payments made under a hybrid financial instrument. Therefore, the right to tax is re-allocated by the primary rule to the country of the payer. Conversely, the defensive rule implies that the country of the recipient should include the “dividends” of the hybrid financial instrument in the taxable base of the recipient. However, to prevent the taxpayer from double taxation, the latter rule may only be applied either when no primary rule exists in the counterparty jurisdiction or when the existing rule is not applicable to the financial instrument in question. Hence, the application of the primary rule has priority over the application of the defensive rule.

Furthermore, the scope of the OECD proposal is limited to related parties of which the shareholding in the holding company exceeds 25%.\textsuperscript{52} Nevertheless, OECD linking rules likewise apply to any other entity that is a party to any structured arrangement that has been developed to shift profits and reduce the tax burden.\textsuperscript{53}

In addition to the OECD, the EU also undertook initiatives against situations of double non-taxation deriving from mismatches. In June 2014, the ECOFIN Council agreed on an amendment to the Parent-Subsidiary (PS)
Directive (2011/96) implementing a rule that links the tax treatment of a payment to its treatment in another State.\textsuperscript{54} The new EU provision in the PS Directive differs from the OECD recommendations in the sense that it does not make a distinction between a “primary rule” and a “defensive rule”. Instead, it merely obliges Member States to implement a linking rule with a defensive nature.\textsuperscript{55} A similar provision is included in the proposal for an EU Anti-Avoidance Directive, published on 28 January 2016.\textsuperscript{56} The proposal sums up a number of measures designed to implement BEPS Action Plan, from CFC legislation to hybrid mismatch rules. Nevertheless, since the legality of secondary EU law remains outside the scope of this paper, no further value is attached to the EU initiatives.

### III. ENFORCEABILITY OF OECD LINKING RULES

The previous chapter examined the solution suggested by the OECD to address the issue of tax arbitrage. This chapter further analyses whether Action 2 will successfully achieve its goal. To answer this question, the enforceability of OECD linking rules is determined in the light of EU law. In this regard, the analytical framework of the ECJ will be used as a benchmark.

#### Primacy of EU law

Direct taxation (i.e. income taxation) is regarded as a matter of each Member State’s sovereignty, while the authority to regulate indirect taxation (i.e. value added tax) belongs to the EU.\textsuperscript{57} Nevertheless, for direct tax rules to be enforceable domestically, it is settled ECJ case law that Member States need to respect supranational EU law.\textsuperscript{58} This follows from the “primacy of EU law” principle. This, in turn, goes back to the milestone case \textit{Van Gend & Loos} in


\textsuperscript{57} Mathieu Isenbaert, \textit{EC Law and the Sovereignty of the Member States in Direct Taxation} (IBFD 2008) 220.

\textsuperscript{58} Case C-311/97 \textit{Royal Bank of Scotland} [1999] ECR I-2651, para 19; Case C-446/03 \textit{Marks & Spencer} [2005] ECR I-10837, para 29.
which the Court recognised for the first time that EU law prevails over national law.\textsuperscript{59}

When assessing the relationship between direct tax laws and EU law, the ECJ considers whether they constitute a breach of the EU fundamental freedoms. The TFEU comprises the following fundamental freedoms:\textsuperscript{60}

- Free movement of goods (Article 28);
- Free movement for workers (Article 45);
- Right of establishment (Article 49) and freedom to provide services (Article 56);
- Free movement of capital (Article 63).

These four freedoms constitute the basis on which the ECJ assesses the relationship between domestic law and EU law. The question as to which fundamental freedom is at stake in each case is relevant, as only the free movement of capital applies to third-country situations and is, therefore, not limited to pure EU cases. However, as the ECJ has yet to rule in a general manner on the hierarchy between the fundamental freedoms, the question concerning the prevalence of any freedom will receive no further attention throughout this paper.

Furthermore, in performing its assessment, the ECJ adopts a self-developed analytical framework. This framework will likewise be used in the paragraphs below to determine the enforceability of OECD linking rules in the light of EU law. Figure 4 below provides an overview of the analytical framework adopted by the ECJ.

\textsuperscript{59} Case 26/62 \textit{Van Gend & Loos} [1963] CMLR 105.

\textsuperscript{60} TFEU (n 16).
Before invoking EU law against a potentially discriminatory measure, one needs to determine the existence of a cross-border element. Indeed, the application of the EU treaties is conditioned on the existence of a cross-border element. Given the inherent cross-border context in which hybrid mismatches arise, one can assume that the EU founding treaties, including the TFEU which incorporates the fundamental freedoms, are applicable. In the next step, the question arises whether a measure should be perceived as discriminatory.

(C)overt discrimination

According to the ECJ, each of the fundamental freedoms encompasses a non-discrimination principle, which implies that in tax matters “comparable situations must not be treated differently and different situations must not be treated in the same way unless such treatment is objectively justified”. This principle not only bans overt discrimination on grounds of nationality, but also covert discrimination. A measure gives rise to covert discrimination when it is

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“intrinsically liable to affect” cross-border situations more than pure domestic situations.\(^{63}\)

Regarding linking rules, a deduction or an exemption might be denied if a hybrid instrument is treated differently under the laws of two or more jurisdictions. Since mismatches by their nature arise exclusively in a cross-border context,\(^{64}\) no primary rule or defensive rule can be triggered in purely domestic situations. Indeed, contrary to taxpayers operating abroad, those who only conclude contracts domestically, do not bear the risk of losing their tax benefits following the application of linking rules. Hence, despite their neutral formulation, one would expect that linking rules are intrinsically liable to affect cross-border situations and, thus, give rise to covert discrimination.

Whether linking rules are discriminatory, depends ultimately on the comparability analysis carried out by the ECJ.\(^{65}\) Indeed, discrimination only arises when comparable situations are treated differently for tax purposes, unless such difference is objectively justified.\(^{66}\) Therefore, the comparability of the domestic situation with the cross-border situation is critical in analysing the existence of discrimination. In that regard, the ECJ adopts two approaches: the “per-country approach” which considers the situation of the taxpayer on a stand-alone basis, and the “overall approach” which looks at the cross-border situation as a whole.\(^{67}\)

**Per-country approach**

The first approach under which the ECJ carries out its comparability analysis is the per-country approach. According to this approach, no consideration is given to the different tax treatment in other Member States. Instead, it requires that

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\(^{67}\) Jessica Di Maria, ‘Comparability in the Case of Hybrid Mismatch: In Search of an Approach Suitable for the Current European Landscape’ in Kasper Dziurdz and Christoph Machgraber (eds), *Non-Discrimination in European and Tax Treaty Law* (Linde Verlag 2015) 186; Carril (n 65) 106.
the ECJ only examines the tax treatment of a stand-alone taxpayer in contrast with the situation of comparable taxpayers from the same jurisdiction. 68

The Court used this approach in the *Eurowings* case. 69 In this case, a German-resident company leasing aircrafts from a lessor in Ireland was subjected to a higher trade tax than a similar company who leased the same goods from a lessor in Germany. According to the Court, this measure violated the freedom to provide services. Germany tried to justify its difference in tax treatment by arguing that the Irish-resident lessor was subjected to lower taxation than in Germany. The Court, however, dismissed this argument, because “[a]ny tax advantage resulting for providers of services from the low taxation to which they are subject in the Member State in which they are established cannot be used by another Member State to justify less favourable treatment in tax matters given to recipients of services established in the latter State”. 70

In short, in *Eurowings*, the ECJ analysed the disadvantage regarding transactions with non-residents under German law on a stand-alone basis and, thus, disregarded the potentially favourable tax treatment in other Member States. The Court adopted the same reasoning in its later case law. Regarding financial benefits reserved for recipients of dividends of domestic companies, the ECJ argued in the *Lenz* case that “the level of taxation of companies established [abroad] cannot justify a refusal to grant those same financial advantages to persons receiving revenue from capital paid by those latter companies”. 71

**Overall approach**

As opposed to the per-country approach, the overall approach implies that the ECJ examines the cross-border situation as a whole when carrying out its comparability analysis. Thus, in addition to the tax treatment of a taxpayer in their country of residence, consideration is given to the different tax treatment in other Member States. 72 Once the overall tax burden of a taxpayer or group of taxpayers is determined in the light of different jurisdictions, the ECJ looks at similar situations to assess whether discrimination exists.

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68 Carril (n 65) 109.
70 ibid para 44.
71 Case C-315/02 *Lenz* [2004] ECR I-7063, para 42.
72 Carril (n 65) 111.
The ECJ first introduced the overall approach in the *Schumacker* case. This case concerned the denial of tax benefits for family circumstances by German tax authorities to a Belgian resident who earned 90% of his income from work carried out in Germany. Under German tax law, such advantages were only available to residents in Germany. According to Schumacker, this constituted a breach of freedom of movement for workers, because he would receive tax benefits as a German resident due to his family circumstances. For its assessment of possible discrimination, the Court looked at the tax treatment of Schumacker in Belgium. It determined that Belgium could not grant any benefits for family circumstances, as Germany was allowed to tax Schumacker's profits under the Belgium-Germany double tax treaty. Therefore, by taking into account the overall tax treatment of Schumacker, the ECJ decided that the State of employment, Germany, was obliged to provide the tax benefits in question.

The ECJ followed a similar approach in the *Schempp* case. In this case, the ECJ accepted German rules, under which the deductibility of alimony payments depended upon the taxable outcome in another Member State. Mr Schempp was a German resident taxpayer who paid alimony to his former spouse in Austria. Under German law, maintenance payments were deductible, provided that they were taxed in the hands of the recipient. Since such payments were not taxed in Austria, Mr Schempp was unable to claim a deduction in his German tax return. According to Mr Schempp, a deduction would have been granted if his former spouse was a resident of Germany. Despite this existing difference in treatment as opposed to situations where alimony is paid to German residents, the Court concluded that German law was not discriminatory due to the lack of comparability between the two situations. Indeed, in contrast to Austrian law, German law requires that alimony payments are subject to taxation. Because of this different tax treatment, alimony payments to an Austrian resident cannot be compared to similar payments to a German resident. Since discrimination can only arise in comparable situations, the Court found that German law was compatible with EU law.

Along the lines of the judgement in *Schumacker* and *Schempp*, one would expect that a cross-border situation in which a mismatch arises regarding hybrid financial instruments, cannot be compared to a domestic situation where no mismatch exists regarding the same instrument. Due to this lack of

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74 ibid paras 36-38.
75 Case C-403/03 *Schempp* [2005] ECR I-06421.
76 ibid para 35.
77 ibid para 39.
78 Di Maria (n 67), 184.
comparability, linking rules which deny tax benefits in cross-border situations should not be considered discriminatory.

**Comparability in the event of tax arbitrage**

Regarding OECD linking rules, the approach employed by the ECJ in carrying out its comparability analysis will have a significant impact on its findings. If the Court follows a per-country approach which focuses on the situation of the taxpayer on a stand-alone basis, one would expect that it will ignore the tax treatment of the counterparty jurisdiction when assessing the discriminatory nature of linking rules. Consequently, a discrimination arises between cross-border situations and domestic situations since two comparable taxpayers are subjected to a different tax treatment. Conversely, under an overall approach which examines the cross-border situation as a whole, one would expect that, along the lines of the judgement in *Schumacker* and *Schempp*, the ECJ will perceive cross-border hybrid mismatches as incomparable to domestic situations regarding the same hybrid instrument, but without classification conflict. Due to this lack of comparability, linking rules which deny tax benefits in cross-border situations should not be considered discriminatory.

As the ECJ has not shown preference for either of the aforementioned approaches, legal uncertainty prevails regarding the question whether or not the implementation of OECD linking rules creates discrimination and, thereby, infringes the EU fundamental freedoms. Hence, for the sake of legal certainty, the ECJ should take a clear position when performing its comparability analysis in the future. In this author’s view, since policy considerations supporting anti-hybrid mismatch measures exist, the overall approach should be upheld. Indeed, tax arbitrage not only results in significant revenue loss, but it also causes distortion of competition between companies subjected to different tax avoidance requirements. Furthermore, it violates the principle of neutrality, since taxpayers are encouraged to invest abroad rather than in their home country, which in turn causes a negative impact on economic efficiency.\(^79\) However, Di Maria raises one convincing argument to support the per-country approach.\(^80\) She argues that the per-country approach corresponds to the current European landscape in which Member States can freely draw up their tax policies. Indeed, because they enjoy sovereignty in direct taxation, Member States cannot be required to adjust their tax rules to those of other jurisdictions.

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\(^79\) OECD (n 14) 11.
\(^80\) Di Maria (n 67) 187.
Therefore, the overall approach of the Court should not be perceived desirable in a non-harmonised European tax environment.\footnote{ibid 189.}

In any case, considering the preeminent risk that the ECJ finds linking rules discriminatory following the per-country approach, it is worth examining the next step of the ECJ analytical framework, namely the question as to whether a potential restriction can be justified on grounds of an overriding public interest.

**Justification of potential discrimination**

**Rule of reason**

The ECJ has adopted a doctrine of justification ("rule of reason") to justify breaches of the fundamental freedoms resulting from discriminatory measures. Indeed, in the *Cassis de Dijon* case,\footnote{Case C-120/78 *Rewe-Zentral AG* [1979] ECR 649.} the Court accepted for the first time unwritten justification grounds which constitute an overriding reason in the public interest.\footnote{ibid para 8.} Since then, a variety of justification grounds have been introduced. However, this section will only focus on those which are closely related to tax arbitrage, namely the prevention of tax abuse and the fiscal coherence.

As a preliminary point, one could argue that ensuring single taxation constitutes an overriding reason which justifies the potential restriction of the EU basic freedoms. Nevertheless, the ECJ has not yet recognized such justification ground.\footnote{Jakob Bundgaard, ‘Hybrid Financial Instruments and Primary EU Law – Part 2’ (2013) 53(12) European Taxation 587, 587.} Indeed, as the Court has stated, "it is settled case law that any advantage resulting from the low taxation to which a subsidiary established in a Member State other than the one in which the parent company was incorporated is subject cannot by itself authorise that Member State to offset that advantage by less favourable tax treatment of the parent company".\footnote{Case C-196/04 *Cadbury Schweppes* [2006] ECR I-07995, para 49 (citations omitted).} Consequently, the mere fact that hybrid financial instruments can reduce the overall tax liability of a taxpayer due to their different tax treatment in another Member State, does not justify a potential restriction. In addition to low taxation, other reasons that are connected to hybrid mismatches, but have been
rejected by the Court, include loss of tax revenue,\(^{86}\) as well as double non-taxation.\(^{87}\)

**Prevention of tax abuse**

The prevention of tax abuse is the first justification accepted by the ECJ, which is also relevant to the field of hybrid mismatches. In *Cadbury Schweppes*, the ECJ argued that a restriction on the fundamental freedom of establishment may be justified by the prevention of tax avoidance, provided that it specifically targets “wholly artificial arrangements which do not reflect economic reality”.\(^{88}\) Thus, to be perceived justifiable by the ECJ, a restricting measure that prevents tax avoidance cannot have a general scope. Instead, its application must be limited to “wholly artificial arrangements”. The latter do not reflect economic reality and have the objective of circumventing tax laws.\(^{89}\)

In the same case, the ECJ identified two factors that determine whether a transaction constitutes an artificial arrangement: the subjective element and the objective element. The subjective element refers to the intention of the taxpayer to avoid taxes, while the objective factor relates to the failure to comply with elements ascertainable by third parties which suggest that the arrangement corresponds to economic reality.\(^{90}\) Both elements need to be evaluated on a case-by-case basis. An example of a wholly artificial arrangement proposed by the court is a “letterbox”,\(^{91}\) which is established merely for tax purposes and does not conduct economic activity. Additionally, restrictive tax measures need to comply with the principle of proportionality. Therefore, taxpayers must be given the opportunity to prove that any genuine economic justification exists for its actions.\(^{92}\)

In light of the *Cadbury Schweppes* case, it seems unlikely that OECD linking rules can be justified by the prevention of tax avoidance. Indeed, although they may be used to obtain tax savings, hybrid financial instruments usually serve the objective of financing investments and economic activities.\(^{93}\) Thus, not all

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\(^{86}\) Case C-422/01 *Skandia* [2003] ECR I-6817, para 53.


\(^{88}\) *Cadbury Schweppes* (n 85) para 51.

\(^{89}\) ibid para 55.

\(^{90}\) ibid para 64.

\(^{91}\) ibid para 68.

\(^{92}\) Case C-524/04 *Thin Cap Group Litigation* [2007] ECR I-2107, para 82.

\(^{93}\) Bundgaard (n 84) 591.
hybrid financial instruments can be considered “wholly artificially arrangements” as they will generally fail to pass the objective test. Limiting the scope of their linking rules to wholly artificial arrangements, would allow Member States to comply with the *Cadbury Schweppes* doctrine. However, one would expect that this undermines the effectiveness of linking rules since most financial instruments would fall outside their scope.

Alternatively, Member States could avoid the strict “wholly artificial arrangement” requirement of the *Cadbury Schweppes* judgement by invoking the prevention of the tax abuse justification in combination with the preservation of a balanced allocation of taxing rights. The latter, which was first introduced in the *Mark & Spencer* case in 2005, entails that Member States have the right to levy taxes on either a tax subject or a tax object (or both) that has a reasonable tie with its tax jurisdiction. The ECJ accepts that, without fulfilling the wholly artificial requirement, the prevention of tax abuse can still justify a discrimination provided that the balanced allocation ground is met. Indeed, in determining that Belgian transfer pricing regulation complies with EU law, the ECJ used a joint assessment of both justification grounds in the *SGI* case. Regarding the artificial arrangement requirement, the Court argued that “[e]ven if the specific purpose of a national legislation is not to exempt from tax benefits prescribed in the law fictitious arrangements that are not economically viable […] such legislation may nonetheless be considered justified in this context by the aim to prevent tax avoidance in conjunction with the aim to maintain a balanced allocation of taxing rights between member states”. The Court followed a similar approach in the *Oy AA* case concerning the Finnish cross-border loss relief.

Following this case law, one could argue that, regarding OECD linking rules, the ECJ would likewise adopt a joint assessment of justification grounds. However, it remains undetermined whether the ECJ will allow the balanced allocation of taxing rights as a justification ground for linking rules. As pointed out by Bundgaard, their intention is not to protect a State’s tax claim regarding the activities carried out on its territory, but to eliminate potential tax savings that arise from a divergence in qualification between countries. In other words, OECD linking rules are adopted to counter double non-taxation in the OECD.

94 *Marks & Spencer* (n 58).
95 Case C-311/08 *Société de Gestion Industrielle* [2010] ECR I-487, para 60.
96 ibid para 66.
98 Case C-231/05 *Oy AA* [2007] ECR I-6373, para 63.
99 Bundgaard (n 84) 589.
Member States altogether, rather than to protect the tax base of single Member States. Therefore, it seems highly unlikely that the ECJ will accept the balanced allocation of taxing right, in combination with the prevention of tax abuse as potential justification grounds for linking rules.

Fiscal coherence

One of BEPS’s policy goals is establishing “international coherence in corporate income taxation”.¹⁰⁰ Like the OECD, the ECJ recognises the importance of fiscal coherence by accepting it as a justification ground. The coherence justification allows Member States to maintain a symmetry between the taxability of an income and the deductibility of the corresponding expense.¹⁰¹ The ECJ first introduced this justification ground in the Bachmann case.¹⁰² This case dealt with the relation between the deductibility of insurance premiums paid in Belgium and the taxability of the pensions paid by insurers. According to Belgian law, contributions paid to an insurer under a pension contract in Belgium were deductible when the pensions related to the contributions were likewise taxable in Belgium. Bachmann, who concluded a pension contract with a non-Belgian insurance company, was not allowed to deduct his contributions as they were not paid in Belgium. According to the Court, the discriminatory tax treatment of insurance contributions was justified by fiscal coherence, as Belgium had no certainty that it would be able to tax the amounts paid by foreign insurers.¹⁰³

Regarding OECD linking rules, fiscal coherence could be evoked as a potential justification since a connection arises between the tax benefit of one company and the tax disadvantage of another company. However, in later case law, the Court refined the coherence ground by requiring the existence of a direct link between the tax benefit and the fiscal burden. Initially, such a direct link requires that the tax levy and tax benefit must be present in the same category of tax and with regard to the same taxpayer.¹⁰⁴ Hence, the ECJ has rejected in the past the existence of a direct link between the right to tax profits

¹⁰⁰ OECD (n 45) 15.
¹⁰¹ Helminen (n 87) 335.
¹⁰³ ibid para 28.
of a subsidiary abroad and the deduction of losses of a subsidiary located in the United Kingdom (UK), because it concerned different taxpayers.\(^{105}\)

Following the strict reasoning of the Court, one would expect that a direct link likewise does not exist regarding OECD linking rules, as both the primary rule and the defensive rule do not relate to the same taxpayer. Indeed, the tax benefit of one subsidiary is aligned to the tax treatment of the hybrid instrument in the hands of another subsidiary. Consequently, numerous scholars have argued that, due to the lack of “direct link”, OECD linking rules cannot be justified on the ground of fiscal coherence.\(^{106}\)

However, one cannot simply ignore the fact that, over the years, the Court has adopted a less rigorous approach regarding the direct link requirement. The \textit{Marks \& Spencer} case of 2005, for example, concerned the deductibility of losses in foreign subsidiaries against its taxable profits in the UK.\(^{107}\) In that case, the ECJ found the refusal of the UK to allow the claim of \textit{Marks \& Spencer} justifiable on three different grounds. In addition to the prevention of tax abuse and the double deduction of losses, the Court accepted the denial on the basis that “profits and losses are two sides of the same coin and must be treated symmetrically in the same tax system” (even though they did not concern the same taxpayer).\(^{108}\) Along the same lines, the Court has considered the coherence justification in numerous cases regarding the distribution of dividends without referring to the existence of a direct link in the event of one and the same taxpayer.\(^{109}\)

Moreover, the ECJ seems to abandon the condition of a direct link regarding a single taxpayer even further by moving the question of fiscal coherence from the national level to the broader level of States entering into tax treaties.\(^{110}\) Indeed, in the \textit{Danner} case, the Court ruled that, due to the double taxation conventions “fiscal cohesion is no longer established in relation to one and the same person… but is shifted to another level, that of the reciprocity of the rules applicable in the Contracting States”.\(^{111}\) Neyt and Peeters argue that the Court applied a similar reasoning in case \textit{K}.\(^{112}\) In that case, the ECJ found a
direct link between the capital losses at the occasion of the sale of real estate in France and its potential capital gains.\textsuperscript{113} According to the authors, one could posit that, from the viewpoint of the Member States concerned, the losses and profits are not directly linked “on the level of each taxpayer individually, but on a higher level between all profits and all losses with respect to their respective foreign real estate”.\textsuperscript{114}

In accordance with the above case law, AG Kokott claimed that the coherence justification is applicable even if the fiscal burden and tax advantage do not regard to the same taxpayer, provided that a twofold prerequisite is met.\textsuperscript{115} Firstly, it is required that tax advantage and tax burden concern the same income or the same economic process. Secondly, the tax disadvantage which accrues to one taxpayer needs to be “real and in the same amount” as the tax advantage accruing to the other taxpayer.

Since linking rules align the tax treatment of a hybrid financial instrument in one jurisdiction with the tax outcome of the same instrument in another jurisdiction, no concerns shall arise regarding the first condition. However, the same cannot be said for the second requirement. Indeed, due to different corporate income tax rates among Member States, the tax advantage of one taxpayer will differ from the tax disadvantage accruing to the other. The application of the primary rule can be used as an example to illustrate this.

Suppose a payment of 100 EUR is deductible at the level of the payer at a 10\% rate, while the corresponding amount is taxed at the level of the recipient at a 30\% rate. Due to a mismatch, the recipient is granted a tax exemption regarding the full amount which results in a tax benefit of 30 EUR (100 x 30\%). Under the primary rule the deduction of the same amount in the hands of the payer will be rejected, accruing a tax disadvantage to the latter of only 10 EUR (100 x 10\%).

The most effective method to ensure equality between the tax advantage and the tax disadvantage would be the harmonisation of the corporate income tax rate among OECD Member States. However, considering the refusal of a Common Consolidated Corporate Tax Base,\textsuperscript{116} it seems highly unlikely that, even within the EU, States would be willing to harmonize their income tax rates. Whether this precludes the existence of a direct link regarding linking rules, depends on the value that the ECJ attaches to the difference in income tax rate

\begin{footnotes}
\item[113] Case C-322/11 K [2013].
\item[114] Neyt (n 112).
\item[115] Opinion of AG Kokott in Case C-319/02 Manninen [2004] ECR I-7477, para 61. See also Opinion of AG Madura in the Marks & Spencer case (n 58), para 71.
\end{footnotes}
between the country of the payer, where the payment is deducted, and the country of the recipient, where the payment is taxed. At least in the *Schempp* case, the Court did not pay much attention to these different rates. Therefore, German law which made the deductibility of alimony payments depend on the taxable outcome in another Member State was found compatible with EU law. Regarding linking rules, one could argue that, in line with *Schempp*, the Court will identify a direct link between the fiscal burden and the tax benefit by disregarding the difference in tax rates among the countries concerned.

Although the current version of the linking rules successfully eliminates situations of double non-taxation, the same cannot be said for double taxation. Indeed, pursuant to the defensive rule, the country of the recipient must include the “dividends” of the hybrid financial instrument in the taxable base of the recipient when these are deductible in the hands of the payer. However, there is no provision in place that requires the country of the recipient to provide an exemption if the payment is not deductible in the country of the payer following the application of tax deductibility restrictions (for example, thin cap and transfer pricing regulation). One could argue that the one-sided nature of the linking rules prevents the existence of fiscal coherence. Indeed, as noted by AG Kokott, fiscal coherence generally entails “no more than avoiding double taxation or ensuring that income is actually taxed, but only once (the principle of only-once taxation)”.

Along the same lines, Helminen argues that a coherent tax system implies that “always when a payment is deductible, the payment is taxable as regards the recipient, and always when a payment is not deductible, it is exempt as regards the recipient”. Following this reasoning, linking rules can only be justified if they work bilaterally in the way that one State is obliged to provide a tax benefit for a payment when the other State refused to give one regarding the same payment. Consequently, Member States should not only implement linking rules suggested by the OECD to neutralize double non-taxation, but likewise implement the following rules that cover double taxation.

- Regarding the primary rule: “The payments are deductible to the extent that such payments are not exempt in hands of the recipient”.
- Regarding the defensive rule: “The payments are exempt to the extent that such payments are not deductible in the hands of the payer”.

By combining OECD linking rules with the rules suggested above, Member States respect fiscal coherence, because the income from a cross-border transaction is only taxed once. Furthermore, this outcome can be

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117 AG Kokott (n 115) para 51.
118 Helminen (n 87) 336.
rationalized on theoretical as well as practical grounds.\textsuperscript{119} Firstly, on a theoretical level, eliminating both situations of double taxation and double non-taxation avoids the rise of distortion and, thus, creates economic efficiency. Indeed, the decision of economic agents to invest abroad or in their home country remains unaffected, because cross-border transactions are neither taxed more heavily nor less onerous than domestic transactions. Secondly, from a practical perspective, double taxation can result in a very high fiscal burden which discourages cross-border investments. Conversely, double non-taxation creates an incentive for taxpayers to invest in foreign jurisdictions and to erode the tax base of their home State.

Based on the above, one would expect that any discrimination resulting from the application of linking rules can be justified by fiscal coherence. Whether these rules should, therefore, be considered enforceable in the light of EU law, depends on the evaluation of the final stage of the ECJ analytical framework which encompasses the proportionality test.

\textbf{Proportionality principle}

As a final step, the ECJ considers whether domestic rules are not disproportionate in achieving their goal. This so-called “proportionality” principle can be divided into two sub-tests. Firstly, it implies that domestic legislation breaching EU law does not go beyond what is necessary to obtain its objective. Secondly, it requires that a violation of the four freedoms is appropriate to achieve its aim.\textsuperscript{120}

In the light of the ECJ judgement in the \textit{Papillon} case,\textsuperscript{121} it remains questionable whether the ECJ would perceive the current version of OECD linking rules “not to go beyond what is necessary” to attain their objective of fiscal coherence and, thus, pass the first proportionality sub-test. The \textit{Papillon} case concerned the French tax consolidation regime which provided for the neutrality of intra-group transactions. The regime only applied to French companies and was not applicable to subsidiaries of the parent which were indirectly held through a non-resident subsidiary. According to the Court, the French regime achieved fiscal coherence, because a direct link existed between tax advantages of the consolidation regime and the neutralization of intra-group transactions, which avoided a double deduction of losses at the level of resident

\textsuperscript{120} Case C-55/94 Gebhard [1995] ECR I-4165, para 37.
\textsuperscript{121} Case C-418/07 Papillon [2008] ECR I-8947.
companies subjected to the consolidation regime. However, the subsidiaries of the non-resident subsidiary were unable to prove that no risk of double use of losses existed in their particular case. Therefore, the Court argued that the French legislation, which did not provide the companies involved the opportunity to provide proof to the contrary, went beyond what was necessary to attain its aim of fiscal coherence, and was thus perceived disproportionate.

Following this judgement, Member States implementing OECD linking rules will have to afford the taxpayer, whose tax benefit is denied, the opportunity to prove that no divergence in the qualification of the hybrid financial instrument emerges. Otherwise, the Court may conclude that, due to their automatic application, OECD linking rules go beyond what is necessary to attain fiscal coherence. Moreover, considering the effectiveness principle, the right to provide counterproof cannot be excessively burdensome, “so as to render virtually impossible or excessively difficult the exercise of rights conferred by Community law”. The question arises as to whether the burden of proof of the tax treatment in another State does not impose an excessive onus to the taxpayer that could constitute a breach of the effectiveness principle. Arguably, such an administrative constrain can be condoned since the Mutual Assistance Directive provides the required information regarding the tax treatment of a financial instruments in other Member States. Indeed, in its previous case law, the ECJ has already considered the application of the Mutual Assistance Directive in determining whether an excessive administrative burden can serve as a potential justification.

Regarding the appropriateness of OECD linking rules in achieving fiscal coherence, it is important to note that their scope does not cover all situations of hybrid mismatches. Indeed, while the qualification of payments between related parties (and unrelated entities that are party of a structured arrangement) are aligned under OECD linking rules, double non-taxation can still arise regarding payments between regular unrelated parties. Due to the different treatment between related and unrelated parties, OECD linking rules are not in every respect adequate to achieve their objective. Indeed, the second ECJ proportionality sub-test will only be met if situations of double non-taxation are abolished entirely. Hence, although there are practical reasons to rationalize the

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122 ibid para 51.
123 ibid para 61.
124 AG Kokott (n 115) para 73.
126 Bammens (n 63) 91.
limited scope of application (for example, the gathering of information regarding tax classification), Member States should extend the scope of the OECD proposals to include unrelated parties.

CONCLUSION

The research question addressed in this paper is the following: “Are OECD linking rules proposed in Action 2 suitable to address tax arbitrage enforceable in the light of EU law?”

To answer this question, the following topics have been examined above: the issue of tax arbitrage, BEPS Action 2, and the analytical framework adopted by the ECJ.

The use of hybrid financial instruments in cross border-transactions may give rise to a double tax benefit due to the lack of harmonization in tax classification systems currently applicable among jurisdictions. This issue of tax arbitrage negatively affects tax revenue, competition, economic efficiency, transparency and fairness. To cope with the externalities resulting from tax arbitrage, the OECD proposes the implementation of linking rules in BEPS Action 2. These rules make the qualification of a particular payment conditional on its qualification in the other State in order to ensure that cross-border hybrid instruments are always subject to tax.

The ECJ adopted an analytical framework which encompasses several steps to assess the compatibility of domestic law with EU law. Following these steps, one would expect that linking rules suggested by the OECD as a means to address tax arbitrage are enforceable in the light of EU law, provided that the Member States implementing these rules complement them with additional conditions. Firstly, by modifying linking rules domestically in the way that they not only eliminate double non-taxation but also double taxation, Member States can fully respect fiscal coherence. Hence, any potential discrimination resulting from the application of linking rules can be justified by an overriding reason in the public interest. Secondly, Member States should afford the taxpayer, whose tax benefit is denied, the opportunity to prove that no divergence in the qualification of the hybrid financial instrument emerges. Otherwise, linking rules would violate the proportionality principle by going beyond what is necessary to attain fiscal coherence. Thirdly, the proportionality principle likewise requires that linking rules are suitable to achieve their objective. Since fiscal coherence requires that double non-taxation is entirely abolished, Member States have to extend the scope of the OECD proposals to include unrelated parties.
In conclusion, under the right conditions, OECD linking rules successfully address tax arbitrage. However, only time will tell whether Member States want to implement such conditions, and whether they are keen on implementing linking rules in the first place.
A Robust Restatement of the Presumption of Capacity Under the Mental Capacity Act 2005: *WBC (Local Authority) v Z, X, Y*

Urania Chiu*

INTRODUCTION

In the recent judgment of *WBC (Local Authority) v Z, X, Y*,1 a twenty-year-old woman with Asperger Syndrome and a borderline learning disability was declared to possess legal capacity, both to participate in the litigation and to make decisions regarding her residence, social contacts and care. This judgment is important because it recognises a strong presumption of capacity under the Mental Health Act 2005 (MCA 2005) and provides a comprehensive example of the Act’s application to a complex and finely balanced set of facts.

Background

The applicant in the case, the local authority in whose area Z lived, initiated proceedings in the Court of Protection in June 2014. It sought a declaration that Z lacked capacity under the MCA 2005 to make decisions as to:

(i) choosing her residence;
(ii) making contacts with others;
(iii) dealing with her care; and
(iv) litigating in the proceedings.

The local authority had for several years been involved in caring for Z, whom Cobb J described as in many ways ‘typical of a young person her age’.

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A Robust Restatement of the Presumption of Capacity

She was, among other things, ‘fascinated by celebrity status’ and enjoyed ‘social media, through which she recently met a partner.’ Cobb J also considered that ‘Z has, as my judgment reveals, taken many risks in the past in the way she has lived her life and made her relationships; some of that risk-taking has probably caused her harm.’

The hearing, in which Cobb J considered the gateway issue of whether Z possessed capacity to engage in the litigation, took place 18 months after the Local Authority initiated proceedings. The questions to be answered were:

(i) whether Z’s risk taking indicated a lack of capacity as opposed to merely evincing the type of conduct typical of adolescence; and
(ii) whether, since the commencement of proceedings, Z has matured to the extent that she now enjoys capacity.

General Principles

Cobb J began by setting out the relevant principles under the MCA 2005 governing the test for capacity, including the presumption of capacity under section 1(2), the requirement to consider both the ‘diagnostic’ and the ‘functional’ elements of capacity under sections 2 and 3, respectively, and the time and matter-specific nature of the capacity test under section 2(1). Cobb J reiterated that a person is not to be treated as ‘unable to make a decision’ unless ‘all practicable steps to help [her] have been taken without success’ (section (1)(3)) or ‘merely because [she] makes an unwise decision’ (section 1(4)). These principles are supplemented by those set out in case law, including that it is not necessary for a person to use and weigh every detail of the respective options available in order to demonstrate capacity but merely the salient factors. Further, even though a person may be unable to use and weigh some information relevant to the decision in question, they may nonetheless be able to use and weigh other elements sufficiently to be able to make a capacitous decision.

Cobb J emphasised that the question for the court is ‘not whether the person’s ability to take the decision is impaired by the impairment of, or disturbance in the functioning of, the mind or brain but rather whether the

2 WBC v Z, X, Y (n 1) [2].
3 ibid.
4 WBC v Z, X, Y (n 1) [11].
5 CC v KK [2012] EWHC 2136 (COP).
6 Re SB (A Patient) (Capacity to Consent to Termination) [2013] EWHC 1417 (COP).
person is rendered *unable* to make the decision by reason thereof — an important point clarified in *Re SB*. Finally, he stated that the burden of proof lies with the person asserting a lack of capacity, which in this case was the local authority seeking a declaration as to Z’s capacity in relation to the matters mentioned above.

As there was no dispute that Z did suffer from an impairment of, or a disturbance in the functioning of, the mind or brain under section 2 of MCA 2005 by reason of her being diagnosed with Asperger Syndrome and a learning disability, Cobb J focused on the ‘functional’ element of the capacity test. Under this limb, Cobb J considered whether Z was ‘unable to make a decision for [herself]’, due to an inability to ‘use or weigh’ information about risk to herself.

### The Time and Decision-Specific Nature of Capacity

Because section 2(1) stipulates that capacity is to be assessed ‘in relation to a matter’ and ‘at the material time’, the capacity test is time and decision-specific. The assessment does not concern a person’s capacity to make decisions generally, but rather whether at the time of the assessment, a person was unable to make the relevant decision. This aspect of the test was particularly relevant in Z’s case, given the 18-month delay between the commencement of proceedings and the capacity assessment. Thus, while Cobb J acknowledged that ‘the Local Authority was perfectly justified in initiating proceedings in June 2014’, when Z ‘probably did lack capacity to make decisions on matters under review at that time’, this had no bearing on the question of Z’s capacity at the time of the hearing.

Cobb J concluded that the local authority had not rebutted the presumption of Z’s capacity in relation to the matters in question. As the question turned on *current* capacity, he relied upon new evidence available to the court to reach his conclusion. A majority of Cobb J’s discussion of the evidence is focused on how Z had learnt from her past mistakes, as well as how she had

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7 *WBC v Z, X, Y* (n 1) [15] (emphasis added).
8 ibid [10]-[16].
9 MCA 2005, s 2(1).
10 MCA 2005, s 3(1)(c).
11 *WBC v Z, X, Y* (n 1) [14].
12 ibid [59].
13 ibid (emphasis added).
made improvements in understanding and weighing information relevant to living independently and making social contacts, between the start of the proceedings and the date of the hearing. For example, Cobb J found that, although Z may have shown an ‘unusual’ degree of interest in fame and celebrity in the past, more recent discussions showed that she had a ‘good degree of awareness’ of the deficiencies of her unsuccessful talent show audition, and a ‘more realistic appraisal of her quest for fame’.14

The Information Relevant to the Decision

Under section 3(4) of the MCA 2005, the information which needs to be understood, retained, and used or weighed by an individual as part of the process of making the decision, includes information about the reasonably foreseeable consequences of deciding one way or another, or failing to make the decision. Cobb J further cited the finding in CC v KK that it is not necessary for a person to use or weigh every detail of the respective options available to determine capacity, but merely the salient factors. Applying this construction of section 3(4) of the MCA 2005, he was satisfied that Z was able to ‘use or weigh’ the evidence relevant to decisions related to residence and making social contacts. The rationale underlying the decision in CC v KK is to bolster ‘the fundamental principle enshrined in [section] 1(2) of the 2005 Act – that a person must be assumed to have capacity unless it is demonstrated that she lacks it’.15 It would be unrealistic to expect an ordinary person to apprehend the nuances of every option open to her, especially if the decision involves complicated, technical details about medical care. Such an approach to section 3(4) would render the protection of autonomy afforded by the presumption of capacity futile, because it would be too hard to prove that information had been used or weighed sufficiently in the decision-making process.

Unwise Decisions and Incapacity

Cobb J introduced his judgment with the following statement: ‘It is well known that young people take risks. Risk-taking is often unwise. It is also an inherent,

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14 ibid [64].
15 CC v KK (n 5) [74].
inevitable, and perhaps necessary part of adolescence and early adulthood
experience.\textsuperscript{16}

This statement set the tone for Cobb J’s assessment of Z’s capacity: he
reiterated several times in his judgment the principle under section 1(4) of MCA
2005 according to which a person is not to be treated as unable to make a
decision merely because she makes an unwise decision.\textsuperscript{17} Pointing in particular
to the fact that Z was a young woman of twenty years old, Cobb J stated that it
was necessary to distinguish between evidence indicating unhealthy, dangerous,
or unwise adolescent risk-taking, and evidence revealing a lack of capacity. In
Cobb J’s opinion, some of Z’s behaviour, seen as risky by the expert psychiatrist
Dr Rippon, was only ‘risky to some extent, but not more than usually risky for a
young person who is in love’.\textsuperscript{18} Therefore, he did not find her incapable of
making decisions.

This interpretation of section 1(4) of MCA 2005, incorporating a robust
presumption of capacity, is consistent with case law. In The Mental Health Trust v
\textit{DD}, an earlier case also decided by Cobb J, he ruled that the person in question
lacked capacity, not just because her decision-making was ‘unwise’, but because
it ‘lacks the essential characteristic of discrimination which only comes when the
relevant information is evaluated, and weighed.’\textsuperscript{19} In the more recent and much-
reported case of \textit{Kings College Hospital NHS Foundation Trust v C}, MacDonald J
decided that the fact that others in society might consider the person’s decision
to be unreasonable, illogical or immoral, was not evidence of a lack of capacity.\textsuperscript{20}
This is because a competent individual is entitled to make decisions based on
her own value system and personality without conforming to societal
expectations.\textsuperscript{21} Such a strict application of section 1(4) of MCA 2005 is to be
welcomed, as the freedom for competent individuals to make whatever decision
they like, whether it be irresponsible, irrational, or seemingly morally
reprehensible, must be protected if their autonomy is to be respected. This
freedom cannot be protected unless a clear line is drawn between the
assessment of capacity and normative judgement of the perceived
reasonableness of someone’s decision.

\textbf{Expert Opinion}

\begin{footnotes}
\item[16]\textit{WBC v Z, X, Y} (n 1) [1].
\item[17]\textit{ibid} [67].
\item[18]\textit{ibid} [66].
\item[19][2014] EWCOP 11 [86].
\item[20][2015] EWCOP 80 [30].
\item[21]\textit{ibid}.\end{footnotes}
Although Cobb J referred to Dr Rippon’s expert opinion in great detail in his judgment, it is notable that he differed in his opinion from Dr Rippon’s at many points. He questioned the usefulness of relying solely on expert reports – having read Dr Rippon’s reports several times, he was ‘left unsure that [he] had received a complete or rounded picture of what Z was saying’. Moreover, he considered that some of the responses used to illustrate a lack of capacity on Z’s part could just as easily be interpreted to have shown naivety, immaturity, diffidence, or embarrassment, which, as explained above, did not necessarily evidence a lack of capacity. While admitting that expert opinion in these cases would often likely be of considerable importance, Cobb J’s approach was to weigh the expert evidence against his findings on other evidence, particularly his own assessment of Z when she gave evidence in court herself.

The weight accorded by Cobb J to Z’s performance in court cannot be understated. Contradicting Dr Rippon’s scepticism about Z’s ability to understand the evidence to be given in court, and to use the information to instruct her counsel appropriately, Cobb J believed that Z showed a high degree of attention to the evidence, gave instructions to her counsel, and answered questions well. Moreover, he was of the opinion that Z ‘impressed as someone who was more than just aware that “people should treat you with respect”, apparently mindful that people had not done so in the past’. These two personal assessments on Cobb J’s part about Z were crucial to his finding that the presumption of capacity had not been rebutted by the local authority in the case.

Cobb J’s approach is consistent with Baker J’s decision in *CC v KK*. In that case, Baker J explained in detail the approach that a court must take in considering evidence in an assessment of capacity. This includes considering not only the views of the independent expert, but all evidence, such as: evidence from other clinicians and professionals who have treated and worked with the patient, evidence from family and friends, and direct evidence from the patient herself if available. The underlying rationale is to guard against what was described in *CC v KK* as the ‘protection imperative’, namely the possibility that professionals and the court may be unduly influenced by the desire to protect a vulnerable person and be drawn towards an outcome that is more protective, thus failing to carry out a ‘detached and objective’ assessment of capacity.

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22 *WBC v Z, X, Y* (n 1) [41].
23 ibid.
24 ibid [64].
25 *CC v KK* (n 5) [24].
26 ibid [25].
is not to say that direct evidence from the person in the proceedings must automatically be given primary importance. After all, one’s performance in court may not always be a reliable indicator of one’s capacity to make decisions regarding many other areas of life. The point is that, instead of invariably according priority to expert opinion, a court must pay due regard to all available evidence in order to reach a satisfactory decision as to capacity.

CONCLUSION: A ROBUST RESTATEMENT OF THE PRESUMPTION OF CAPACITY

The judgment of *WBC v Z, X, Y* is significant in that it comprehensively summarises the statutory principles required by the MCA 2005 to be applied in an assessment of capacity, as well as the supplementary principles developed in the case law. These principles include: only requiring that individuals are able to use or weigh the *salient* factors in their decision-making process, separating the assessment of capacity from a judgment of ‘good’ or ‘bad’ decisions, and not giving undue deference to expert opinion. These are all important in establishing a robust presumption of capacity, which, in turn, is crucial to protecting individuals’ autonomy. As Cobb J concluded in his judgment, while it might be tempting for a court to take a paternalistic or overly risk-adverse approach to cases involving vulnerable individuals such as Z, it would have been ‘unprincipled and wrong’ to do so.\(^{27}\)

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\(^{27}\) *WBC v Z, X, Y* (n 1) [70].
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The Status of Natural or Legal Persons According to the Annulment Procedure Post-Lisbon

Magdalena Kucko*

ABSTRACT

In 2007, the Lisbon Treaty introduced changes to private parties’ rights to file actions for annulment of European Union measures. As pre-Lisbon, it was exceedingly difficult for private parties to succeed in filing such an action, the aim of the new Article 263 TFEU was primarily to relax standing conditions for these actors. However, as the new provision contained terms that were not defined anywhere else in the Treaty, it took several decisions of the European Court of Justice to clarify the position of private parties under Lisbon. By analysing both the pre- and post- Lisbon case law of the European Court of Justice, this article identifies that the new Article 263 TFEU now contains two different standing tests: the 'general standing test' for legislative acts where applicants have to prove direct and individual concern, and the 'Lisbon test' of direct concern for regulatory acts that do not contain implementing measures. It concludes that, while the Lisbon Treaty has made it easier for natural or legal persons to challenge non-legislative acts of general application, the status of private parties wishing to challenge European Union acts that have been adopted under the ordinary legislative procedure has remained unchanged.

INTRODUCTION

Article 6 of the European Convention on Human Rights and Fundamental Freedoms lays down the fundamental right to an effective legal remedy. This right has furthermore been included in the Charter of Fundamental Rights of
the European Union,¹ and because of its importance, it has also found its way into the Treaty on the Functioning of the European Union (TFEU).²

As the European Union (EU) develops its policy through regulations, directives and decisions, it can effectively be regarded as having a fully functioning legal system. It is vital for an institution with such pervasive legislative power to contain a mechanism for testing the legality of its measures, and the principal TFEU provision through which this can be done is the annulment procedure codified in Article 263 TFEU.³

Apart from providing European institutions with the right to challenge the legality of EU acts, Article 263 TFEU also grants natural and legal persons, i.e. the so-called ‘non-privileged’ applicants listed in Article 263(4) TFEU, the right to file actions for annulment. According to Article 263(4) TFEU, non-privileged applicants are only allowed to bring an annulment action if they are either (1) addressees of the act; (2) the act in question is of direct and individual concern to them; or (3) against a regulatory act which is of direct concern to them and does not entail implementing measures.

The Lisbon Treaty introduced the aforementioned third type of case in which private parties can bring an action for annulment by removing the requirement for individual concern when it comes to challenging regulatory acts which do not entail implementing measures.⁴ Pre-Lisbon, private parties could traditionally only challenge acts to which they were not addressees if they were able to prove ‘direct and individual concern’ – and it was the requirement of individual concern as interpreted by the Court of Justice of the European Union (the Court) that made it ‘exceedingly difficult’ for them to prove their locus standi pursuant to the old Article 230 E.C.⁵ Namely, in the Plaumann ruling from the early 1960s, the Court developed a highly restrictive test for establishing a private party’s individual concern.⁶ The Plaumann formula, which will inter alia be discussed in this paper, has been severely criticised for making economically

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arbitrary distinctions and for favouring private interests over public ones.\textsuperscript{7} Even though some attempts were made to alleviate the threshold set by \textit{Plaumann}, the formula has remained unchanged until present time.\textsuperscript{8} It was nevertheless the aim of the Lisbon Treaty to, as the Court put it, ‘relax’ the admissibility conditions of the annulment action for natural and legal persons by removing the requirement of individual concern for regulatory acts that do not contain implementing measures.\textsuperscript{9} Unfortunately, the wording of the new provision does not provide us with much clarity, as the precise meaning of both the term ‘regulatory act’ and the expression ‘act which does not contain implementing measures’ has not been defined in the Lisbon Treaty.

In this article, I offer an interpretation of the status of natural or legal persons according to the new Article 263 TFEU as enacted by the Lisbon Treaty. The paper will seek to answer the question as to whether the new provision has successfully managed to make it easier for private parties to file an action for annulment of a EU measure. In order to do so, it will first provide a brief explanation of Article 263 TFEU itself. Then, the pre-Lisbon status of natural or legal persons will be analysed by looking at the old Treaty Articles and case law. Finally, in order to reach a conclusion as to the post-Lisbon status of private parties, the meaning of the new provision will be explained in the light of recent cases.

I. ARTICLE 263 TFEU

Article 263 TFEU gives the Court the power to review the legality of acts of European institutions such as the Council, Commission and the European Central Bank (ECB) other than recommendations and opinions. Acts of the European Parliament (Parliament), the European Council and other EU bodies, offices or agencies can also be reviewed, but only if they are intended to produce legal effects vis-à-vis third parties.

Pursuant to Article 263(2) TFEU, there are four grounds on the basis of which the aforementioned acts can be annulled, namely lack of competence, infringement of an essential procedural requirement, infringement of the Treaties or of any rule of law relating to their application, and misuse of power.


Article 263(2) TFEU stipulates that an action for annulment can be brought by Member States, the Parliament, the Council or the Commission. Given the absence of any words of limitation, it is clear that these applicants have unlimited standing to challenge a measure – they are the so-called ‘privileged’ applicants who are always allowed to bring actions for annulment.\(^\text{10}\) The Court of Auditors, the ECB and the Committee of Regions – the ‘semi-privileged’ applicants – are mentioned in Article 263(3) TFEU, which gives them standing only to protect their own institutional prerogatives.\(^\text{11}\)

As mentioned above, 263(4) TFEU also grants natural or legal persons the right to file actions for annulment. They may do so under the conditions laid down in Article 263(1) and (2) TFEU, meaning that they can only seek to annul acts enacted by one of the institutions listed in Article 263(1) TFEU and only on the basis of one of the grounds mentioned in Article 263(2) TFEU.

Furthermore, all applicants must adhere to the time limit of two months after publication of the measure in question set in Article 263(6) TFEU.\(^\text{12}\)

If an annulment action is well-founded, the Court will declare the act void according to Article 264 TFEU, even though it is possible that only part of the measure will be affected by the illegality ruling.\(^\text{13}\) Nullity is retroactive, thus an act annulled under Article 264 TFEU is considered as having been void \textit{ab initio},\(^\text{14}\) and such a ruling has an effect \textit{erga omnes} by binding all national courts in the EU.\(^\text{15}\)

II. PRE-LISBON SITUATION

The EEC and EC Articles

\(^{10}\) Paul Craig and Gráinne de Búrca (n 3) 514; Chalmers, Davies and Monti (n 7) 413, 397.

\(^{11}\) Damian Chalmers, Gareth Davies and Giorgio Monti (n 7) 397.


\(^{13}\) Treaty on the Functioning of the European Union, Art. 264(2).


The right of natural and legal persons to file an action for annulment was first enshrined in Article 173(2) of the Treaty establishing the European Economic Community (EEC). Article 173(1) EEC gave the Court the competence to review acts ‘other than recommendations or opinions of the Council and Commission’. It then went on to mention Member States, the European Council and the European Commission as applicants who can file appeals on the grounds of ‘incompetence, of errors in substantial form, of infringement of the Treaty or of any legal provision relating to its application, or of abuse of power’.

Article 173(2) EEC provides that ‘[a]ny natural or legal person may, under the same conditions, appeal against a decision which, although in the form of a regulation or a decision addressed to another person, is of direct and individual concern to him.’

With the entry into force of the Treaty establishing the European Community (EC), the annulment procedure was codified in Article 230 EC. There were no substantial changes in the wording of the Article, except that now acts of the European Parliament and the ECB could also be subject to review by the Court. The European Parliament was given the status of privileged applicant together with the Member States, Council and Commission, while the Court of Auditors and the ECB could now file actions for annulment as semi-privileged applicants under Article 230(3) EC.

Article 230(4) EC read as follows:

Any natural or legal person may, under the same conditions, institute proceedings against a decision addressed to that person or against a decision which, although in the form of a regulation or a decision addressed to another person, is of direct and individual concern to the former.

Thus, prior to the entry into force of the Lisbon Treaty on 1 December 2009, it was only possible for private parties to bring an action for annulment against EEC/EC measures that were of ‘direct and individual’ concern to them. The exact meaning of these terms was provided by the Court and will be discussed now.

Direct Concern
As historically, individual concern has been the greater obstacle to *locus standi* for non-privileged applicants, the case law on direct concern has remained limited. This may change in the future, as when it comes to regulatory acts enshrined in the new Article 263 TFEU, the test of individual concern has been removed, meaning that for this type of measures the direct concern test is the only requirement that private parties need to satisfy. More jurisprudence on this matter is therefore to be expected.  

Direct concern has two dimensions. Firstly, there needs to be a direct, causal link between the act that is being challenged and the damage the applicant has suffered. This essentially means that the measure must directly affect the legal situation of the applicant and no discretion is to be left to the addressees of the measure entrusted with its implementation. The implementation must be ‘purely’ automatic and result directly from EU rules – no other transitional rules can apply. If a margin of discretion is left to national authorities with regard to the implementation of a measure, the chain of causation will be broken, as in such a situation it can be argued that it is in fact the national measure that caused damage to the applicant. As was illustrated in cases such as the *International Fruit Case* and *Differdange*, in order to establish potential discretion, the Court will look whether the EU act at hand affords any leeway. Apart from this, it is vital to ascertain whether in practice, this discretion will actually be exercised by national authorities. For example, in *Piraiki-Pitraki*, the Court ruled that after having obtained Commission authorisation to continue a pre-existing regime restricting cotton imports from Greece, ‘there was no more than a theoretical possibility’ that France would not proceed in applying it. Therefore, the Commission authorisation legalising the national regime in question directly concerned the Greek cotton exporters who had sought to annul it.

Secondly, the interest affected by the EU measure in question must be of legal nature. If the measure infringes on a particular interest that has not been recognised by the Court as a legally protected interest, the applicant in question will not be able to prove direct concern. The *Front National* decision provides us with a good example of the Court’s approach in this respect. The issue in this case was that a number of independent MEPs, including several members of the

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16 Damian Chalmers, Gareth Davies and Giorgio Monti (n 7) 415.
17 ibid 416; Paul Craig and Gráinne de Búrca (n 3) 515.
21 Damian Chalmers, Gareth Davies and Giorgio Monti (n 7) 417.
French far-right political party Front National, did not belong to any political group in the Parliament. The MEPs attempted to establish a mixed ‘TDI’ group but Parliament refused to grant it group status. This decision was then challenged both by the independent MEPs individually and the Front National itself. Front National was held not to have direct concern because no legal right was directly infringed by the Parliament’s act: Front National had no legal right to form its own group or to join another group.\textsuperscript{22}

**Individual Concern**

*The Plaumann Formula*

The second part of the test that individual applicants had to pass is that of individual concern as defined in *Plaumann*. In 1961, the German authorities requested Commission authorisation for suspension of collection of duties on clementines imported from non-member states. The Commission refused to grant authorisation and addressed its refusal to the German Government. The applicant, an importer of clementines, contested the legality of the Commission’s decision. As the decision had not been addressed directly to Mr Plaumann, he had to demonstrate individual concern, but the Court ruled that the applicant had no *locus standi*. In doing so, it developed a formula that would remain in use until the present day.

According to the decision in *Plaumann*:

>[P]ersons other than those to whom a decision is addressed may only claim to be individually concerned if that decision affects them by reason of certain attributes which are peculiar to them or by reason of circumstances in which they are differentiated from all other persons and by virtue of these factors distinguishes them individually just as in the case of the person addressed’.\textsuperscript{23}

It is necessary that these attributes or circumstances are fixed and determinate and that they distinguish members from the rest.\textsuperscript{24}

\textsuperscript{22} Case C-486/01 *Front National v European Parliament* [2004] ECR I-6289. See also Case C-15/06 *Regione Siciliana v Commission* [2007] ECR I-2591.


\textsuperscript{24} Damian Chalmers, Gareth Davies and Giorgio Monti (n 7) 418.
When applying the Plaumann test that will determine whether this is the case, regard must be had as to whether, at any certain date in the future, there is a possibility that the group in question will no longer be fixed and determinate.\textsuperscript{25} In Plaumann, the Court effectively adopted this test by ruling that any of us could, in theory, become clementine importers in the future, and that therefore, Mr. Plaumann could not be distinguished from others.

In this respect, one could also make a distinction between open and closed (‘fixed’) categories of applicants. A category can be regarded as an open one when its membership has not been fixed at the time of the decision. A closed category is one where membership is thus fixed. Individual concern can only be claimed in this second case.\textsuperscript{26}

The Plaumann Formula: Regulations and Directives

In Plaumann, an action for annulment was filed against a decision addressed to another. However, pre-Lisbon, there were also cases in which applicants tried to prove individual concern for legal acts that took the form of a regulation or directive. While the text of the old Article 230(4) EC was ambiguous as to whether private parties could challenge the validity of regulations or directives, prior to the entry into force of the Lisbon Treaty, the Court had established that such persons could in principle challenge the legality of a directive. Still, the applicant had to satisfy the strict Plaumann requirement of individual concern.\textsuperscript{27}

When it comes to challenging regulations, the pre-Lisbon situation was more complicated. Initially, there were two tests in case law: the closed category test and the abstract terminology test.\textsuperscript{28} Eventually, the Court adopted the stricter abstract terminology test as exemplified in Calpak and a number of other judgments.\textsuperscript{29} According to Calpak, a regulation could be regarded as a ‘true

\textsuperscript{25} Paul Craig and Gráinne de Búrca (n 3) 520.


regulation’ only if it applied to ‘objectively determined situations and if it produced legal effects with regard to categories of persons described in a generalised and abstract manner’.\(^{30}\) If a regulation was found to be a ‘true regulation’ then the Court would conclude that the applicant was not individually concerned. \(^{31}\)

However, in *Cordoniu* the Court overturned this position by ruling that even if, upon application of the abstract terminology test, a regulation was to be regarded as a ‘true regulation’, it could nevertheless be of individual concern to the applicant. \(^{32}\) Just as in the case of directives, the applicant then had to satisfy the *Plaumann* test. It can thus be said that the dominant approach of the Court post-*Cordoniu* was ‘pure *Plaumann*’. \(^{33}\)

### Criticism and Attempts to Change the *Plaumann* Doctrine

The *Plaumann* test provoked much discussion in the literature, most of it critical. \(^{34}\) The main concerns about the *Plaumann* formula were that the wording of the Treaty did not satisfy such a strict standing test, and that it essentially prevented private parties from exercising their right to judicial redress. From this, it followed that the right to effective remedy was not sufficiently guaranteed in the EU legal system. \(^{35}\)

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Throughout the years, the Court defended its controversial rulings on the ground that applicants who did not have locus standi under Article 230 EC could always seek judicial protection by indirectly challenging a measure in national courts as provided for in Article 234 EC (now 267 TFEU). It has been argued that it was mainly the Court’s fear of opening the floodgates to litigation, together with a desire not to obstruct the EC institutions in their task of implementing Community policies, which led to such a limitative interpretation of first Article 173 EEC and later Article 230 EC.  

In Extramet, Advocate General Jacobs devoted several paragraphs of his Opinion to questioning the Court’s reasoning. However, his biggest attack on the Plaumann formula would come later, in Unión de Pequeños Agricultores (UPA). This case concerned a Spanish trade association representing small agricultural producers who challenged a Council regulation which discontinued certain types of agricultural aid for small producers. Under the Plaumann test, the applicants could not demonstrate individual concern given that they were members of an open category of people. Advocate General Jacobs proposed a new test that would render an applicant individually concerned where a EU measure ‘has or is liable to have, a substantial adverse effect on his interests’. He thus shifted the focus from a formalistic test to one based on the economic impact of the EU measure. The core of Advocate General Jacobs’s Opinion was the stance that it is not automatic that a private applicant who does not have locus standi to bring an annulment action can always obtain a remedy by bringing an action before a national court that will then make a reference on validity to the Court: the national court may simply decide not to do so.

The General Court followed Advocate General Jacobs’s Opinion in Jégo-Quéré v Commission and proposed a further relaxation of the Plaumann formula. In Jégo-Quéré, the General Court stated that:

[I]n order to ensure effective judicial protection for individuals, a natural or legal person is to be regarded as individually concerned by a Community measure of general application that concerns him directly if the measure in question affects his legal position, in a manner which is both definite and immediate, by restricting his rights or by imposing obligations on him. The number and


39 Catherine Barnard and Steve Peers (eds), European Union Law (OUP 2014) 274.
40 Case C-50/00 UPA [2002] ECR I-6677, Opinion of AG Jacobs, paras. 36-49.
position of other persons who are likewise affected by the measure, or who may be so, are of no relevance in that regard.  

Unfortunately, when UPA came before the Court, it chose not to follow Advocate General Jacobs’s advice, but instead to insist on the Plaumann test. The Court also overturned the General Court’s ruling in Jégo-Quéré on appeal. In both cases, it stated that any potential reform must come from the Member States themselves instead of the Court. It should be noted, though, that in its Report to the 1996 Intergovernmental Conference (May 1995) preceding the adoption of the Amsterdam Treaty, the Court expressed its own doubts about the present law on standing:

It may be asked ...) whether the right to bring an action for annulment under Article 173 [later 230] of the EC Treaty, which individuals enjoy only in regard to acts of direct and individual concern, is sufficient to guarantee for them effective judicial protection against possible infringements of their fundamental rights arising from the legislative activity of the institutions.

However, amendments to the wording of the Treaty provision concerning the annulment procedure were only made nine years later with the adoption of the Lisbon Treaty and the new Article 263 TFEU.

III. POST-LISBON SITUATION

A New Article 263 TFEU

The Lisbon Treaty finally succeeded in modifying the original standing rules applicable to natural or legal persons. By adopting the wording of Article III-365 of the ill-fated Constitutional Treaty, the Lisbon Treaty introduced two amendments to the old Article 230 EC. Firstly, Article 263(4) TFEU states that

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44 ibid para 31; Case C-50/00 Unión de Pequeños Agricultores v Council [2002] ECR I-6677, para. 45.
‘any natural or legal person may ... institute proceedings against an act addressed to that person or which is of direct and individual concern to them’, thus replacing the old formulation according to which individuals were able to challenge a decision addressed to them or a decision, ‘which, although in the form of a regulation’ was of direct and individual concern to them. This amendment can be seen as the result of a yearlong court practice according to which, as was noted above, the test of direct and individual concern was also used to test the legality of regulations and directives. In addition, the amendment removed the requirement of individual concern for regulatory acts that are of direct concern and do not entail implementing measures. In order to assess the significance of this amendment, the terms ‘regulatory act’ and ‘implementing measure’ need to be analysed.

**Regulatory Act**

Initially, the meaning of the term ‘regulatory act’ was unclear. While the TFEU makes a clear distinction between legislative and non-legislative acts, with legislative acts comprising regulations, directives and decisions, and non-legislative acts being delegated and implementing acts, the Treaty does not provide any definition of the term ‘regulatory act’. In the absence of case law on the matter, the Future of Europe Convention that preceded the failed Constitutional Treaty provided some guidelines. The Final Report of the Discussion Circle, in discussing the standing requirements for natural or legal persons, expressed the view that the words ‘a regulatory act’ should be inserted into the new article, which would distinguish ‘legislative’ from ‘regulatory’ acts and adopt a ‘more open’ approach towards private individuals who challenge regulatory acts.

While the Final Report suggests that regulatory acts were intended to mean the same as non-legislative acts, it was non-binding and in any case concerned the Constitutional Treaty rather than the Lisbon Treaty. It was only after case law on the matter that the meaning of the term was settled.

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49 ibid Arts. 290-91.

Inuit I & II

The first opportunity for the General Court to interpret the meaning of the words ‘regulatory act’ arose in Inuit Tapiriit Kanatami and Others v European Parliament and Council (Inuit I),\(^ {51}\) followed by Microban v Commission.\(^ {52}\)

In Inuit I, Inuit Tapiriit Kanatami, an association representing Canadian Inuits and a number of other companies involved in the manufacturing of seal products, filed an action for annulment against a Parliament and Council regulation – adopted under the ordinary legislative procedure – which imposed restrictions on the import of these products into the EU. The applicants claimed that the regulation in question was to be regarded as a regulatory act, and that there was therefore no need to show individual concern. The General Court however, referring to the drafting history of the Constitutional Treaty,\(^ {53}\) defined a ‘regulatory act’ as an act ‘of general application apart from legislative acts’.\(^ {54}\) It follows that the term is applicable only to non-legislative acts, for example (but not exclusively) general implementing and delegated acts covered by Articles 290 and 291 TFEU. On the other hand, legislative acts (regulations, directives and decisions) do not fall within this definition and are subject not only the test of direct concern but also to the stricter Plaumann test of individual concern.\(^ {55}\)

As the act challenged in Inuit I was a legislative regulation, the General Court concluded that the general standing test (direct and individual concern) had to be applied. The result was that the applicants were denied locus standi, due mostly to the fact that they failed to pass the Plaumann test.

The General Court’s decision in Inuit I was appealed before the Court of Justice in Inuit II,\(^ {56}\) however the Court confirmed the lower court’s interpretation of ‘regulatory act’. It stated that ‘the concept of “regulatory act” provided for in the fourth paragraph of Article 263 TFEU does not encompass legislative acts.’\(^ {57}\) The Court also held that the new Treaty provision was in line with Article 47 of the Charter of Fundamental Rights of the European Union,


\(^{54}\) Catherine Barnard and Steve Peers (eds) (n 40) 276.


\(^{56}\) ibid para. 56.

\(^{57}\) ibid para. 61.
thus providing a complete system of legal protection based on a combination of Articles 263 and 267 TFEU.\(^{58}\) In addition, it ruled that the test for direct concern remained unchanged post-Lisbon by overruling the General Court’s attempt to restrictively interpret this requirement.\(^{59}\)

*Microban v Commission*

Several weeks after it had determined the scope of ‘regulatory act’ in *Inuit I*, the General Court delivered its decision in *Microban v Commission*.\(^{60}\) This was the first judgment in which the Lisbon Treaty exception was fully satisfied in a situation where the applicant would otherwise not have passed the general test of standing due to lack of individual concern. In *Microban*, an American producer of antibacterial additives brought an action for annulment against a Commission decision addressed to the Member States. The decision removed triclosan, a chemical substance, from the list of additives that could be used in the manufacture of plastics intended for the packaging of food products, which had been summed up in a previous Commission directive. The decision in question was an implementing act.

Applying *Inuit*, the General Court found that the Commission decision was (a) a non-legislative act of general application and thus a regulatory act and (b) of direct concern to the applicant as it directly affected the applicant’s legal status, and clearly no discretion over its implementation was left to the Member States since it imposed a direct prohibition on the use of triclosan. It then addressed the issue of direct concern by emphasising that the interpretation of direct concern under the Lisbon Treaty would remain the same as pre-Lisbon.\(^{61}\) Finally, the Court recognised the applicant’s standing and annulled the Commission decision on the grounds that it had no legal basis and that it breached a procedural requirement.\(^{62}\)

Although the judgment in *Microban* demonstrated how the new test developed under the Lisbon Treaty could benefit natural or legal persons, it did little to clarify the meaning of the injunction that the regulatory act must ‘not entail implementing measures’. However, it did not take long before the courts interpreted this requirement as well.

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\(^{58}\) ibid paras. 48-51.

\(^{59}\) ibid paras. 64, 66.


\(^{61}\) ibid paras. 21-32.

\(^{62}\) ibid para. 69.
Implementing Measures

In reading Article 263(4) TFEU, it is clear that even if the impugned act can be categorised as a regulatory act, if implementing measures are present, then the exception will not apply and the applicant will again need to resort to the Plaumann formula. Three recent cases elucidate the meaning of ‘implementing measures’.

*Palirria Souliotis v Commission*

In *Palirria Souliotis v Commission*, the General Court held that the direct concern test referring to the absence of the addressee’s discretion is different from the requirement set in Article 263(4) TFEU that the regulatory act in question cannot entail implementing measures. This would form the starting point for the judgments in the following two cases.

*Telefónica v Commission*

The *Telefónica v Commission* case was the first to shed light on the meaning of the expression ‘implementing measures’. The case concerned a Commission decision declaring that a Spanish financial aid scheme constituted illegal state aid. The Spanish government was required to recover the aid that was incompatible with the common market, and Telefónica SA, a company which had profited from the scheme, filed an action for annulment against the Commission’s decision.

In its ruling, the Court stated that the question whether a regulatory act entails implementing measures should be assessed by reference to the position of the person invoking the right to bring proceedings under Article 263(4) TFEU. It was irrelevant whether the impugned act entailed implementing

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63 Paul Craig and Gráinne de Búrca (n 3) 530.
65 Case C-274/12 P *Telefónica S.A v Commission* [2013] ECR EU:C:2013:852.
measures ‘with regard to other persons’.66 The Court went on to explain that when determining whether the measure in question entails implementing measures, reference should be made solely to the subject matter of the annulment action, and where only partial annulment of an act is sought, only the implementing measures which that specific part entails must be taken into account.67 The Court made clear that the absence of implementing measures equals the absence of any measure to be taken by the addressee of the measure (that is, the Member State) that could generate ‘specific consequences’ for the applicant.68

Ultimately, the Court rejected the application on the ground that the contested decision entailed implementing measures in Spain with regard to Telefónica SA.69 Specifically, the contested decision simply declared the financial scheme in question to be inconsonant with the common market and did not contain any ‘specific consequences’ for each taxpayer. Those consequences had to be embodied in several administrative documents, which constituted ‘implementing measures’ as codified in Article 263(4) TFEU.70

The Court highlighted that even though in this case, action under Article 263 TFEU was not possible, the applicant could still bring the contested decision before a national court, which could then start a preliminary ruling procedure pursuant to Article 267 TFEU.71

**T & L Sugars v Commission**

Most recently, in April 2015, the Court in *T & L Sugars and Sidul Açúcares v Commission* provided further clarification as to the expression ‘an act which does not contain implementing measures’.72 The applicants in this case were a group of cane sugar refiners established in the EU. In order to increase the sugar supply to the EU market (which was experiencing a shortage at the time), the Commission adopted several regulations. The purpose of these measures was (i) to allow European Union producers to market a limited quantity of sugar in excess of the domestic production quota, and (ii) to introduce a tariff quota

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66 ibid para 30.
67 ibid para 31.
68 ibid para 35; Catherine Barnard and Steve Peers (eds) (n 40) 277.
70 ibid para 35.
71 ibid para 59.
allowing economic operators concerned to import certain quantities of sugar without having to pay import duties. The applicants were negatively affected by these regulations and filed an action for annulment before the General Court. As it was clear to the applicants that it would be impossible to prove individual concern, they sought to challenge the regulations on the basis of direct concern, which involved showing that the regulatory acts in question entailed no implementing measures. The General Court declared the action for annulment inadmissible.73 On appeal, the applicants submitted that the Commission determined every detail of the contested regulations, while the Member States functioned merely as ‘mail boxes’. According to the applicants, the General Court erred when holding that even ‘automatic’ or ‘merely ancillary’ measures adopted by Member States under a EU regulation constitute decisions ‘implementing’ that regulation. They asserted that the existence of discretion should be taken into account when determining whether a Member State measure taken under the EU act in fact adds anything to that act.74

The Court of Justice upheld the General Court’s decision. It first reiterated its reasoning from Telefónica by stating that when determining whether a regulatory act entails implementing measures, reference should be had to the position of the applicant, and that it is irrelevant whether the act contains implementing measures with regard to others.75 It then found that the regulatory acts in question only produced legal effects vis-à-vis the applicants through the intermediary of acts taken by the national authorities. In this case, the regulations in question required the applicants to apply for certain certificates, and according to the Court, the decisions of national authorities in granting or denying such certificates constituted implementing measures within the meaning of Article 263(4) TFEU. The Court emphasised that the ‘mechanical’ nature of the required measures at national level did not call such a conclusion into question.76 As in Telefónica, the Court noted that the route of Article 267 TFEU remained open to the applicants.77

CONCLUSION

When the new Article 263(4) TFEU was enacted under the Lisbon Treaty, its

73 ibid paras. 4-12.
74 ibid paras. 18-20.
75 ibid para. 32.
76 ibid paras. 40-41.
77 ibid paras. 40-41.
practical implications for natural or legal persons were unclear. Pre-Lisbon, the Court had developed a clear pattern of case law where, in order to be admissible before the Court, applicants filing an annulment procedure had to comply with the requirements of direct concern and the strict Plaumann formula establishing individual concern. By being highly restrictive, the Plaumann test rendered it practically impossible for many private parties to be admissible before the Court. The criticism that this formula triggered led to the adoption of a new article under the Lisbon Treaty, which removed the requirement of individual concern for regulatory acts that are of direct concern and do not entail implementing measures. In order for an act not to have to pass the Plaumann test, it is therefore essential that it is both of a regulatory nature and that it does not contain any implementing measures – if one of these two requirements is not satisfied, individual concern will have to be proven after all.

The meaning of the term ‘regulatory act’ was clarified in Innit and Microban. It is now clear that it encompasses acts of general application apart from legislative acts, thus excluding legislative acts (directives, regulations and decisions enacted according to the ordinary legislative procedure) from its coverage. Telefónica and S & L Sugars further explained the meaning of the expression ‘act which does not contain implementing measures’. It is now clear that the question whether a regulatory act entails implementing measures should be assessed exclusively by reference to the subject matter of the annulment action and the person using the right to bring these proceedings under Article 263(4) TFEU. The requirement of absence of implementing measures equals the absence of any implementing measures taken by Member States, meaning that even measures that are automatic or merely ancillary will fall under this definition.

Thus, Article 263 TFEU now entails two standing tests: the ‘general standing test’ for legislative acts where applicants have to prove direct and individual concern, and the ‘Lisbon test’ of direct concern for regulatory acts that do not contain implementing measures.

It can be concluded that the Lisbon Treaty has made it easier for natural or legal persons to challenge non-legislative acts of general application. This means that private parties will now have more chances to successfully challenge measures of the Commission that were enacted in cases where the Parliament does not exercise its direct democratic power. The Microban case provides a good example in this respect. However, as Telefónica and S & L Sugars have shown, applicants wishing to subject regulatory acts to judicial review will also have to prove that no implementing measures took place in Member States, which can sometimes be harder than expected. Nothing, however, has changed with regard to acts adopted under the ordinary legislative procedure, as when it comes to these measures, the Plaumann formula has remained in force. To that
end, natural or legal persons who have been significantly affected by such legislative measures and have good reasons for questioning their legality, will in most cases not be able to file annulment actions for the sole reason that they are unable to satisfy the strict test of individual concern. It remains to be seen whether any future treaty will bring change in this respect.