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WHERE SHOULD WAR CRIMES BE PROSECUTED?

Political and military leaders should be subject to trial in England for alleged war crimes committed abroad. This unequivocal and controversial contention was the subject of a keenly contested debate at the IALS on May 27, with Philippe Sands QC, Joel Bennathan QC and Alex Bates speaking for the motion, and Iain Morley QC, Jonathan Kirk QC and Rodney Dixon opposing it. Speakers were allowed eight minutes, and the event was chaired by Joshua Rosenberg, the former BBC Legal Correspondent and legal commentator who is also a trained lawyer.

Philippe Sands affirmed his support for the principle of universal jurisdiction, under which any person allegedly engaged in war crimes anywhere in the world can be subject to proceedings in any country, including England. He said the world changed in the 1940s when the Geneva Conventions and the Genocide Convention were put place, and exceptions to the universal jurisdiction principle must not be made on the grounds that the states involved are considered to be friendly, or too powerful to antagonise.

A contrary position was taken by Iain Morley, who also said the world had changed – but in 1989 when the Berlin Wall came down and led to the disintegration of the Soviet Union. A new order emerged where ad hoc international tribunals dealt with atrocities that had taken place under regimes in countries including Rwanda, Sierra Leone, the former Yugoslavia and Cambodia (the latter still being in progress). Procedure and case precedents developed in consequence. It is better to make such trials international in nature than attempt to adjudicate in England on events that took place abroad with the all the difficulties involved in trying to establish the facts.

Supporting the motion, Joel Bennathan raised the issue of the UN-commissioned Goldstone Report into the Israeli incursion into Gaza which included amongst its findings the accusation that Israel committed actions amounting to war crimes. Israel is not a state party to the International Criminal Court and the events will not be referred there, so there is no chance of any Israeli facing an international tribunal in connection with the Goldstone findings.

In contrast, Jonathan Kirk took the view that no system of universal justice could ignore the realities of politics. The international ramifications of, for example, prosecuting George W Bush or Tony Blair in England would be enormous. He postulated that universal jurisdiction could have led to war crimes charges being brought against Churchill over Dresden and Munich, and Roosevelt over the dropping of the atomic bomb.

Alex Bates felt that the issue should not be addressed as an "either or" argument. Under the principle of complementarity the ICC should complement, rather than displace, domestic justice systems capable of prosecuting war crimes. A number of mechanisms were needed because limitations existed (for example the ICC cannot act on crimes which took place after 2002 and has restrictions on its jurisdiction).

He contended that international tribunals tend to go after the "big fish", and national courts have a role to play in prosecuting other important participants in war crimes. Universal jurisdiction can plug this particular gap. Furthermore, England has a strong history of participating in the prosecution of serious international crimes; offers a fair, speedy and relatively cost effective system of justice; has a contribution to make as a responsible member of the international community; and is in any event obliged to act in accordance with its international legal obligations under the Geneva Conventions etc.

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Alex Dixon observed that the debate was not a new one, and universal jurisdiction has always tended to be influenced by the politics of the day. There were clear legal obstacles to prosecuting foreign leaders in the UK, and other barriers existed including national security considerations, the problem of obtaining a jury conviction, and immunity issues surrounding heads of state. Arguably the best way forward lay in adopting a more limited interpretation of the principle of universal jurisdiction.

Members of the audience contributed a number of observations and opinions which reflected a broad range of views. Sceptics felt that the practical difficulties posed by staging a trial in England for alleged war crimes committed elsewhere – including persuading witnesses to attend and juries to convict – could render the whole process pointless, always assuming that politics did not intervene first. Those at the other end of the spectrum felt that putting George W Bush and Tony Blair on trial at the Old Bailey over their involvement in the Iraq war would help to prevent such conflicts in the future.

One pragmatist observed that the whole debate was sterile because this country was bound by its international legal obligations and should conform to them. Some audience members also drew attention to the presence in England of a category of individuals who have fled countries where genocide has been committed and are suspected of involvement. They cannot be sent back, but are not being investigated and remain here in limbo. If sufficient evidence against them existed, they should be tried in England.

A further criticism of universal jurisdiction was that it could be used by, for example, Arab or African states to mount trials on their own soil in order to further an anti-Western political agenda by charging politicians, military personnel etc from England and other countries with alleged war crimes. This point was dealt with by Philippe Sands in his summing up, who said the West must accept the risk of such prosecutions occurring. No-one should be above the law – including George W Bush, who authorised the practice of "waterboarding" which plainly amounted to torture.

Joel Bannathan stressed that laws should serve people's moral values. Juries would convict in cases involving war crimes overseas if the evidence was strong enough. Concluding the debate, Iain Morley said that the ICC existed because of the problems experienced by national jurisdictions in bringing witnesses to court and persuading juries to convict. Arguments had shifted away from universal jurisdiction and now centred round the operation of the ICC.

The motion was carried.

Julian Harris

Deputy General Editor, Amicus Curiae

INSTITUTE OF ADVANCED LEGAL STUDIES IALS

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Reforming European financial supervision and the role of EU institutions

by Kern Alexander

INTRODUCTION

The growing integration of European financial markets and the financial crisis of 2007-09 have raised important questions concerning the institutional design of European financial supervision. Over 50 large financial institutions have significant cross-border operations in EU states, while wholesale capital markets are increasingly inter-connected across EU states through electronic exchanges and other complex trading systems. Over the last 10 years, EU financial legislation has grown dramatically in its scope of coverage and application to many areas of market practice. The implementation and enforcement of this legislation has been left ultimately to the discretion and authority of Member State supervisors based on the principle of home country control and mutual recognition. Although this legal and supervisory framework facilitated cross-border trade and investment across EU states, the adoption of the euro and the institutional consolidation of the Lamfalussy process has led to calls for further consolidation of supervisory practices at the EU level. Moreover, the recent financial crisis has demonstrated the importance of having a robust macro-prudential supervisory framework and micro-prudential supervisory regime with the objective of controlling systemic risk.

The European Commission has proposed a significant institutional restructuring of EU financial supervision that involves the creation of a European Systemic Risk Board to monitor macro-prudential risks and three EU supervisory authorities to adopt a regulatory code and to oversee Member States' micro-prudential supervision. The Commission proposals, if approved by Parliament, will lead to significant institutional consolidation at the EU level. This will bring important changes to the existing EU framework of financial supervision that is based on home country control and mutual recognition. It also has important implications for international supervisory and regulatory arrangements because the proposed EU financial supervisory authorities (ESAs) and ESRB are likely to play a significant role in setting the international regulatory agenda. The overarching philosophical rationale for designing the ESRB/ESA institutional structure is that systemic risk and financial instability create negative externalities in European financial markets and it is a necessary policy objective of the European Union institutions to control financial risks that can threaten the efficient operations of the internal market.

This article discusses generally how the growing integration of EU financial markets and the cross-border nature of systemic risk justify a more consolidated institutional model of EU financial supervision. In doing so, it will address some of the advantages and disadvantages of other models, including the proposal for a single EU supervisor. The nature of systemic risk in liberalised financial markets creates significant risks for supervisors and policymakers seeking to protect their economic and financial systems from the fallout of financial failure. This note suggests that the cross-border nature of European financial markets and consequently the cross-border risks posed by financial instability necessitate a re-examination of the institutional design of European financial supervision.

EUROPEAN FINANCIAL INTEGRATION AND SYSTEMIC RISK

The causes of the recent crisis have been attributed to macroeconomic factors, major weaknesses in corporate governance in financial institutions, and serious regulatory failings. The costs of the crisis for EU Member States have been enormous. In the UK, the cost of the crisis in terms of lost output and lower economic growth has been estimated at more than 19 per cent of UK GDP. It is evident that poorly regulated financial markets can lead to huge social costs for the broader economy and that these social costs in regional and globalised markets can be exported to other economies. Indeed, EU states are members of the European Union's internal market with free capital flows and fully liberalised trade in financial services which brings economic benefits but also social costs for the economies of EU states. For example, the collapse of the Royal Bank of Scotland demonstrated how

the risk-taking of a Member State bank can generate cross-border externalities to other EU countries and financial systems. It is essential therefore that Europe have a more comprehensive framework for regulating and controlling the social costs (otherwise known as "negative externalities") of financial risk-taking. These externalities can be transmitted more easily throughout EU financial markets because of the greater degree of financial integration in recent years due to financial liberalisation in the internal market.

A vast literature has emerged documenting the growing integration of European financial markets (Adam et al, 2002; Cabral et al, 2002; Barros et al, 2004; ECB 2008 & 2009; Commission 2009). Following adoption of the euro, there has been significant convergence in interest rate differentials in the wholesale banking and inter-bank markets. Although retail financial markets remain mostly fragmented, the cost of capital for equity and debt issuance has experienced a significant degree of convergence across EU states, while the composition of asset classes in most regulated investment funds has become less home-biased towards the domestic market. However, since the global financial crisis began in 2007, the 27 EU states have had wider dispersions in their cost of capital – the European Commission, *European Financial Integration Report 2009*, Brussels December 11, 2009, Commission Staff Working Document, p 4. The report also notes that the dispersions in cost of capital between EU countries began to converge more in the last half of 2009, presumably in response to the stock market's recovery in the second quarter of 2009.

The evolution of EU markets to more integrated structures based on liberalisation of capital restrictions and trade in financial services has been facilitated by the growing importance of the euro as a reserve currency and advances in technology that enable market participants to operate more easily in a cross-border environment. The challenge arising from the increasing integration of European and global financial markets and the recurrence of financial crises, such as the crisis that began in 2007, is how to strike the right institutional balance between EU institutions and Member States in the regulation and supervision of financial markets. (see Edy Wymeersch (2009), "The Structure of Financial Supervision in Europe: About Single Financial Supervisors, Twin Peaks and Multiple Financial Supervisors," *European Business Organization Law Review* 8: 237-306 (stating that "regulation" refers essentially to rule-making, while "supervision" involves applying the rules and judgment to a specific case). In the EU, most financial regulation is based in the Member State where the financial firm is incorporated or has a headquarters. Supervision is based on the principle of home country control in which the supervisor of the jurisdiction where the bank is chartered or incorporated exercises extraterritorial regulatory responsibility over the bank's EU operations. However, when an EU-based banking group has subsidiaries operating in other EU states, the supervision of those subsidiaries is exercised by the host state supervisor of the jurisdictions where the subsidiaries are incorporated.

The regulatory policy incentives of home country regulators are to protect the depositors and creditors of banks based in their home jurisdictions. This works as long as banking activities are largely confined to one country – normally the country where the bank is incorporated and has its home license. It has also worked well for banking groups which have fragmented management structures in which the management of foreign subsidiaries is largely autonomous from the day-to-day management of the parent group, hence allowing the foreign subsidiaries' management to deal independently with host state supervisors.

However, as global financial markets have become more inter-connected, the structure of banking markets and their management have changed significantly. Large banking groups have been created from a growing number of cross-border bank mergers. As a result, many banking groups today have major operations in multiple jurisdictions where they can pose systemic risk to a host state banking system. In addition, large banks are increasingly dependent on international capital markets for much of their funding. Banking groups are also progressively centralising a number of key functions at the group level. For instance, risk management, liquidity management, funding operations and credit control, are typically exercised at the group level or in specialised affiliates in order to gain economies of scale and synergies in specialist operations. This also has led to the distinction between branches and subsidiaries becoming blurred. For instance, it is no longer the case that a large subsidiary bank operating in one jurisdiction will be allowed to stay in business if its parent company bank defaults or fails in another jurisdiction (at least not for the short-run).

These market changes pose a number of challenges for the existing EU regulatory and supervisory framework. A financial crisis in Europe is now more likely to have substantial cross-border implications than the financial crises of the past. In response, the Commission has proposed several regulations that are now before Parliament and which build on the De Larosiere Commitee's Report in February 2009 that recommended increased institutional consolidation at the EU level to enhance micro-prudential supervision of cross-border financial institutions and macro-prudential surveillance of systemic risk in the broader EU financial system.

The home country control model

EU legislation has traditionally applied the principle of home country control to the cross-border operation of banks and other financial institutions, which holds that regulatory authority over banks that conduct activities through their branches in other member "countries" lies

with the competent authorities in the EU/EEA state where the institution's head office is incorporated: see Council Directive 89/299/EEC of the European Parliament and Council of April 17, 1989, OJ 1989 L 124, p 16; and Council Directive 89/646/EEC of the European Parliament and Council of December 15, 1989 (OJ 1989 L 386, p 1); Directive 2000/12/EC of the European Parliament and Council of March 20, 2000 relating to the taking up and pursuit of the business of credit institutions, OJ 20000 L 126, p 1. Reference should also be made to *Peter Paul and others v Federal Republic of Germany*, judgment of the Court of Justice of the European Communities, Case C-222/02, October 12, 2004 (recognising that Member State national authorities had a number of supervisory obligations pursuant to EU law vis-à-vis credit institutions and the exercise of those obligations throughout the Community based on the principle of home country control).

According to minimum harmonisation, Member States are required to harmonise what are considered to be the essential areas of banking regulation while being free to surpass these essential minimum standards and to maintain higher distinctive regulatory practices in areas not harmonised so long as they are pursuing valid public policy objectives and do not unnecessarily infringe on EC Treaty freedoms: see *Caixa-Bank France v Ministere de l' Economie, des Finances et de l' Industrie*, judgment of the Court of Justice of the European Communities, C-442/02, October 5, 2004 (invalidating a French legislative prohibition on the payment of interest for "sight" accounts for a French subsidiary of a holding company based in another EU state because it constituted an unnecessary restriction on freedom of establishment for the holding company, though the French government justified its prohibition on the grounds of consumer protection and promoting medium and long-term savings). The effective application of the home country principle based on minimum standards and mutual recognition is premised on the pursuit of common regulatory objectives and trust between regulatory authorities.

EC financial services Directives have traditionally adopted a functionalist approach to financial regulation by requiring the same type of activity to be subject to the same regulatory rules, even though the activity may be performed by different types of financial institutions (eg universal bank or investment bank): see First Banking Directive (1977), article 1; Second Banking Directive (1989), article 1(6). Moreover, EC legislation does not require Member States to adopt a particular institutional structure of financial regulation (although this has changed somewhat in the securities area, as EU states are now required to establish a single enforcement authority to enforce the Market Abuse Directive and a single listing authority for all issuers to file prospectuses under the Prospectus Directive. States may use a single regulator for prudential supervision (ie the UK FSA or German Bafin) or divide those responsibilities between two bodies, usually a central bank for prudential regulation and a capital market regulator for conduct of business (so-called "twin peaks" approach, as in the Netherlands), or a three-pillar institutional model (banking, insurance and securities) along sectoral lines. In some systems, the central bank plays an important role in overall prudential supervision and in regulating the clearing and settlement system (Italy), while in other countries a regulator or supervisor exercises these functions (the UK).

Nevertheless, the EU regulatory and supervisory framework of home country control based on mutual recognition and minimum standards has accomplished a great deal in promoting the objectives of the European internal market but has recently come under strain because of growing integration in key areas of European banking and capital markets and cross-border risk exposures. Indeed, the credit and financial crisis that began in 2007 demostrates the cross-border nature of systemic risk in global as well as EU financial markets through, for instance, counterparty exposures in the money markets and disruptions to the cross-border operations of many large banking groups and financial conglomerates. The crisis has demonstrated the inadequacy of the EU's existing supervisory and crisis management framework.

The Lamfalussy model and institutional consolidation

The role of EU Member State institutions in regulating financial markets has undergone significant changes as well in recent years. The EU Financial Services Action Plan (FSAP) recognised the Lamfalussy four-level framework as essential in achieving the EU Treaty objectives of an open internal market for capital movement and trade in financial services. The four levels consist of:(1) legislative proposals of high level principles through the traditional EU co-decision process; (2) based on the legislative proposals, EU finance ministers agree to implementing measures for Member States; (3) Member State regulators make proposals to Level 2 finance ministers regarding the implementing measures and then consult with each other regarding implementation; and (4) national compliance and enforcement (see Lamfalussy Committee, *The Final Report of the Committee of Wise Men on the Regulation of European Securities Markets*, February 15, 2001, Brussels). The process now applies to all major financial sectors, including banking, securities, insurance and pension fund management (Commission Decision 2001/527/EC (6 Jan 2001) (establishing Committee of European Securities Regulators); Commission Decision 2004/5/EC (5 Nov 2003)(establishing Committee of European Banking Supervisors); and Commission Decision 2004/6EC (establishing Committee of European Insurance and Operational Pensions Supervisors (CEIOPs)).

The three so-called Lamfalussy Level 3 networks presently consist of the Committee of European Securities Regulators (CESR), the Committee of European Banking

Supervisors (CEBS), and the Committee of European Insurance and Occupational Pensions Supervisors (CEIOPS). These three committees have been acting in a regulatory capacity and prior to the crisis were successful in expediting the regulatory standard-setting process by making it more flexible and efficient. The successful operation of the regulatory networks depends on cooperation and frequent contacts between Member State supervisors. To this end, the committees have begun a number of initiatives to increase cooperation and convergence; but the changing structures of financial markets necessitates further institutional coordination in the Level 3 committees to address the growing cross-border effects of financial crises and the cross-border activities of large financial groups.

The Lamfalussy programme does not create a legislative competence to supervise financial markets at the European level. Indeed, the original Report of the Committee of Wise Men in 2000 envisioned only two principal functions for the Level 3 committees: (1) technical advice regarding the development of implementing measures, and (2) promotion of consistent implementation of Community legislation and enhancement of convergence in EU supervisory practices. It is essentially a regulatory process that relies on existing comitology procedures as set forth in ((Article 202 of the Treaty of Rome ?)) to develop EU financial legislation based on proposals from national finance ministers and regulators, in consultation with industry. Although the early stages of implementation of the Lamfalussy programme ignited some controversy concerning the scope of legislative authority for EU institutions, it has resulted in streamlined decision-making, promoted a wide ranging dialogue with industry and consumer groups and has disseminated its work and proposals to all relevant stakeholders. The Council and Parliament have recognised the early success of the Lamfalussy programmes and the ongoing work of the networks of the three regulatory committees.

The Lamfalussy framework has, however, been criticised as being too slow and lacking the institutional capacity to respond effectively to a cross-border financial crisis within the European Union (Alexander et al, 2007). Prior to the crisis, EU authorities had recognised that the changing structure of European financial markets and the cross-border operations of large banking groups necessitated further institutional consolidation at the EU level and in particular raised important issues regarding how much authority the three Level 3 committees should be given in overseeing national supervisors and cross-border firms and wholesale capital markets: see CEBS and the European System of Central Bank's Banking Supervisory Committee (BSC) Joint Guidance (2006) (extending the guidance role of the Level 3 committees from "going-concern" activities to crisis management cooperation). Moreover, the International Monetary Fund's 2004 surveillance report identified the weak link in EU supervisory arrangements to be the absence of a clear framework of coordination between EU national supervisors with respect to the oversight of the cross-border operations of financial groups in EU states: IMF article IV Surveillance Report, (2007) p 27, and see also IMF article IV Surveillance Report (2006) para12. The recognised weaknesses in the EU institutional framework of financial supervision became even more apparent in 2007 and 2008 when the credit crisis incapacitated wholesale financial markets and EU supervisory authorities were unable to respond in a coherent or effective manner.

Macro-prudential and micro-prudential supervision

A major weakness in the Lamfalussy framework and in most EU Member States' prudential regulation was that supervisory practices were focused primarily on individual financial firms and investors, while not taking into account broader macro-economic factors, such as aggregate levels of risk in the financial system or how risk was being shifted to non-bank firms and investors in the broader capital markets. Supervisory practices were focused narrowly on individual firms, while neglecting structural developments in capital markets and in clearing and settlement systems. For instance, one of the major failures in UK regulation over the last 10 years was that prudential regulation was too market-sensitive; it focused on the individual institution and did not take into account the level of risk or leverage building up in the whole financial system. The UK FSA's supervisory approach was largely microprudential, that is, that if individual firms were managing their risk appropriately, then the financial system would be stable. This failed to take into account the fallacy of composition that what appears for individual firms to be rational and prudent actions in managing their own risk exposures under certain circumstances can, if followed by all firms, potentially produce imprudent or sub-optimal outcomes for the whole financial system.

In the case of the UK, excessive reliance on principles-based regulation (PBR) also exacerbated weaknesses in the UK supervisory framework. The PBR approach focused on incentivising individual firm to experiment with different risk management practices so long as they achieved satisfactory firm outcomes that were measured by firm performance (ie shareholder prices) and whether the FSA's 11 high level principles were being achieved (ie treating customers fairly). The FSA's PBR approach did not take into account the aggregate effect of firms' performance on the financial system in terms of leverage generated and liquidity risks from wholesale funding exposures. To address adequately these macro-prudential risks in the future, prudential regulation will necessarily become more rules-based at the level of the firm and at the level of the financial system.

The De Larosiere Report (2009) and the UK FSA's Turner Review (2009) support the creation of a macro-prudential regulatory regime that is directly linked to the micro-prudential oversight of individual firms. Macro-prudential

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regulation will change regulation for individual banks in two main areas: (1) the regulation of individual firms must take into account both firm level practices and broader macro-economic developments in determining how regulatory requirements will be applied to firm risk-taking (ie linking the growth of asset prices and GDP with contra-cyclical bank reserves and liquidity ratios), and (2) limitations on the type of financial products anjd investments offered because of controls on the overall levels of risk-taking and leverage at the level of the financial system (ie limits on loan-to-value and loan-to-income ratios). Implementing macro-prudential regulation will require that micro-prudential regulation become more rules-based because tighter ex ante constraints will be needed for the risk exposures of individual firms (ie leverage ratios and limits on maturity mismatches in wholesale funding). Prudential regulation will gradually become more rules-based in order to achieve macro-prudential objectives. Macro-prudential regulation will change the nature of PBR because the supervisory focus will be expanded to include the application of macro-prudential controls to the broader financial system. Naturally, this will create new incentives for market participants to avoid the requirements by adopting new financial instruments and structures which may lead to new regulatory risks. Supervisors and central banks should be vigilant therefore as to how the market may respond to new macro-prudential controls.

The new focus on macro-prudential supervision will require supervisors to engage in surveillance of the financial system by monitoring aggregate leverage in the markets, the inter-connectedness between firms (large and small) in wholesale funding markets, and the impact of monetary policy on financial markets. Supervisors will also have to take into account macro-prudentual factors in deciding how to apply micro-prudential controls on individual firms. Any consideration of a future model of EU supervision must take into account the links between micro-prudential regulation of individual firms and macro-prudential oversight of the financial system.

Macro-prudential supervision and the central bank's role

Most central banks have a mandate to assess and monitor financial stability which necessarily involves them in collecting supervisory information from banks and financial markets. A central bank would be well-situated to conduct macro-prudential supervision because it has access to data on the economy and financial markets – comprising both market intermediairies, markets and market infrastructures. Wide access by central banks to supervisory information renders their financial stability assessment more accurate and effective in forecasting and monitoring systemic stresses. Similarly, supervisors may find the macro-prudential assessment useful in providing them with information to monitor certain categories of risk. The central bank can more effectively discharge its financial stability functions – ie overseeing the payment and settlement systems – by having access to micro-prudential data, while supervisors (whether inside or oustide the central bank) can enhance their risk assessments of individual firms by using macro-prudential data. This two-way flow of information between central banks and supervisors is the basis for the Financial Stability Forum's 2008 report suggesting enhanced interaction and exchange of information between central banks and supervisors.

This type of interplay between macro-prudential assessors and micro-prudential supervisors has not occurred in EU states where central banks are prohibited from conducting micro-prudential supervision and are left with the broader macro-prudential tasks of overseeing the payment and settlement system, monetary policy, and financial stability assessments. This is the case with the European Central Bank (ECB) which is expressly prohibited from engaging directly in prudential supervision under Article 127(6) of the Treaty on the Functioning of the European Union (TFEU). Nevertheless it has responsibility to "contribute to the smooth conduct of policies pursued by the competent authorities relating to the prudential supervision of credit institutions and the stability of the financial system" (Art 127 (5) TFEU). How might the ECB "contribute to the smooth conduct of policies" in the Eurosystem and throughout the EU without having access to supervisory information? An examination of the EU legal framework applicable to the exchange of information between central banks and supervisory authorities suggests that the EU regime is "asymmetric" because although the ECB and European System of Central Banks are obliged to contribute to the smooth functioning of supervisory policies, supervisory authorities do not have an equivalent responsibility to contribute to the tasks of the ECB or ESCB. Until this asymmetry is rectified, the EU will fail to have effective macro-prudential supervision.

THE COMMISSION'S PROPOSALS FOR MICRO-PRUDENTIAL AND MACRO-PRUDENTIAL SUPERVISION

The Commission's legislative proposals build on the proposals of the High Level committee chaired by Jacques de Larosiere. The proposed regulations to establish a European System of Financial Supervisors (ESFS) and a European Systemic Risk Board (ESRB), consisting of three ESAs, will lead to significant institutional consolidation of European financial supervision and macro-prudential oversight. The creation of a ESFS would lead to important changes for the operations and functions of the three Level 3 Lamfalussy committees by creating three ESAs with legal personailty and authority to ensure consistent application of EU financial legislation. The creation of a ESRB aims to enhance EU Member States' capacity to assess and monitor systemic risks across European and global

financial markets and to obtain data from supervisors on large systemic financial institutions and wholesale financial markets.

European Systemic Risk Board (ESRB)

The ESRB was established to be the main body responsible for macro-prudential oversight and surveillance of EU financial markets. ESRB Regulation, article 3(1) (proposed) states:

> *"The ESRB shall be responsible for the macro-prudential oversight of the financial system within the Community in order to prevent or mitigate systemic risks within the financial system, so as to avoid episodes of widespread financial distress, contribute to a smooth functioning of the Internal Market and ensure a sustainable contribution of the financial sector to economic growth."*

Despite its lack of formal institutional structure, it has a broad remit to exercise a number of important functions in the field of macroprudential oversight, including monitoring sources of systemic risk and other risks to financial stability across EU countries and financial sectors and serving as an institutional voice for EU central bankers in shaping and developing macroprudential supervisory practices. It also will interact with global financial stability bodies to develop effective early warning systems. The ESRB will aim to identify and prioritise the risks and use stress testing and other methodologies to analyse how they can impact financial stability.

The ESRB would consist of 61 representatives and officials consisting of the EU central bank governors, representatives of the European Supervisory Authorites, the Economic and Finance Committee, and the European Commission, all serving on a General Board. The ESRB secretariat would be entrusted to the European Central Bank; the legal basis of the Regulation is Article 114 of the Treaty on European Union (as amended).

Under the proposal, the ESRB would monitor and assess systemic risks arising from individual banks and across the whole European financial system. In doing so, it will seek to draw connections between macro-economic conditions and structural developments in financial markets, and identify vulnerabilities with particular institutions. The ESRB would also issue recommendations and warnings to countries or financial groups or other concerned entities and would report all recommendations and warnings to the Council of Ministers. The ESRB would devise specific follow-up procedures and "moral incentives" to follow recommendations or explain why not. The ESRB can inform the Council if unsatisfied with a Member State or entity's explanation and can conduct "name and shame" publicity if necessary.

The ESRB will be assisted by a steering committee that will assist it in decision-making, reviewing and preparing for meetings of the General Board, and monitoring the ESRB's work progress. The steering committee membership will be the chair and vice-chair of the ESRB; five other members of the General Board who are also members of the General Council of the ECB (who will be elected by and from the central bank members of the General Board for two year periods); a member of the European Commission; the Chairs of each of the ESAs; and the president of the Economic and Financial Committee. The Regulation confers a specific role for the European Central Bank in the ESRB's operation: the ECB's President and Vice President serve on the ESRB Board.

The ECB would provide the secretariat for the ESRB while performing administrative, logistical and analytical support. This would also include drawing on technical advice from the 27 EU national central banks and supervisors (see speech of Jose Manuel Gonzalez-Paramo, Member of the Executive Board of the ECB, January 22, 2010, p 4)

Some economists, however, have raised concerns that the ESRB would not be able to perform its function of identifying and monitoring systemic risk because there is inadequate understanding of the causes of systemic risk and that the proposed ESRB Regulation does not provide any information on what systemic risk means and how to measure it (see oral evidence of Jon Danielsson, The Committee's Opinion on proposals for European financial supervision, House of Commons Treasury Committee (Sixteenth Report of session 2008-09), Ev 1). Accordingly, it was argued that the design of the ESRB is flawed and should be substantially revised. In addressing this concern, it is submitted that although systemic risk is difficult to measure, and its causes are even more difficult to identify precisely (especially for a future financial crisis), EU policymakers should not conclude therefore that they should not try to establish institutional frameworks to monitor systemic risks across EU financial markets. Indeed, the financial crisis demonstrates that macro-prudential risks are evident in the European financial system (see "Financial Supervision and Crisis Management in the EU" (December 2007), K Alexander, J Eatwell, A Persaud, and R Reoch, Commissioned Report for the European Parliament Committee on Economic and Monetary Affairs, pp 2-3, 17-18). Banks have exposure to each other throughout Europe in the money markets through a variety of risk exposures, and European policy-making needs to have better surveillance of the systemic risks posed by certain banking groups and financial institutions that operate in Europe.

The crisis also demonstrates that systemic risk arises in the wholesale capital markets – especially through the securitisation and the over-the-counter credit default swap markets – as well as from individual financial institutions. The Turner Review recognised that the sources of systemic risk can be macro-prudential in nature and that this necessitates that central banks and regulators establish enhanced cross-border (international and European)

frameworks for identifying and monitoring macro-prudential systemic risks and, in certain circumstances, for issuing early warnings to affected countries. The absence of a consensus view on the sources of systemic risk therefore does not preclude the design of effective cross-border institutional structures to monitor and measure systemic risks in European financial markets.

Other critics raised the concern that the composition of the ESRB was too heavily weighted in favour of central bankers and in particular favouring the ECB and that the ESRB lacks democratic accountability. Professor Willem Buiter for example observed that a ESRB dominated by EU central bankers should not be given such an important role because over the last decade "the ECB, the Eurosystem NCBs, and the rest of the national NCBs [had] not exactly covered themselves with glory in the area of macro-prudential supervision and regulation": see "The Committee's Opinion on proposals for European financial supervision", House of Commons Treasury Committee, (Sixteenth Report of session 2008-09) p 18. Also, because all decisions to bail out a bank or provide other crisis assistance requires approval of national fiscal authorities, finance ministries should also be represented on the ESRB.

Nevertheless, the ESRB's absence of legal personality provides it with more institutional flexibility and scope to fulfil its core functions and broad mandate to monitor the whole European financial system. It also allows the ESRB to interact flexibly with the ESAs and Member State supervisors to form a common framework of regulation that allows for regulatory innovation to address evolving market risks. However, the ECB's integral role in providing administrative support, and overseeing and discharging the operations of the ESRB, is constrained by Article 114 (6) TFEU that requires a unanimous vote by the Council for the ECB to carry out any function for the ESRB that directly involves the prudential supervision of financial institutions. So the extent and scope of the ECB's secretariat role may be limited to functions not involving macro-prudential supervision if not approved by a unanimous vote in Council.

The European System of Financial Supervisors (ESFS)

The ESFS would consist of a network of Member State supervisors that would operate within three different ESAs with responsibility for banking, insurance and securities markets, respectively (Regulation of the European Parliament and of the Council COM(2009) 503 (establishing a European Securities and Markets Authority), COM(2009) 502 (establishing a European Insurance and Occupational Pensions Authority), and COM(2009) 501 (establishing a European Banking Authority)). Each Member State supervisor would continue to be responsible for discharging its supervisory functions, but under the proposed regulations would have to account for its supervisory practices to the relevant ESA. Each ESA will be responsible for adopting a harmonised rule-book, technical standards and guidance for the application and implementation of EU financial legislation. The ESAs would provide a point of contact for national supervisors to interact and coordinate their oversight of cross-border financial firms and address matters of mutual concern between Member State supervisors and the ESAs. The ESAs would perform specifically delegated tasks, such as mediating disputes between supervisors and, if necessary, resolving disputes. As discussed below, their most important immediate responsibility would be to formalise the operations of the colleges of supervisors which presently oversee the cross-border operations of Europe's largest 50 or so banks and financial institutions.

The decision to build the ESFS along sectoral lines – banking, securities and insurance – was influenced significantly by the existing sectoral approach of the Lamfalussy framework. EU policy makers could have diverged away from the Lamfalussy sectoral approach by proposing instead to create a single EU financial supervisor for all financial services, or alternatively a single EU supervisor for each of the three financial sectors. Rather, the Commission chose to build directly on the existing framework by transforming the three Level 3 supervisory committees into more formalised institutional structures with legal personality and the power to resolve disputes between supervisors and to issue Directives enjoining supervisors to bring their practices into compliance with EU law and regulatory codes. This path-dependent approach recognised that the transaction costs – both institutional and political – would have been much higher if EU policymakers had proposed a more dramatic institutional shift away from the Lamfalussy framework. Also, equally important, the use of the Lamfalussy institutions on which to build the ESFS recognised that a new formalised EU institutional structure was nevertheless to be firmly and primarily anchored in Member State competence to supervise financial markets. The ESFS/ESA framework builds on the existing decentralised Member State supervisory approach by enhancing the ability of supervisors to coordinate cross-border oversight along with enhanced accountability to other Member States to ensure faithful implementation of EU law.

Moreover, the proposed institutional framework recognises the interdependence between micro- and macro-prudential risks across EU financial markets and the need to be accountable to the views of market participants and all EU stakeholders, including financial institutions, investors and consumers (Annex B). It provides a more consolidated and rational institutional design for linking micro-prudential supervision of individual firms with the supervision of the linkages between institutions and between institutions and the broader financial system. The ESRB is expected to provide a broader perspective of the financial system and to interact with supervisors in monitoring and assessing system-wide risks. In this capacity, the ESRB would serve as the basis

for developing a more integrated EU supervisory structure that would improve consistency in regulatory and supervisory practices and approaches across EU/EEA states, thus creating a level playing field and a more efficient regulatory framework for controlling systemic risk and preventing market failure

The ESFS and Colleges of Supervisors

The ESFS would place greater emphasis on using colleges of supervisors from EEA states to supervise the operations of Europe's largest cross-border banks and financial institutions. The proposed European Banking Authority (formerly the Lamfalussy Level 3 Committee of European Bank Supervisors (CEBS)) would have responsibility for overseeing the implementation of guidelines and decision-making procedures for the colleges. Membership of the colleges would include: All EEA supervisors of subsidiaries; EEA supervisors of branches recognised as significant; third country supervisors with equivalent confidentiality provisions; and central banks as appropriate. Moreover, the Capital Requirements Directive (CRD) (Art 131a) provides the legal basis for a single college for global EEA-based banks.

The main function of colleges will be to exchange information between supervisors, coordinate communication between supervisors of the financial group, voluntary sharing and/or delegation of tasks, joint decision on model validation (eg Basel II). The colleges will also be involved in joint risk assessment and joint decision on the adequacy of risk-based capital requirements. The planning and coordination of supervisory activities for the financial group and in preparation of and during emergency situations (ie crisis management). The ESAs will have oversight of the colleges and will have authority through conciliation and mediation to resolve disputes between member authorities in the colleges. Some concern has been expressed that this power of conciliation and mediation might infringe Member State fiscal autonomy, but the better view holds that these concerns are exaggerated as the ESAs will only be able to resolve disputes and devise rules and technical standards for national supervisors based on existing EU financial legislation.

The fiscal autonomy of Member States

The proposals for the ESFS and ESRB provides no authority for EU institutions to order Member States to spend taxpayer funds in a crisis (ie bail out a bank). Indeed, the Commission proposals do not provide a crisis management mechanism that would require a member authority to use public funds in a crisis. In other words, the sovereignty of Member States with respect to their fiscal prerogative to support ailing financial institutions has not been intruded upon. In fact, the fiscal safeguards provision of article 23 of the ESA does not permit the ESAs to take any measures under articles 10 or 11 that would require a Member State to make fiscal expenditures. The fiscal safeguards provision applies to the authority of the ESAs to resolve disputes between member supervisors under article 11.

Some Member State Parliaments, however, have expressed concern that the fiscal safeguard provisions of article 23 only apply to orders issued by an ESA under articles 10 and 11, and that an ESA could potentially order a member authority under some other article of the regulations to take action that might involve fiscal expenditure. This possibility was pointed out with respect to article 21 of the ESA regulations which authorises the ESAs with Commission approval to order a member authority to comply with a recommendation or warning issued by the ESRB. Council addressed these concerns by amending the ESA regulations to make it clear that no order of a ESA could require a Member State to use public funds.

It should be noted however that pursuant to article 9 of the regulations the ESA would have authority to order a member authority to comply with existing EU financial legislation and the ESA codes and technical standards implementing such legislation, which may indirectly involve the Member State spending public funds. The relevant EU financial legislation which an ESA can order a Member State to comply with are listed in the respective regulations establishing a European Banking Authority, a European Securities and Markets Authority, and a European Insurance and Occupational Pension Authority.

Another area of possible legal challenge concerns the Commission's use of Article 114 (ex art 95) of the Treaty as the legal basis to adopt the regulations creating the ESAs and the ESRB. Article 114 (ex art 95) authorises EU institutions to create EU agencies and other EU bodies with delegated powers to facilitate the harmonised implementation of EU law. However, the scope of delegated authority under Article 114 to these EU agencies/bodies is limited by the so-called Meroni doctrine that holds that EU agencies cannot be delegated ultra vires powers (that is, powers that are not conferred on EU institutions) to implement EU law. Moreover, ECJ jurisprudence also prohibits EU institutions from delegating intra vires powers to EU agencies or bodies if such powers delegate substantial discretion to EU agencies to adopt rules and standards or take other related decisions to implement EU law. For instance, the Commission's delegation of authority to the ESAs to promulgate a harmonised EU regulatory code and technical standards that create a level regulatory playing field between Member States vests considerable decision-making authority in the ESAs not only to devise a EU regulatory code but also to decide if states and financial firms are in breach of the code and to order the relevant Member State regulators to take remedial action. Although Commission approval must be obtained before the ESA codes and standards become effective, considerable discretionary rule-making and enforcement authority has been delegated to the ESAs.

These constitutional concerns have already been raised by the UK Parliament (Treasury Committee Report, 2009) and may possibly form the basis of legal challenges by Member States or certain financial institutions subjected directly to the EU code. Nevertheless, these constitutional concerns may legally be justified by the fact that EU institutions can be authorised by qualified majority vote to exercise certain limited competences in the supervisory field and the proposed framework requires that the ESAs consult and obtain the Commission's approval before imposing any order or Directive against a Member State or a financial institution based in a Member State.

Establishing a single EU supervisor?

Considerable support has emerged for a single EU financial supervisor across financial sectors or for a sectoral approach along the lines of banking, securities and insurance (Andenas & Avgerinos 2003 (suggesting the ECB as supervisor); Avegerinos 2003 (suggesting an EU SEC) especially in light of the financial crisis (ESFRC 2009). The main argument for institutional consolidation at the EU level is that Europe's growing internal financial market is much more integrated – both at the level of the financial system and at the level of firms operating cross-border – which cannot be supervised efficiently by Member States because of different institutional capacities for implementation and enforcement. A centralised supervisory body would promote a level playing field in supervisory practices by overseeing the activities of Member State authorities and coordinating and conducting cross-border surveillance and enforcement. The creation of an EU supervisor could potentially reduce the high transaction costs of monitoring and enforcing EU law on a cross-border basis. Further, a single supervisor could assist with resources and training for some member authorities in need of assistance.

Although there are recognised benefits to such a centralised institutional structure, there are some concerns regarding the sovereignty costs states would incur by allowing such an authority to have jurisdiction to monitor and enforce EU law in their jurisdictions. An extensive literature has emerged questioning the utility and effectiveness of the single supervisory model for Europe (Vives 2001, Ferran, 2005). Moreover, on constitutional grounds, there are critics who assert that the Commission and EU bodies do not have a conferred power to engage in prudential supervision or even macro-prudential surveillance (House of Commons 2009) According to this view, the Meroni doctrine would prohibit the Commission and Council from creating an EU agency and then delegating powers to the agency to supervise EU financial markets on the grounds that prudential supervision has not been conferred by the Treaty on EU institutions and therefore cannot be delegated to a newly created EU supervisory agency.

For those in favour of more institutional consolidation, the Commission's proposals to create the ESAs should be welcomed because the Treaty would probably be interpreted as prohibiting any further institutional consolidation in supervision in the form of a single EU supervisor for all financial markets or a single EU supervisor along financial sector lines. Despite the potential legal challenges on "delegation of power" grounds, the exercise of financial supervision will remain decentralised and based at the Member State level. The Commission's proposals therefore may withstand constitutional challenge because they maintain the essential decentralised supervisory structure with Member States exercising ultimate competence to supervise financial markets while building lines of accountability to other EU states through the European supervisory agencies.

Nevertheless, there remains an important objection to the proposals on public policy grounds that they do not go far enough. In the aftermath of the crisis, there have been proposals to establish a single EU supervisor for the largest 50 or so financial institutions with cross-border operations throughout Europe. Their significant regional, and indeed global, scope makes them amenable to a transnational supervisory structure that is consolidated at the European level in the form of a single EU prudential supervisor that would have full competence to supervise these firms and their foreign branches and subsidiaries. Similarly, a single EU supervisor could also play an important role in supervising the growing inter-connected infrastructure of EU capital markets, in particular the clearing houses and certain settlements systems that operate at EU level.

As mentioned above, an important rationale for this is that national supervisors have high transactions costs in supervising the cross-border dimension of financial markets and a single EU supervisor can reduce these transaction costs by coordinating the activities of member authorities. The rationale for this is not only that it would be extremely difficult for national supervisors to obtain a clear picture of these institutions and their operations, but even more because their potentially risky operations may create significant cross-border externalities, which makes supervising them solely by one national supervisor suffer from a serious incentive problem. Further consolidation of EU supervision, however, would not be permitted by the Treaty. The Treaty for European Union crystallises this institutional limitation. But some argue that politicians should address this absence of Treaty authority for creating a single EU supervisor by amending the Treaty to allow this to be done (ESFRC 2009).

CONCLUSION

European financial markets are increasingly integrated in terms of cross-border operations of institutions and wholesale capital markets and system infrastructure. EU financial regulation needs more effective supervision that links micro-prudential supervision with macro-prudential oversight of the financial system. Although the European Central Bank is responsible for contributing to the smooth

operation of eurozone payment systems, it is prohibited legally from engaging in prudential supervision unless it obtains unanimous support from EU states. Therefore, the more realistic debate regarding which supervisory model to adopt for Europe involves the extent to which institutional consolidation should occur based on the Lamfalussy framework and the Commission's proposals which build upon it, or should a EU supervisor be created that is not a central bank but has full competence to supervise and regulate EU financial markets? Any proposal for the latter would be controversial and attract much political criticism from many EU states and would legally be unsound on Treaty grounds.

In the meantime, the Commission's proposals, though institutionally complex, essentially maintain Member State competence to supervise markets, but require supervisors to coordinate their actions with respect to cross-border firms and incorporating systemic risk concerns into their supervisory practices. Overall, the proposed ESFS and ESRB are adequate institutionally to build an effective macro-prudential supervisory framework that is durably linked to micro-prudential supervsion. However, simply creating new EU institutions is not enough. EU policy makers should also be concerned with the substantive requirements of financial legislation and whether they are creating an incentive compatible framework that limits systemic risk.

Another important area that should be recognised is that crisis prevention – through prudential supervision – and crisis management – mitigating a crisis by resolution – are part of a seamless process. Effective prudential supervision also requires effective crisis management mechanisms, which include resolution procedures for banks and other systemically important firms, policies regarding too big to fail banks, and deposit insurance. Indeed, the ESAs are not authorised to engage in crisis management and would have no authority to use public funds to resolve bank failures or some other systemic problem involving a financial institution. Therefore, their ultimate effectiveness can be called into question. Is it really realistic to create EU bodies with ex ante responsibilities for micro and macro supervision while not having the authority to bail out, nationalise, or unwind a large bank or engage in other financial rescues? The link between crisis prevention and crisis management therefore should be high on the EU policy agenda and without a better balance between the two at the EU level the present proposals for institutional reform will be ineffective.

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Article

Religious "irrationality" and civil liberties

by John Warwick Montgomery

The theme of the Ecclesiastical Law Society's 2010 Day Conference, held on March 13 in London, was "Freedom of religion: protection or equality?" One of the speakers, Lucy Vickers, professor of law at Oxford Brookes University and specialist on religious discrimination in the workplace, declared that in her opinion the fundamental ground for legally protecting religious belief and practice is the essential irrationality of religious positions: since their truth cannot, unlike scientific views, be demonstrated, they need the protection of the law even more than do other ideas. Another speaker, Christopher McCrudden, professor of human rights law at the University of Oxford, indicated that he felt very uncomfortable with this argument, though there was no time at the conference to go into the issue in depth.

Then, a little over a month later (April 29), Lord Justice Laws issued his opinion in the case of *McFarlane v Relate Avon Ltd [2010] EWCA Civ B1* on appeal from the Employment Appeal Tribunal. Gary McFarlane, a relationships counselor in Bristol with strong evangelical Christian beliefs, had refused to provide sexual counseling to homosexual couples; as a result, he was dismissed by the Relate Avon organisation, whose position was upheld by the Employment Tribunal. Lord Justice Laws denied McFarlane's subsequent application to have his case heard by the Court of Appeal. The Lord Justice gave his *ratio* as follows: "[I]n the eye of everyone save the believer religious faith is necessarily subjective, being incommunicable by any kind of proof or evidence. . . . [I]t lies only in the heart of the believer, who is alone bound by it. No one else is or can be so bound, unless by his own free choice he accepts its claims. The promulgation of law for the protection of a position held purely on religious grounds cannot therefore be justified. It is irrational, as preferring the subjective over the objective" (paras 23-24).

These remarks created a considerable flap in the press, and former Archbishop George Carey took sharp issue with Lord Justice Laws' refusal to allow McFarlane's appeal. Some critics reasoned *ad hominem,* condemning the Laws LJ on the basis of his reputation as a "legal activist."

But the especially interesting aspect of the decision is that, whilst agreeing entirely with Professor Vickers' view that religion is essentially subjective, and therefore unprovable and irrational, Laws LJ concludes that, instead of particularly deserving the protection of the law, religious claims must not be upheld legally against the (non-religious) views of others. In other words, from the premise of religious irrationality, Vickers and Laws draw precisely opposite conclusions!

In the present essayist's view, neither Vickers nor Laws is correct, and for three compelling reasons: (1) It is incorrect to suppose that ideological conflicts in society pit "religious" beliefs against "non-religious" positions. (2) Religious beliefs are not necessarily irrational. (3) A proper basis for the protection – and the limitation –of religious practices must be found in an entirely different realm from that of supposed "religious irrationality." Let us briefly speak to each of these points.

1. The 20th-century theologian Paul Tillich stressed that there are in fact no atheists, since everyone has an "ultimate concern"—a value system determining his or her actions individually and societally. Thus, in *McFarlane*, Relate Avon, no less than McFarlane himself, held religious convictions—for Relate Avon, that homosexual relationships are ethically proper and as such deserve the benefits of sexual counseling no less than heterosexual relationships. Lord Justice Laws himself therefore acted irrationally in rejecting on grounds of religious irrationality McFarlane's overt religiosity in favour of Relate Avon's unstated, but no less religious, value system.
2. As for the claim by Vickers and Laws that religions are *per se* irrational, we might paraphrase George Orwell: all religions are equal, but some are more equal than others. There are indeed religions such as Buddhism that rely 100 per cent on personal, subjective experience as verification for their beliefs, as well as cultic movements such as Scientology having no way of objectively demonstrating the factuality of their doctrines (eg, that "body thetans" are the product of Xenu of the Galactic Confederacy and need to be treated through therapeutic "auditing" processes). But this is hardly a description all religious phenomena. An obvious counter-example is classic Christian faith, which centres on the historical facts of Jesus' life, death, and resurrection. The centuries-old discipline of Christian apologetics has offered powerful objective evidences for the truth of the Christian worldview; one thinks of the work of Pascal,

William Paley, John Henry Newman, C S Lewis, Richard Swinburne—and lawyers such as Hugo Grotius (*De veritate religionis Christianae*), Simon Greenleaf (*The Testimony of the Evangelists*)—and Sir Norman Anderson, late director of the University of London's Institute of Advanced Legal Studies (*The Evidence for the Resurrection*). In recent years, the arguments for cosmic, universal "intelligent design" as presented by scientists such as William Dembski and Francis Collins have brought even distinguished atheistic philosophers (eg, Antony Flew) to belief in God.

3. Where, then, should one go to find an adequate basis for the protection of religious beliefs and practices—and proper grounds for limiting them? The answer is not to label religion as "irrational" and then to draw positive or negative conclusions from that characterisation, but rather to consider far more carefully the proper function of law in general in an open society. As political philosopher John Rawls emphasised by way of his First Principle of Justice (that dealing with civil liberties): "Each person is to have an equal right to the most extensive scheme of equal basic liberties compatible with a similar scheme of liberties for others." This means that unless one's belief or desired activity—including religious belief and activity—hurts others, it should be allowed. It also means that if the courts can find a way for a belief or activity to function without significant hurt to others, that belief or activity should be legitimated. In the *McFarlane* matter, therefore, since other relationship counsellors holding worldviews other than McFarlane's could readily treat the homosexual couples, McFarlane should have been allowed to retain his position—respect being shown to his personal beliefs by allowing him to give sex therapy only to heterosexual couples. (This is in line with medical practice in many civilized countries, where physicians and nurses opposing abortion do not have their public hospital privileges taken away, but are exempted from performing abortions and instead are assigned to perform other medical procedures.)

There is a further consideration of the greatest consequence to the judicial evaluation of religious belief and practice. That principle is encapsulated in a celebrated remark attributed to Voltaire: "I may not agree with what you say but I will defend to the death your right to say it." In an open society, even beliefs regarded by some as "irrational" need to be tolerated. Why? Because of the inherent dignity of the human persons holding those ideas. We need a free marketplace of ideas, not a society where some ideas (religious ones, for example) are given such second-class status that actions dependent on them are *per se* removed from legal protection—even when their alleged harm to the society cannot be demonstrated. Today, in certain European states, one can be jailed for unpopular ideas (holocaust revisionism, for example); such obnoxious notions ought to be refuted in the public marketplace of ideas, not repressed by law. Religious beliefs, even those we disagree with, need to expressed—and practiced—in an open society. And, surely, those religious positions with solid, objective evidence in their behalf must not suffer ostracism simply because of their religious label! Otherwise, political correctness will prevail, and political correctness is no less a religion because it does not use that terminology. Indeed, in many ways it is far more dangerous to the public weal than are the religious ideas and practices it endeavours to repress.

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Articles for Amicus Curiae

Amicus Curiae welcomes contributions, which should be accompanied by the name and contact details of the author. The journal publishes articles on a wide variety of issues, ranging from short pieces of 700-1,200 words and longer articles of 4,000 words of so (the upper limit can be extended where appropriate). Articles should be written in an informal style and without footnotes.

Anyone interested in submitting a piece should email Julian Harris (julian.harris@sas.ac.uk).

IALS Conference Report

Debarment: too big a stick?

"Corporate death penalty or rehabilitation? Towards best practice in debarment" was the title of a seminar held at the IALS on March 11. Speakers included Susan Hawley of Corruption Watch, Sope Williams-Elegbe of the University of Nottingham, Monty Raphael of Peters and Peters, Ian Trumper of FTI Consulting and Transparency International, and Simone White of the European Anti Fraud Office and the IALS, who wrote this report.

The seminar title reminds us that debarment (also known as exclusion or black listing) is a serious measure, which can lead to the bankruptcy of an economic operator. It is not possible here to do justice to all the issues discussed during the seminar, however the contributions will be published *in extenso* in the *Utrecht Law Review,* so it will suffice to give here just a few highlights of the discussion. For the sake of brevity, comments on the area of defence procurement are not included here,

Legal basis for debarment

The starting point is Article 45 of consolidated Directive 2004/18/EC which lays down the rules for the exclusion of economic operators (Directive of the European Parliament and of the Council of 31 March 2004 on the coordination of procedures for the award of public works contracts, public supply contracts and public service contracts, OJ L (2004) 134, p 114). The reader may be familiar with this article, which is given in an Annex to this report. The directive has been transposed into the legal orders of all EU Member States. In the UK, Article 23 of the 2006 Public Contracts Regulations provides the basis for debarring or mandatorily excluding companies convicted of money laundering, corruption, fraud and participation in a criminal organisation from public contracts.

Some issues arising from the present EU legal framework

In practice, debarment raises a large number of legal issues. One set of questions relate to the interpretation of Article 45. Is it meant to cover convictions outside the EU? What of Convictions by related companies? Is there an obligation on contracting authorities to enquire and investigate? Can remedial action by the companies be taken into consideration to mediate length of the exclusion? And if this is possible, what might the rehabilitation procedure be? Furthermore, in the UK, it is not clear at present whether clause 7 offences (failure to prevent bribery) could trigger an "Article 45." Clarification is needed on all those points.

Another practical issue relates to the possibility of checking whether a legal person has been convicted in the UK (or indeed at EU level), in the absence of a register of convicted legal persons.

Debarment dependent on use of criminal law

Debarment depends on a criminal law approach. Whenever a civil law approach is preferred (as it is sometimes in the UK) or when criminal proceedings are not opted for on public interest grounds, exclusion can be circumvented, raising questions of transparency over the settlement or fine (see, for example, the Balfour Beatty case).

One possible, innovative approach, according to Monty Raphael, would be the adoption of a clear prosecution policy with deferred prosecution agreements. This would make it possible to inflict a financial penalty and to monitor the rehabilitation process of the company. This would have the benefit of introducing transparency.

Rehabilitation/ "self-cleaning"

Ian Trumper explained that Transparency International was interested in how the "rehabilitation" process was managed – more often than not it seemed to mean the targeted company acquiring a new board. There was a need for the rehabilitation process to be monitored.

Existing models to draw on

Drawing on a vast comparative study of debarment systems, Sope Williams-Elegbe mentioned that the World Bank made use of "conditional non-debarment" for firms peripherally involved and it had a voluntary disclosure programme. There was often no clarity on what rehabilitation ("self-cleaning") measures should consist of. Nor was it clear how the national security/public interest exception should be interpreted.

Simone White explained that at the level of the EU institutions, similar debarment provisions applied through the EU Financial Regulation and its Implementing Regulation. The Commission has run a Central Exclusion Database (Commission Regulation 13022/2008 on the central exclusion database, OJ (2009) L 344/12) since 2009 for part of its EU budget expenditure. However the debarment list is not published. International organisations do not yet have access to the database, even though projects are often funded jointly by the Commission and an international organisation. On the positive side, the Central Exclusion Database has a system in place for the exchange of

information between the European Commission and national authorities through contact points and it should be possible to draw on this experience soon.

To conclude, debarment offers the potential for effectiveness in discouraging some categories of financial crimes. As argued by Sue Hawley during the seminar:

> *"An effective and fair debarment system based on clear rules and transparent processes in the UK and across the EU is an essential and necessary part of the fight against organised and white collar crime such as corruption. Debarment is one of the most effective deterrents for companies and individuals considering engaging in such crimes and has the potential to bring about real cultural change in company behaviour. This is particularly the case in countries like the UK, where fines for companies are historically very low and arguably of little real deterrent value."*

Hawley also referred to the need to "iron out the vagueness in Article 45." Given the nature of Directives, that might be a long shot. Yet it should be possible, within the confines of the present legal framework, to adopt approaches at national level that increase transparency and make rehabilitation a part of debarment. This includes deferred prosecution and a monitoring of the rehabilitation process.

Annex: Article 45 of consolidated Directive 2004/18/EC

Personal situation of the candidate or tenderer

1. Any candidate or tenderer who has been the subject of a conviction by final judgment of which the contracting authority is aware for one or more of the reasons listed below shall be excluded from participation in a public contract:

(a) participation in a criminal organisation, as defined in Article 2(1) of Council Joint Action 98/733/JHA(20);

(b) corruption, as defined in Article 3 of the Council Act of 26 May 1997(21) and Article 3(1) of Council Joint Action 98/742/JHA(22) respectively;

(c) fraud within the meaning of Article 1 of the Convention relating to the protection of the financial interests of the European Communities(23);

(d) money laundering, as defined in Article 1 of Council Directive 91/308/EEC of 10 June 1991 on prevention of the use of the financial system for the purpose of money laundering(24).

Member States shall specify, in accordance with their national law and having regard for Community law, the implementing conditions for this paragraph.

They may provide for a derogation from the requirement referred to in the first subparagraph for overriding requirements in the general interest.

For the purposes of this paragraph, the contracting authorities shall, where appropriate, ask candidates or tenderers to supply the documents referred to in paragraph 3 and may, where they have doubts concerning the personal situation of such candidates or tenderers, also apply to the competent authorities to obtain any information they consider necessary on the personal situation of the candidates or tenderers concerned. Where the information concerns a candidate or tenderer established in a State other than that of the contracting authority, the contracting authority may seek the cooperation of the competent authorities. Having regard for the national laws of the Member State where the candidates or tenderers are established, such requests shall relate to legal and/or natural persons, including, if appropriate, company directors and any person having powers of representation, decision or control in respect of the candidate or tenderer.

2. Any economic operator may be excluded from participation in a contract where that economic operator:

(a) is bankrupt or is being wound up, where his affairs are being administered by the court, where he has entered into an arrangement with creditors, where he has suspended business activities or is in any analogous situation arising from a similar procedure under national laws and regulations;

(b) is the subject of proceedings for a declaration of bankruptcy, for an order for compulsory winding up or administration by the court or of an arrangement with creditors or of any other similar proceedings under national laws and regulations;

(c) has been convicted by a judgment which has the force of res judicata in accordance with the legal provisions of the country of any offence concerning his professional conduct;

(d) has been guilty of grave professional misconduct proven by any means which the contracting authorities can demonstrate;

(e) has not fulfilled obligations relating to the payment of social security contributions in accordance with the legal provisions of the country in which he is established or with those of the country of the contracting authority;

(f) has not fulfilled obligations relating to the payment of taxes in accordance with the legal provisions of the country in which he is established or with those of the country of the contracting authority;

(g) is guilty of serious misrepresentation in supplying the information required under this Section or has not supplied such information.

Member States shall specify, in accordance with their national law and having regard for Community law, the implementing conditions for this paragraph.

3. Contracting authorities shall accept the following as sufficient evidence that none of the cases specified in paragraphs 1 or 2(a), (b), (c), (e) or (f) applies to the economic operator:

(a) as regards paragraphs 1 and 2(a), (b) and (c), the production of an extract from the "judicial record" or, failing that, of an equivalent document issued by a competent judicial or administrative authority in the country of origin or the country whence that person comes showing that these requirements have been met;

(b) as regards paragraph 2(e) and (f), a certificate issued by the competent authority in the Member State concerned.

Where the country in question does not issue such documents or certificates, or where these do not cover all the cases specified in paragraphs 1 and 2(a), (b) and (c), they may be replaced by a declaration on oath or, in Member States where there is no provision for declarations on oath, by a solemn declaration made by the person concerned before a competent judicial or administrative authority, a notary or a competent professional or trade body, in the country of origin or in the country whence that person comes.

4. Member States shall designate the authorities and bodies competent to issue the documents, certificates or declarations referred to in paragraph 3 and shall inform the Commission thereof. Such notification shall be without prejudice to data protection law.

IALS Courses

Details of the three courses at masters level offered by the Institute are provided below:

LLM in Advanced Legislative Studies

This LLM is a response to the frequent demand – from students as well as from foreign government departments – for a UK-based postgraduate taught programme in the field of legislative drafting in its broader sense. It is also available via distance learning (for further information see article under the Sir William Dale Centre).

Legislative drafting is often perceived as a technical skill, which one learns on the job. Our view here at IALS has always been that legislative drafting encompasses the theoretical analysis and practical application of the whole process of legislating. The LLM examines issues related to the legislative process, constitutional law, the methods of drafting in a modern democratic context, legislative ethics and law reform. It is designed for postgraduate students with a background in law or social sciences as well as professionals and academics who wish to enhance their drafting skills.

Course website:
http://www.ials.sas.ac.uk/postgrad/courses/cls_MA.htm

LLM in Financial Governance, Financial Regulation and Economic Law

IALS is delighted to offer this new and innovative programme, which will now be moving into its third year. The programme builds on the Institute's existing research expertise in the area of company law, corporate governance, international economic law, financial regulation, and financial law.

The programme, which can be taken over one year or two, began in October 2008 and is being taught by leading academics from the University of London and other European universities. The programme offers courses that analyse corporate governance, financial regulation and international economic and financial law from a European and comparative perspective. Some of the main themes include the role of international economic organisations in globalised financial markets and the emerging legal and regulatory institutions that govern European financial markets. The United Kingdom's legal and regulatory regime will be an important area of focus, including the various institutional models of regulation and the single regulator approach of the UK Financial Services Authority. Although the programme's core courses focus mainly on an academic analysis of the relevant legal and regulatory concepts and principles, there will be optional courses offered by legal and regulatory practitioners that address the practical aspects of corporate governance and financial regulation.

The programme is designed for postgraduate students with a background in law and/or the social sciences and for mid-level professionals and academics who wish to develop a specialised understanding of corporate governance concepts and the role of financial regulation in today's globalised financial markets.

Course website:
http://ials.sas.ac.uk/postgrad/courses/LLM_ICGFR.htm

MA in Taxation (Law, Administration and Practice)

The MA in Taxation is an advanced level programme in all aspects of taxation, including tax law, tax administration, tax policy and taxation in practice. It is aimed at those who have decided that they intend to devote a substantial part of their working careers to the field of taxation, whether as government officials, tax advisors or in-house tax specialists. Applications are particularly welcomed from those with several years of experience in the taxation field, whether in government or in the private sector. The degree is not focused solely on UK taxation, and applications are particularly welcomed from overseas candidates.

The programme is not limited to tax law, and applicants are not required to have a prior law degree, nor a prior degree or professional qualification in accountancy or taxation. Just as tax in practice attracts bright individuals from a diverse range of backgrounds, this programme is devised for those who come from a range of academic disciplines.

Course website:
http://www.ials.sas.ac.uk/postgrad/courses/MA_tax_law.htm

IALS Events

All events take place at the Institute of Advanced Legal Studies except where otherwise indicated. Lectures and seminars free unless specified, but if you wish to attend an event please RSVP to Belinda Crothers. CPD accreditation is provided with many events. For CPD and all other enquiries contact Belinda Crothers, Academic Programmes Manager, IALS, 17 Russell Square, London WC1B 5DR (tel: 020 7862 5850; email: IALS.Events@sas.ac.uk). See also our website for further information (http://www.sas.ac.uk/events/list/ials_events).

Friday 22 October

Conference

From school exclusion orders to anti terror laws: human rights and the use of law in the modern state

This conference is an initiative between SOLON, the Institute of Advanced Legal Studies and the Centre for Contemporary British History. The objective is to initiate a wide-ranging discussion on human rights issues in the context of their management via the law. How do individual citizens use law? What expectations do they have when invoking the concept of human rights? What reactions do they expect from the State – and what, in turn, are the expectations of the State when invoking a human rights rhetoric? How significant are factors such as multi-culturalism? In setting up human rights models within the law – where there are competing demands for protection from the law, whose rights are prioritised? In school exclusion orders, for instance – the rights of the child, the teacher or the institution? How can "justice" in such cases be seen to be done in ways which has the support of the community and the political state? The role of the media (including the internet) in either supporting or undermining human rights issues and the role of the law, is another issue. And while the label of human rights is new, the concept is not – are there lessons to be learned from exploring the past? A key feature of this conference is our desire to bring together apparently small or 'insignificant' issues such as school exclusion orders with those having a clear national/international dimension – believing there is a need to discuss the full range of issues associated with law and human rights in a single event, in order to identify the connections between them both in theory and practice.

Wednesday, 3 November, 9.30am

One day conference

Exploring the "socio" of socio-legal studies
Keynote Speaker: SUSAN S SILBEY

Professor of Sociology and Anthropology, MIT, USA; co-author of *The Common Place of Law: Stories from Everyday Life* (with Patricia Ewick); former editor of *Studies in Law, Politics and Society* and the *Law & Society Review*.

Confirmed invited speakers: **PROFESSOR NICOLA LACEY**, LSE, and **PROFESSOR JOHN CLARKE**, the Open University (UK).

The conference will provide an opportunity to explore the meanings and implications of the "socio" aspect of socio-legal studies, and to lay out potential pathways for future study. This conference is organised by the Socio-Legal Studies Association with support from the Institute of Advanced Legal Studies.

Cambridge International Symposium on Economic Crime 2010

Sunday, 5 September – Sunday, 12 September

Jesus College, University of Cambridge

The New Deal – ensuring integrity, stability and survival

The 28th Symposium will focus on the threats confronting the financial system, and in particular financial institutions, from those who engage in self-dealing, corrupt practices and fraud or who assist and facilitate the crimes of others. Such threats, however, are complex and manifest themselves at many different levels. For example, as in previous years considerable emphasis is placed on the problems that confront those who operate in the financial world, primarily as a result of regulatory and enforcement actions designed to address specific criminal issues such as the disruption of highly profitable crime or terrorism.

Principal sponsors of the Symposium are the Serious Fraud Office of England and Wales and the People's Bank of China. Organising institutions include the IALS and the Society for Advanced Legal Studies.

For further information please contact the Symposium Manager, Angela Futter, at the Cambridge International Symposium on Economic Crime, Jesus College, Cambridge CB5 8BL (tel: + 44 (0) 1223 872160/ + 44 (0) 7950 047259; fax: + 44 (0) 1223 872160; email: info@crimesymposium.org). A copy of this year's programme can be downloaded from the Symposium website (www.crimesymposium.org).

Library News

IALS librarians honoured

Jules Winterton wins Wildy Law Librarian of the Year 2010

The Associate Director and Librarian at the IALS, Jules Winterton, has been awarded the highly prestigious Librarian of the Year Award during the annual dinner at the Conference of the British and Irish Association of Law Librarians (BIALL) in Brighton on June 11.

The citation to the award, which is sponsored by Wildy, mentioned that:

"Jules Winteron is one of BIALL's most distinguished members. This is a law librarian who has represented the law library profession in many different forums and has a CV packed with achievement. He heralds from the academic side of the legal information world and he has been highly influential and has always remained at the forefront of developments in legal information provision throughout his career. He has published widely in the professional literature, spoken at conferences and been visiting fellow, lecturer and professor at a number of different institutions, not least the prestigious Max Planck Institute for Comparative and International Law in Hamburg and the Coordinamento Centrale Biblioteche at the University of Florence. Where BIALL is concerned he has been Chairman (1994/95) and has played an active role in various capacities within the Association for many years. He is also involved with the Society of Legal Scholars (as Convener of the Libraries Committee), is a member of the Board of Directors and a Trustee for the BAILII (British and Irish Legal Information Institute) project and he is Chair of the FLARE group concerned with foreign legal research issues. These represent just some of his accomplishments.

"Perhaps even more notable even than these achievements is that fact that since 1995 Jules Winterton has been involved with IALL, the International Association of Law Libraries, of

which he is currently President and has been so since 2004, having previously acted as Vice-President. In 1998 he jointly won the Wallace Breem Memorial Award, together with the late Betty Moys, for editing the invaluable second edition of the book Information Sources in Law, published by Bowker-Saur. And all this while carrying out his duties in his demanding 'day-job' as Associate Director and Librarian at the Institute of Advanced Legal Studies."

In his acceptance speech, Jules said that "colleagues and friends in various places but especially at IALS did most of the work and had most of the ideas and the award is a tribute to them as much as to" him. He was presented with an inscribed crystal block in the shape of a book.

Steven Whittle receives Wallace Breem Award 2010

The IALS Information Systems Manager, Steven Whittle, received the Wallace Breem award at the BIALL conference in Brighton the evening before Jules Winterton was made Librarian of the Year.

The Wallace Breem Memorial Award is sponsored by the Inner Temple and BIALL and is presented biennially in recognition of especially good contributions to law librarianship. It was inaugurated in 1990 in memory of Wallace Breem, former librarian of the Inner Temple Library and a founder member of BIALL. Steve received the award from the President, Daniella King, at the BIALL Conference First Night Dinner which took place at the Thistle Brighton Hotel.

According to the citation "the award reflects Steven's considerable contribution to projects such as the FLAG (Foreign Law Guide) database, Intute Law, the CALIM (Current Awareness for Legal Information Managers) database and the FLARE Index to Treaties."

Nominating Steve, Dr Peter Clinch of Cardiff University said: "He is one of the unsung innovators of UK law librarianship. Many law librarians and others use the products of his expertise without knowing it. He is the ideal partner in IT projects, having a thorough understanding of the technical issues but equally able to appreciate the needs of legal users and their community.

"The judging panel agreed and were pleased to acknowledge the information community's debt to Steven's expertise."

Steve said: "This is a huge honour and great pleasure for me. It is a great privilege to receive this particular award with its many associations of integrity and innovation through the memory of Wallace, work of Inner Temple library and the achievements of previous distinguished recipients. Thank you so much. Of course many of the national online legal services I've been able to work on have been collaborative projects – owing much to the opportunities and encouragement that characterise work at IALS and to the knowledge, skill and good humour of the people I am lucky enough to work with.

"Forgive me for mentioning just a few. I am fortunate to have worked with inspirational Institute Librarians (originally the late Muriel Anderson and in the Internet age Jules Winterton) and with many dedicated friends and colleagues including: David Gee, Deputy Librarian; Lesley Young, Information Resoures Manager; Narayana Harave and Lindsey Caffin (my Information Systems team); Heather Memess (Intute project officer) and beyond the Institute – Dr Peter Clinch (for work on FLAG and the Treaty Index); and Sue Pettit and Debra Hiom (at Bristol for work on Intute: law and the Internet for Law tutorial). I would also like to thank the many academic and practising lawyers and researchers (our community of users) across the UK and overseas who have responded to the services and help us keep them relevant and useful. In the current difficult economic climate – as we work to maintain and develop services at IALS and cope with fewer staff, higher prices and tighter budgets in the University (as elsewhere) – this award is particularly important to us."

Annual closure

The Library will close to readers at 5:00pm on Friday, September 10 for essential annual stock moving and refurbishment work and will re-open at 9:00am on Monday, September 27. The Document Supply Service will continue to operate as normal during this period.

Article

Recent developments in intellectual property law in Australia with some reference to the global economy

by Susan Crennan

INTRODUCTION

This paper addresses recent developments in Australia in intellectual property law, with some reference to the global economy, and deals with two patent cases, two copyright cases and a designs case.

It is a given that intellectual property laws are closely tied to the economy, these days a global economy. Such laws are intended to strike the correct balance between encouraging innovation and investment on the one hand, and, on the other, securing the interests of industry, indeed society at large, in having access to the spread of knowledge.

The five cases I have chosen to discuss have two aspects in common. First, they have all been decided relatively recently and represent the current state of the law in Australia in respect of the points they decide. Second, they collectively demonstrate that although technological advances pose undeniable challenges for intellectual property laws, some basic concepts, laid down some time ago, have often proved remarkably supple. This is not to deny a body of academic criticism of intellectual property laws which alleges a lack of coherence or a lack of ability to deal with novel technology, particularly in the context of copyright law and the ease of copying with digital technology. Examples of this include David Vaver, "Reforming Intellectual Property Law: An Obvious and Not-so-Obvious Agenda: The Stephen Stewart Lecture for 2008", (2009) *Intellectual Property Quarterly* 143; and Kenneth Himma, "The Justification of Intellectual Property: Contemporary Philosophical Disputes", Berkeley Center for Law and Technology (2006) Paper 21; http://repositories.cdlib.org/bclt/Its/21.

Rather, it is my intention to provide recent examples of Australian intellectual property laws operating on particular sets of facts and to examine the questions to which these cases give rise.

Burge & Ors v Swarbrick

In the designs case, *Burge & Ors v Swarbrick* (2007) 232 CLR 336; [2007] HCA 17 a naval architect, Mr Swarbrick, designed and through his private company manufactured, a racing yacht, the JS 9000. In the course of doing so a "plug" was made, that is a handcrafted full scale model of the hull and deck sections of what became the finished yacht. Hull and deck mouldings were reproduced from moulds which were exact, but inverted, copies of the plug.

In proceedings for copyright infringement, Mr Swarbrick contended that the plug and the hull and deck mouldings, were works of "artistic craftsmanship" within the definition of artistic works in section 10 of the Copyright Act 1968 (Cth) ("the Copyright Act"). He had not obtained any protection for them as designs under the Designs Act 1906 (Cth) ("the Designs Act").

The case raised for the first time, in Australia, the question of the proper test for determining whether a work was a work of "artistic craftsmanship" because, in the absence of design protection, under the Designs Act, Mr Swarbrick was only able to rely on such copyright as he had in the works as works of "artistic craftsmanship". Under section 77 of the Copyright Act, copyright protection against three-dimensional reproduction of an artistic work was denied where the "corresponding design" (whether or not registrable under the Designs Act) had been "applied industrially" by or with the licence of the copyright owner. The alleged infringer, Boldgold Investments Pty Ltd ("Boldgold") defended its actions in attempting to reverse engineer the racing yacht by claiming that the plug and the hull and deck mouldings were "corresponding designs" within the meaning of that phrase in section 74 of the Copyright Act and as no designs had been registered by Mr Swarbrick there was no copyright infringement because of the statutory loss of protection under section 77.

It was explained in a unanimous judgment that the statutory phrase "artistic craftsmanship" was doubly

significant for the case. First, it is a species of "artistic work" capable of attracting copyright protection. Second, the phrase has been used recently to supply the discrimen to mark off the perennially problematic overlap between copyright and design protection. The ultimate issue in the case was whether the racing yacht, the JS 9000, embodied "a work of artistic craftsmanship" in the statutory sense.

The historical difficulties with overlap between copyright and design protection, both in the United Kingdom and Australia, are canvassed in the judgment. The court particularly noted the description of the Copyright, Designs and Patent Act 1988 (UK) ("the 1988 UK Act") by Pumfrey J in *Mackie Designs Inc v Behringer Specialised Studio Equipment (UK) Ltd* [1999] RPC 717 at 723:

> *"[i]t was clearly the intention of the framers of [the 1988 UK Act] that copyright protection was no longer to be available to what can be compendiously described as ordinary functional commercial articles".*

That Act created a new system for protecting designs of industrial products, partly through copyright law, but more significantly, through dual systems governing both registered and unregistered designs.

To return to the Australian case, *Burge v Swarbrick* was governed by the Copyright Amendment Act 1989 (Cth) which was designed to overcome the similar copyright/design overlap difficulties dealt with by the 1988 UK Act. It resulted in changes to the Copyright Act. As mentioned, a new section 77 operated to deny copyright protection against three-dimensional reproduction where the "corresponding design" (whether registrable or not under the Designs Act) had been "applied industrially", that is applied to more than 50 articles.

A relevant exception to the operation of these loss of protection provisions was provided in section 77(1)(a) which provided that the loss of protection provisions applied where copyright subsists in artistic work "other than … a work of artistic craftsmanship". The effect of that provision was that a work of "artistic craftsmanship" retained copyright protection but only if not registered under the Designs Act.

In construing the phrase "artistic craftsmanship" for the purposes of the Australian legislation, the High Court had regard to what Lord Simon of Glaisdale had said in *George Hensher Ltd v Restawile Upholstery (Lancs) Ltd* [1976] AC 64. This differed considerably from what was said by others who heard the appeal. That case concerned a popular suite of furniture of distinctive design described as "boat shaped" and marketed as the Bronx. The appellants sued for infringement of copyright in respect of the prototype. The copyright relied upon was that in respect of works of "artistic craftsmanship" as provided in the 1956 UK Act.

Lord Simon had recognised the composite nature of the phrase "a work of artistic craftsmanship" and construed it as a whole. He also recognised that there was no relevant distinction between the phrase "a work of artistic craftsmanship" used in the Copyright Act 1956 (UK) and that found in the Copyright Act 1911 (UK), where it had originated. He then referred to the Arts and Crafts Movement and the activities of John Ruskin and William Morris and said it was that movement with its emphasis on "the applied or decorative arts" which prompted the legislature in 1911 to give copyright protection to "works of artistic craftsmanship."

As to a work of craftsmanship, Lord Simon said (at 91):

> *"'Craftsmanship', particularly when considered in its historical context, implies a manifestation of pride in sound workmanship – a rejection of the shoddy, the meretricious, the facile."*

He then said (at 93):

> *"Even more important, the whole antithesis between utility and beauty, between function and art, is a false one – especially in the context of the Arts and Crafts movement. 'I never begin to be satisfied', said Philip Webb, one of the founders, 'until my work looks commonplace.' Lethaby's object, declared towards the end, was 'to create an efficiency of style.' Artistic form should they all held, be an emanation of regard for materials on the one hand and for function on the other."*

Lord Simon then asked whether the work under consideration was a work of "one who was … an artist-craftsman"; in the course of answering that he distinguished between various crafts particularly by reference to functional constraints.

Having approved that approach of Lord Simon, the High Court in *Burge v Swarbrick* concluded that (at 364):

> *"It may be impossible, and certainly would be unwise, to attempt any exhaustive and fully predictive identification of what can and cannot amount to 'a work of artistic craftsmanship' within the meaning of the Copyright Act as it stood after the 1989 (Amendment) Act. However, determining whether a work is 'a work of artistic craftsmanship' does not turn on assessing the beauty or aesthetic appeal of work or on assessing any harmony between its visual appeal and its utility. The determination turns on assessing the extent to which the particular work's artistic expression, in its form, is unconstrained by functional considerations."*

The appeal was ultimately decided on the basis that the plug was not a work of artistic craftsmanship because the work of Mr Swarbrick in designing it was not that of an artist-craftsman. The evidence had demonstrated that matters of visual and aesthetic appeal were subordinated to the achievement of purely functional requirements. As a necessary corollary the hull and deck moulds were also not works of artistic craftsmanship.

Further amendment to the copyright legislation by the Designs (Consequential Amendments) Act 2003 (Cth)

intended to further deal with the copyright/designs overlap did not include a recommendation that had been made by the Australian Law Reform Commission that "artistic craftsmanship" should be defined. Accordingly the primary issue decided in the appeal continues to be relevant.

The decision is important for its commercial ramifications and could be of some interest in the United Kingdom, despite a different regime for protecting individual designs, because "original artistic works", as defined in section 4 of the Copyright, Designs and Patents Act 1988 (UK), includes "a work of artistic craftsmanship". It can be noted that in the United States, the Vessel Hull Design Protection Act 1998, 17 USC § 1301, 1302 conferred *sui generis* protection upon designs for vessel hulls including "plugs" and "moulds."

Lockwood Security Products Pty Ltd v Doric Products Pty Ltd [No 2]

The second case is a patent case reported as *Lockwood Security Products Pty Ltd v Doric Products Pty Ltd [No 2]* (2008) 235 CLR 173; [2007] HCA 21 ("*Lockwood v Doric [No 2]*"). It raised a common dilemma in patent law: namely, the standard of inventiveness sufficient to justify the monopoly of a patent.

Historically, the separate requirement of inventiveness sprang from novelty from which, at first, it was not clearly distinguished. This can be traced easily through a series of cases mostly in the second half of the 19th century (see *Crane v Price* (1842) 1 Web Pat Cas 393 at 409 per Tindal CJ; *Tatham v Dania* (1869) Griffin Pat Cas 213 at 214 per Willes J; *Britain v Hirsch* (1888) 5 RPC 226 at 232 per Cotton LJ; *Cole v Saqui* (1888) 6 RPC 41 at 44 per Lindley LJ; *The Edison Bell Phonograph Corporation Limited v Smith* (1894) 11 RPC 389 at 398 per Lord Esher MR).

The requirement of "ingenuity" or "inventiveness" was "a brake"on too ready a grant of patent protection for analogous uses (Lewis Edmunds, *The Law and Practice of Letters Patent for Inventions*, (2nd ed, 1897 at 84). The requirement of an inventive step and the correlative, that a patent not be granted for an improvement which was obvious, were control mechanisms intended to inhibit the grant of weak or worthless patents which would inhibit the development of improvements well within the skill of the noninventive persons in the relevant art.

Lockwood v Doric [No 2] concerned a lock mechanism. Lockwood's new lock was designed so that when the lock was opened from the outside the inside lock disengaged thus overcoming the problem whereby a person on the inside could become trapped because without a key they could not unlock a deadlocked door from the inside. The main question was whether the new lock involved an inventive step over the prior art or whether it was a step which would have been obvious to a person skilled in the relevant art.

As with an earlier case, *Aktiebolaget Hässle v Alphapharm Pty Ltd* (2002) 212 CLR 411; [2002] HCA 59 ("*Alphapharm*"), the court had regard to historical considerations concerning the development of the inventive step requirement and the law concerning obviousness. The High Court in *Lockwood v Doric [No 2]* restated the position that the requirement of an inventive step balances competing policy considerations as follows (at 194):

> *"The emergence of the independent requirement for an inventive step, first in case law, then in legislative requirements for patentability as occurred in the United Kingdom, the United States and Australia, has always reflected the balance of policy considerations in patent law of encouraging and rewarding inventors without impeding advances and improvements by skilled, non-inventive persons."*

It had been noted in *Alphapharm* that the term "obvious" first appeared in legislation in the United Kingdom, United States and Australia after detailed judicial exegesis (at 428-429 [36] per Gleeson CJ, Gaudron, Gummow and Hayne JJ). Now, the legislatures both here in the United Kingdom and in Australia have laid down a conceptual framework for determining inventiveness and obviousness which in each case is intended to ensure that patents will not be granted without inventiveness over prior art.

The threshold for inventiveness had been raised in the United Kingdom with the introduction of section 3 in the Patents Act 1977 (UK). Membership of the Patent Union had necessitated aligning domestic patent law with the European Patent Convention which involved rebalancing the competing policy considerations adverted to in *Lockwood v Doric [No 2]*. Before turning to section 3, it needs to be noted that s 2(2) of the Patents Act 1977 (UK) defined the "state of the art" as follows:

> *"[I]t shall be taken to comprise all matter (whether a product, a process, information about either, or anything else) which has at any time before the priority date of that invention been made available to the public (whether in the United Kingdom or elsewhere) by written or oral description, by use or in any other way."*

Section 3 of the Patents Act 1977 (UK) was explicated by Sir Donald Nicholls VC in *Mölnlycke AB v Proctor & Gamble Ltd [No 5]* [1994] RPC 49 at 112:

> *"Under the statutory code … the criterion for deciding whether or not the claimed invention involves an inventive step is wholly objective. It is an objective criterion defined in statutory terms, that is to say whether the step was obvious to a person skilled in the art having regard to any matter which forms part of the state of the art as defined in section 2(2). We do not consider that it assists to ask whether 'the patent discloses something sufficiently inventive to deserve the grant of a monopoly['\]. Nor is it useful to extract from older judgments expressions such as 'that scintilla of invention necessary to support a patent'."*

This was a clear rebuff to the notion that it is appropriate to concentrate on the quantum of inventiveness; what is put in the forefront, in the place of quantum is the need to establish the quality of inventiveness.

The prior art base has also been extended in Australia. The Patents Act 1990 (Cth) first defined "prior art base" and "prior art information" and the Patents Amendment Act 2001 (Cth) expanded the prior art base, against which "inventive step" is assessed so as to include public oral disclosures and actions anywhere in the world.

In *Lockwood v Doric [No 2]* the court recognised that "the problem and solution" approach mandated here in the United Kingdom is useful, however the approach is to be applied with care in Australia so as not to exclude inventions containing a sufficient quantum of inventiveness.

The court found a "scintilla of invention" remains enough in Australia so that Australian law blends considerations of both the quantum and the quality of inventiveness and is therefore quite distinct from the law generated by the European Patent Convention which refers to a "problem and solution" approach to the question of inventive step. In any event it has been recognised that the "problem and solution" approach has its limitations and is not the only way to go about considering obviousness *(Actairs UK Limited v Novartis AG* [2010] EWCA Civ 82 at [26] and [39] per Jacob LJ).

It is of interest to note that in *KSR v Teleflex* 127 Sct 1727, 1741-43 (2007) the Supreme Court of the United States of America suggested that courts and patent examiners should go further than considering the "problem and solution approach."

The question of what is the correct threshold for inventiveness can be expected to remain under scrutiny particularly with applications for global patent protection in respect of novel subject matter such as gene patenting. Because genes and genetic products are emerging as both diagnostic and treatment tools for cancer, it may be contended in the future that the balance needs to be restruck between the need for the protection and encouragement of biotechnology innovations and the competing need for the public to have ready access to the benefits of genetic testing and technology.

Certainly, as Professor Cornish observes, the decision of the United States Supreme Court in *Diamond v Chakrabart* 65 Law Ed. (2d) 144 (1980), which upheld patent protection for a genetically engineered organism which could disperse oil spills, "sent a crucial signal to the world that patenting must be made available in any country which sought to join the race for commercial returns on biotechnological research" (Cornish and Llewellyn, *Intellectual Property: Patents, Copyright, Trade Marks & Allied Rights*, 6th ed (2007) at 221, [5-65]).

A not unrelated question is whether the exclusion of methods of medical treatment from patentability under European law should remain (see Directive 98/44/EC on the Legal Protection of Biotechnological Inventions, [1998] O.J. L213/13). Any redrawing of the boundaries of the patent system is inevitably a restriking of the balance which I have mentioned.

Yet another contemporary American context in which an argument has been raised for heightening the threshold of inventiveness (or non-obviousness) is the context of patents for interfaces which may impede interoperability among information and communication technologies: Pamela Samuelson, "Are Patents on Interfaces Impeding Interoperability?", (2009) 93 *Minnesota Law Review* 1943 at 1979. That proposal seems referable at least in part to a recognition that patents for interface designs may be sought for anticompetitive purposes, that is as a tool for blocking competitors from developing compatible products and for controlling the market for complementary products.

Finally, there has been continuing public discussion in IP Australia's consultation paper entitled *Getting the Balance right: Toward a Stronger and More Efficient IP Rights System* (November 2009) about whether the threshold for inventiveness should be raised so as to be more closely aligned with patentability standards in regions which are Australia's major trading partners.

Northern Territory of Australia v Collins and Anor

The third case is the second of the patent cases, *Northern Territory of Australia v Collins and Anor* (2008) 235 CLR 619; [2008] HCA 49. This concerned a quite narrow question of contributory infringement.

Mr and Mrs Collins, a married couple, were the joint registered proprietors of an Australian patent for methods of producing essential oils from Cypress pine timber. Such oils were produced for use in aromatherapy. The Northern Territory granted four licences to a company to enter various plantations to take and harvest Cypress pine timber. Mr and Mrs Collins sued the Northern Territory alleging contributory infringement under section 117 of the Patents Act 1990 (Cth) ("Patents Act"). Section 117 relevantly provided:

"(1) If the use of a product by a person would infringe a patent, the supply of that product by one person to another is an infringement of the patent by the supplier unless the supplier is the patentee or licensee of the patent.

(2) A reference in subsection (1) to the use of a product by a person is a reference to:

(a) …

(b) if the product is not a staple commercial product – any use of the product, if the supplier had

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reason to believe that the person would put it to that use; or

(c) …"

It can be seen that subsection (2)(b) provided what was in effect an exception to the concept of use where the product supplied was a "staple commercial product". The Northern Territory submitted that the timber in question was a staple commercial product within the meaning of section 117(2)(b) of the Act. Section 117 does not refer to the exclusive rights given to exploit the invention for the term of the patent (Patents Act s 13). Section 117 identifies conduct namely the "supply of [a] product" by one to another. Liability for infringement is imposed when "the use of [the] product" by the person to whom it is supplied "would infringe [the] patent".

In considering whether the timber taken under the statutory licences was a "staple commercial product", a reference was made, in the judgment of Gummow ACJ and Kirby J, to cognate expressions in both the United Kingdom and the United States (*Northern Territory v Collins* at 625-26 [24-27]). The evidence in the case showed that the timber under consideration was suitable for use in a variety of applications. The conclusion that the timber in question was a "staple commercial product" was determinative of the appeal. Accordingly, whilst there had been a relevant supply of timber, the supply was not capable of constituting contributory infringement.

Whilst this case was resolved on a narrow basis, the idea of contributory or indirect infringement in patent law influenced the United States Supreme Court in the *Sony* case (*Sony Corporation of America v Universal City Studios* (1984) 464 US 417) which involved an infringement-enabling device and the question of whether copyright infringement was made out in circumstances where the device could be used for "substantial non-infringing uses."

The whole area of the liability of businesses for the infringements of their customers is likely to continue to be interesting as the United States Supreme Court further considers secondary liability for copyright infringement. For a discussion of these issues and the cases see Jane C Ginsburg, "Separating the Sony Sheep from the Grokster Goats: Reckoning the Future Business Plans of Copyright – Dependent Technology Entrepreneurs", Columbia Law School, *Columbia Public Law Research* (2008), paper 08–166.

Copyright Agency Limited v New South Wales

The last two cases for consideration are copyright cases. *Copyright Agency Ltd v State of New South Wales* (2008) 233 CLR 279; [2008] HCA 35 concerned government copying of material being survey plans compulsorily lodged with relevant authorities. The final case, *IceTV v Nine Network Aust P/L* (2009) 83 ALJR 585; [2009] HCA 14, concerns copyright in respect of compilations.

Copyright Agency Ltd v State of New South Wales involved a statutory licence scheme under the *Copyright Act* 1968 (Cth) ("Copyright Act"). As noted in the judgment (at 296-267 [48]):

> *"[t]he emergence and refinement of statutory licence schemes has been a distinct part of the modern development of copyright law reflecting the competing economic interests of copyright owners and others with a legitimate interest in 'being able to use copyright material on reasonable terms'. The quest to maintain the balance between a public policy encouraging creativity and a public policy of permitting certain uses on some reasonable basis, continues to preoccupy the legislature, particularly as modern techniques for copying, especially digital electronics are 'both immensely efficient and easy to use'." (footnotes omitted)*

The appellant, Copyright Agency Ltd, was a recognised collecting society. Collecting societies have become increasingly relevant beyond their original function in respect of musical performance rights. This is because of photocopying technology and more recently new digital technology for the easy distribution of information. One of the members of Copyright Agency Ltd was the Australian Consulting Surveyors Association. Members of the Surveyors Association produced survey plans of land and strata in the state of New South Wales; they owned the copyright in survey plans produced by them.

The survey plans were "artistic works" protected by s 10(1) of the Act. The copyright in the artistic works, the survey plans, included the exclusive right to reproduce the survey plans in a material form (s 31(1)(b)(i)) and to communicate them to the public (s 31(1)(b)(iii)).

Two international treaties signed in Geneva in December 1996, the WIPO Copyright Treaty and the WIPO Performances and Phonograms Treaty, expanded the right of communication to the public, making it an independent and exclusive right consonant with the technology of the Internet. The *Copyright Amendment (Digital Agenda) Act* 2000 introduced the novel and exclusive right of communication to the public and section 10 of the Copyright Act defines "communicate" as "to make available online or electronically transmit (whether over a path, or a combination of paths, provided by a material substance or otherwise) a work or other subject-matter". Section 36(1) of the Copyright Act provided that the copyright in an artistic work was infringed by a person who, not being the owner of the copyright, and without the licence of the owner of the copyright, did or authorised the doing in Australia of any act comprised in the copyright.

The survey plans in question were necessary to enable the State to create and maintain an accurate record of land and interests in land. There were legal requirements for the preparation and lodgement of such survey plans. Only registered surveyors could prepare such plans which they did by following certain legal requirements. Typically surveyors charged their clients for the production of survey

plans. The Registrar-General, Land and Property Management Authority, with whom the plans were lodged was obliged by law to provide copies of registered plans to members of the public upon request. The Copyright Agency Ltd applied to the Copyright Tribunal for a determination of the terms upon which the State could make digital copies of the survey plans and communicate them to the public. In doing so it relied on section 183 which provided a licensing scheme for government use. The scheme of section 183 is to provide that the doing of an act comprised in the copyright in an artistic work does not constitute an infringement of copyright in the work "if the acts done are done for the services of" the State.

The Copyright Agency Ltd argued that section 183 is a statutory licence scheme leaving no room for the implication of a licence to copy the plans or communicate them to the public. It was contended that there was no need to imply a licence when an express statutory licence was available.

The State submitted that in all the circumstances it was not dependent on section 183 to except it from infringement, because it has an implied licence, binding on the owners of the copyright in the plans, to do everything it was required to do within the statutory and regulatory framework which governs the plans. Implicitly the State contended that by reason of the implied licence it had free use of such plans.

The court accepted the appellant's argument. The court recognised that the Act had several licence schemes which developed in tandem with improved techniques for copying of copyright works. It also noted that two related developments in the middle of the 20th century constituted the setting in which a special committee was appointed to reconsider inevitable tensions between the rights of copyright owners and the public need for reasonable access to copyright works.

First, Article 7 of the 1948 Brussels Revision of the *Berne Convention for the Protection of Literary and Artistic Works* 1886, had provided that the terms of copyright protection shall be for the life of the author plus 50 years after the date of the author's death. This raised the prospect that the system of compulsory licensing then in place would prevent copying long after the economic interest in doing so had dissipated. Second, Crown immunity for copyright infringement was abolished in the United Kingdom which raised the question of Australia following suit and instituting a system whereby the Crown might use copyright material without the risk of infringement. Section 183 had been introduced by the Copyright Act 1968 (Cth) to ensure that the Commonwealth and the States had a right to use copyright material in circumstances where such use was without the owner's consent.

The result reaffirmed the efficacy of the particular statutory licensing system with which it was concerned. It can be expected that statutory licensing schemes will be subject to continual updating as new technologies emerge which simplify copying. A related issue which I simply mention is the burgeoning of "fair use" exceptions to copyright infringement which may call for some future rationalisation.

IceTV Pty Ltd v Nine Network

The final case, *IceTV Pty Ltd v Nine Network* concerned a compilation of factual material. Nine Network ("Nine") sued IceTV Pty Ltd ("IceTV") for alleged infringement of copyright in Nine's television programme schedules. These were literary works under section 10 of the Copyright Act as "literary work" includes "a table or compilation, expressed in words, figures or symbols". The case gave rise to the question of whether copyright protection was confined to a particular mode of expression and whether it could be extended to facts or information. Australian legislation has no counterpart to the 1996 Directive of the European Parliament and of the Council on the Legal Protection of Databases.

The appellant, IceTV, published an online television programme guide for use with digital recording devices. The electronic guide was compiled from various sources including the weekly programme schedules compiled and released to the public by television networks. The respondent network claimed that IceTV had infringed copyright in it weekly schedules by directly reproducing details of the titles of its programmes and the times at which they would be broadcast. That information referred to as "time and title" information was claimed by the network to be a substantial part of its weekly schedules of programmes. This gave rise to the submission that IceTV had appropriated the skill and labour of the network's employees in the process of selecting programmes to be screened and placing them in particular timeslots so as to optimise advertising revenue.

One of the interesting issues to which the case gave rise was whether mere "sweat of the brow" in preparing a compilation was sufficient to establish the subsistence of copyright. In *Feist Publications Inc. v Rural Telephone Service Co Inc* 499 US 340 (1991) the United States Supreme Court rejected the argument that "sweat of the brow" in compiling information was enough and found that some creative spark was necessary to establish copyright in a compilation.

The judgments confirmed the proposition that copyright does not protect facts or information; what copyright protects is the particular form of expression in which facts and information are to be found. It was further held that assessing the substantiality of the part copied should not be carried out at too high a level of abstraction because that created a risk that "ideas" of an author would be protected rather than the expression in a material form of the ideas.

Another interesting aspect of the judgments is the confirmation that originality of the compilation was to be

determined by reference to the whole of the work. The expression of the "time and title" information was essentially dictated by the nature of that information therefore it lacked originality associated with mental effort or exertion.

Furthermore, all the judges recognised that in assessing whether reproduction of a substantial part of an original work involves an appropriation of skill and labour of the author (or authors) it is necessary to examine the skill and labour and to ask whether it is in fact directed to the originality of the form of expression. In one of the joint judgments, the various stages in the production of the weekly schedules was considered and the three judges in that joint judgment found that the preponderance of steps taken in relation to the production of the weekly schedules were steps directed to Nine's [ie the television network's] business, and that the steps directed to producing the weekly schedule and revising it and making last minute changes involved only modest skill and labour.

Because the expression of the time and title information was essentially dictated by the nature of the information, and involved no particular, or extremely modest, exertion, IceTV's taking and use of the time and title information was found not to amount qualitatively to a reproduction of a substantial part.

One commentator on the decision has pointed out that this decision aligns the Australian law in relation to factual compilations with its major trading partners. Glenn McGowan SC, "*IceTV v Nine Network* and the copyright in factual compilations in Australia", (2009) 83 ALJ 840 said (at 848):

- "United States – *Feist Publications, Inc. v Rural Telephone Co* 499 US 340 (1991) where copyright subsistence was denied in telephone books because no creativity and mere sweat-of-the-brow;
- Canada – *CCH Canadian Ltd v Law Society of Upper Canada* [2004] 1 SCR 339; 2004 SCC 13, roughly applied *Feist*, finding the exercise of skill and judgment must not be so trivial that it could be characterised as a purely mechanical exercise;
- England and Europe – EU Database Directive 1996, 96/9/EC, March 11, 1996; *British Horseracing Board v William Hill* [2005] EWCA (Civ) 863 where BHB failed to protect its racing data."

This case is also significant in its rejection of use of copyright for essentially anti-competitive purposes.

The five cases discussed all involved intellectual property issues which transcend national boundaries and some touch upon issues which form part of the ongoing debates in the United Kingdom, the United States of America and Australia, about the scope of patent and copyright law. If one takes copyright as a representative example, the Berne Convention for the Protection of Literary and Artistic Works 1886 and the revisions thereto, the TRIPS Agreement of 1994 and, as mentioned above, the treaties of 1996 (which build on the Berne Convention), collectively demonstrate the global possibility of relatively uniform standards of national protection, including new provisions creating new exclusive rights in the current world of internet communications.

That still leaves for consideration the argument advanced by Simon Stokes in *Digital Copyright Law and Practice*, 3rd ed (2009) at 3 that:

> *"the effect of strengthening copyright law in recent years to address the digital agenda will be to seriously and unjustifiably restrict the dissemination of speech, information, learning and culture while not providing any decisive incentives to the creator." (footnotes omitted)*

In the United Kingdom, the Treasury published the *Gowers Review of Intellectual Property* on December 6, 2006. More recently on December 16, 2008, the Intellectual Property office published *Developing a Copyright Agenda for the 21st Century*. Likewise, in Australia various government-run consultations have just been completed or are still in progress in relation to numerous aspects of intellectual property, particularly in relation to the challenges to copyright law posed by new technologies.

In the contemporary global economy, intellectual property also has to be assessed by reference to anti-competitive conduct and the general embrace of competitive market principles in many parts of the world. Whilst public debate about the scope and duration of patent, designs, trade marks and copyright protection will surely continue, individual cases such as those discussed above, show the continual restriking, by the courts, of the balance between a perceived need to reward innovation, investment and original work and the need to ensure fair public access to knowledge, information and culture.

In *Making History Now and Then* (2008), an historiographical study concerning Britain's Industrial Revolution, David Cannadine makes the point (at pp 83-111) that the first half of the 1970s saw a turning point in the world economy and the West, such that a steady pattern of post World War II economic progress halted. He observes that "by the 1980s it was clear that Britain was in the midst, not just of a new and severe cyclical depression reminiscent of the inter-war years, but of a transformative and scarring process of 'de-industrializing' that was occurring more rapidly that elsewhere in the Western World." One can add to that description of "de-industrializing", the contemporary experience of a global financial crisis and current scepticism about the efficacy of many of the 20th century policies intended to assist developing countries.

Individual intellectual property cases frequently require an understanding of the history and progress of the relevant legislation. What that undoubtedly shows is that

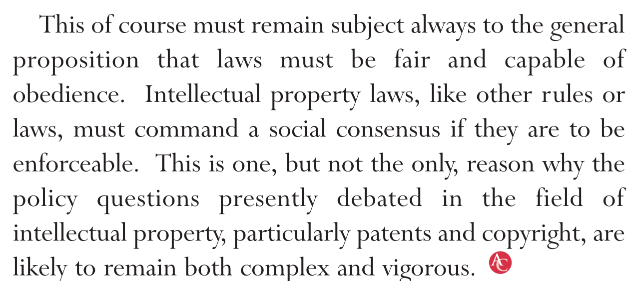
Anglo-American intellectual property law developed significantly in the late 19th century as a reflection of the industrial and social progress conventionally associated with the Industrial Revolution: see Adam Mossoff, "The Use and Abuse of IP at the Birth of the Administrative State", (2009) 157 *University of Pennsylvania Law Review* 2001 at 2022, and also Susan Crennan, "Obviousness – Different Paths Through Scylla and Charybdis", (2007) (71) *Intellectual Property Forum* 12. Australian intellectual property law followed suit as the second half of the 19th century was a period of great development in Australia, especially in the boom years of the 1870s and 1880s (see Andrew Kenyon, Megan Richardson and Sam Ricketson (eds), *Landmarks in Australian Intellectual Property*, (2009) at xviii).

CONCLUSION

In conclusion, may I venture the view that, whatever the economic or technological imperatives for change to intellectual property laws in the 21st century, certain ideas which blossomed in the last third of the 19th century and in the early 20th century are likely to remain constants. They are that there is great social utility in rewarding inventors and designers with limited monopolies and also in protecting, for a period, the original works specified under copyright legislation. International patent applications now reflect the great interest of China, now the world's sixth largest producer of patent applications, and Japan in becoming major producers of intellectual property. Significant investment in research and development leads to economies which favour the protection given by intellectual property laws.

We are more likely to see relevant intellectual property laws adapting to assimilate new technologies and what they make possible, such as file saving, and remaining relevant to them rather than to see a diminution in the scope of intellectual property laws or in the duration of the protection which such laws give. This may involve greater emphasis on secondary infringement rather than upon infringement by consumers of works available through digital media.

This of course must remain subject always to the general proposition that laws must be fair and capable of obedience. Intellectual property laws, like other rules or laws, must command a social consensus if they are to be enforceable. This is one, but not the only, reason why the policy questions presently debated in the field of intellectual property, particularly patents and copyright, are likely to remain both complex and vigorous.



- The paper is taken from a lecture given at the Institute of Advanced Legal Studies on February 15, 2010.

Susan Crennan

Justice of the High Court of Australia

Article

Duty of care and responsibilities of the management board of a German public company

by Frank Wooldridge

The above matters are regulated by the rather complex provisions of paragraph 93 of the German Aktiengesetz; the meaning of certain of them has given rise to some doctrinal controversies. The present article will be mainly concerned with paragraph 93 AktG, and will also deal with the prohibition of competition imposed on the members of the management board (board of directors) by paragraph 88 AktG.

THE EFFECT OF PARAGRAPH 93(1) AKTG

Paragraph 93(1) *AktG* provides that in carrying on business, the members of the management board shall exercise the degree of care of a diligent and conscientious manager. They shall not disclose confidential information or secrets of the company, especially trade and business secrets, which they have become aware of as the result of their service on the management board. Paragraph 93(1) has been said to impose an objective standard of conduct on the members of the management board: they are liable in damages to the company if they fail to attain the required standard. One of the leading textbooks indicates that this standard must be attained in the exercise of the specific tasks imposed on the management board by the relevant provisions of the *Aktiengesetz*, such as paragraphs 76, 80, 81, 83, 88, 90 and 92 thereof (see Uwe Hüffer, *Aktiengesetz*, 6th ed, pub C H Beck, 2004, p 472).

Confidential information consists of all information which has been acquired by the directors acting in this capacity, not necessarily as the result of their own efforts. Business secrets consist of all facts which are not published and which, according to the express or presumed intentions of the company, regard being paid to interests, should not be made public, provided that there is an objective need for such secrecy (BGHZ 64, 325). They indicate such matters as processes of manufacture or production, particularly of customers, and financial plans and decisions concerning staff. The duty to preserve confidentiality is not limited to the time when a director holds office, and is imposed on all the directors, including those who are appointed by the court, or who are deputies, or who represent the employees in accordance with the Codetermination Acts.

The requirement of confidentiality is inapplicable when the giving of information is in the interests of the company. Thus, such information may be given in the context of a due diligence exercise, or when shares are to be purchased on a stock exchange.

Liability for breach of duties

Paragraph 93(2) *AktG* provides that members of the management board who are in breach of their duties shall be jointly and severally liable to their company for any resulting damage. They shall bear the burden of proof in the event of a dispute as to whether or not they have employed the degree of care of a competent and conscientious manager. It is not entirely clear whether this provision is applicable both to their duties under the relevant provisions of company law and those governed by their contract of appointment, or whether it applies only to the first mentioned duties. (See Hüffer, *op cit*, p 415, who appears to take the latter view). The relevant paragraph applies to the deputies of members of the management board, and to members thereof who are appointed by the court; it is also applicable to those who are defectively appointed.

Members of the management board may not be found to have acted in breach of their duties to the company if they have merely been guilty of errors of judgment and mistakes. (An approach similar to that taken in the American "business judgment" rule has been taken by German courts in two important recent cases in which it was recognised that members of the management board must have a margin of discretion (*Handlungspielraum*), without which their tasks would be impossible. These two decisions are *ARAG/Garmenbeck* BGHZ 135, 244, 251 and *Siemens/Nold* BGH NJW 1996, 2815, 2816). However, the

members of the management board are likely to incur liability to their company if they have acted in an absolutely unjustifiable manner. Such liability may be imposed on them if what they have done is clearly not in the interests of the company, or if they have taken unjustifiable risks when acting on its behalf. It will be necessary to show that there has been a defect in the management of the company, and that at the time of the relevant decision or transaction which gave rise to the liability, it was evident that there was such a defect, or that such evidence was available to the member of the management board against whom the action was brought on some other basis. In one case which was heard by the *Oberlandsgericht* of Dusseldorf, the impugned transaction involved the grant of a loan amounting to 55 million German marks by the financial board of a company to another company without taking security. The latter company became insolvent and the members of the financial board of the lender were unsurprisingly held liable (see *AG (Die Aktiengesellschaft)* 1997, 231, 234 and Hüffer, *op cit* at p 136).

The fact that a member of the management board does not take part in a transaction does not exclude him or her from liability. Such a person cannot maintain that they have forgotten what has been told them about the transaction at a meeting of the board. A member of the management board must take account of the impressions that they have received of the activities of the other members of the management board at a meeting thereof. He or she has a right to object when there is concrete evidence that the responsible manager is not fulfilling their duties. This is apparent from a case (see BGHZ 133, 378 *et seq*) in which there was evidence that because the relevant company was in a situation of crisis employees' contributions to sound security were not properly made. In other cases of a less blatant character, evidence will also have to be given of the failure of members of the management board to fulfill their duties.

A member of the management board is not liable to pay damages when they can show that they have exercised the necessary degree of care. Such a person does not incur liability when employees of the company have acted in a manner which has caused damage to it. It is necessary to show that the wrongful act or omission of the member(s) of the management board has caused the damage to the company in order for the latter to become liable. The damage is required to consist of a diminution in the company's assets in a manner which is inconsistent with its object. The making of social security contributions on behalf of the employees does not constitute such a diminution.

As already indicated, paragraph 93(21), sentence 2 *AktG* provides that the members of the board bear the burden of proving that they have employed the degree of care required of a diligent and conscientious manager. (They are required to bear the burden of proving that there was no wrongful act or omission on their part. The company must show the existence and amount of the damage, mention the act or omission of the relevant managers, and show the causal effect of the act or omission (see Hüffer, *op cit*, p 477). The action against the members of the management board is brought by the company's supervisory board, provided that the general meeting resolves by a simple majority in accordance with paragraph 147(1) *AktG*. In addition, paragraph 148(2) *AktG* provides that shareholders who hold at least 1 per cent of the share capital may require the court to bring a direct action in the company's name against the managers.

It does not always prove readily possible to show that the breach of duty by a manager has occurred which has resulted in damage. The courts have sometimes resorted to presumptions in order to overcome this difficulty. Thus where a significant amount of cash is missing, or goods are no longer in a warehouse, the courts have sometime presumed that this is the fault of the managers. However, the courts have not been willing to assume that any diminution in assets is necessarily the fault of the managers, and have sometimes applied a restrictive interpretation of paragraph 93(2) sentence 2 *AktG* in such cases.

Managers who are jointly and severally liable to the company for damage caused to it in accordance with paragraph 93(2) *AktG* may claim a contribution from those of their number who can be shown to have a greater degree of responsibility for the relevant action. Shareholders who suffer injury as the result of acts or omissions of the management board cannot claim that paragraph 93(2) is a *Schutsgesetz* (protective statutory provision) intended for the protection of others, and requires reparation on the basis thereof. (Paragraph 813(2) of the Civil Code imposes an obligation to make reparation upon a person who infringes a statutory provision intended for the protection of others). Such protective provisions which may be invoked by shareholders suffering damage include paragraph 266 of the Penal Code and paragraph 399 *AktG*, which imposes criminal liability for making false statements.

It appears that third parties such as creditors cannot make claims against members of the management board of the company under paragraph 93(2) *AktG*, or under that provision coupled with paragraph 823(2) of the Civil Code. It is apparent that creditors may do under paragraph 92(2) *AktG* which is concerned with the initiation of insolvency proceedings, and which has held to be a provision intended for the protection of others within the meaning of paragraph 823(2) of the Civil Code. In addition, members of the management board may incur delictual liability (tortious liability) towards third parties who are harmed by their acts or omissions. In a case decided by the German Supreme Court in 1994 (see BGHZ 125, 366) the managing director (*Geschaftsführer*) of a German private company was held liable in tort for negligently failing to take precautions, where such

negligence resulted in the infringement of another person's property rights. This decision has encountered substantial criticism in the relevant literature, because it has been contended that paragraph 823(2) of the Civil Code applies to positive action rather than to failures to act.

The special rules contained in paragraph 93(3) Aktg

The above provision stipulates that members of the management board shall in particular (*sind namentlich*) be liable for damages in nine specific circumstances. Eight of these circumstances involve the making of payments or distribution of shares or assets by the company, whilst the other consists of the issue of share certificates before the issue price has been fully paid. In each case the action must be one which is contrary to the *Aktingesetz*. (Note in this sense Hüffer, *op cit*, p 479 and *Die Aktiengesellschaft*, 2003, p 321. However, certain other provisions of the *Aktiengesetz*, ie paragraphs 92(2) and 400 thereof, may be regarded as protective statutory provisions for the benefit of creditors in the sense meant in paragraph 823(2) of the Civil Code).

Exclusions of liability under paragraph 93(4) Aktg

According to the first sentence of the above provision, a member of the management board shall not be liable top the company for damages if they acted in accordance with a lawful resolution of the shareholders' meeting. Such a resolution must not be void or voidable. Every resolution of the general meeting concerning the management of the company passed without being requested by the management board is void, according to the provisions of paragraph 119(2) *AktG*. The nullity of a resolution which is void may no longer be asserted if it has been registered in the Commercial Register and three years have elapsed. (See para 242(2) *AktG*. In addition, by para 242(1) *AktG*, the nullity of a resolution of a shareholders' meeting which contrary to para 130(1) and (4) has not been recorded or properly recorded may no longer be asserted if the resolution has been entered in the Commercial Register.) A resolution which is voidable becomes no longer so within one month after its adoption, according to paragraph 246(1) *AktG*. It appears that once the nullity of a resolution may no longer be asserted it can no longer be treated as a nullity under paragraph 93(4). The same would seem to be true of a voidable resolution once it may no longer be avoided.

It will be noted that the exclusion of a member of the management board from liability for damages is contingent on his or her acting on the basis of a lawful resolution of the general meeting. Such a person who acts on the basis of an unlawful resolution which he or she has himself or heself procured by giving wrongful information may still be liable (note in this sense Hüffer, *op cit*, p 481.)

According to paragraph 93(4) sentence 2 *AktG*, liability for damages shall not be excluded by reason of the fact that the supervisory board has consented to the act. The waiver or compromise of a claim for damages by the accompany against members of the management board is dealt with by paragraph 93(4) sentence 3 *AktG*. This text provides that such a transaction may take place upon the expiry of three years after the claim has arisen, provided that the shareholders' meeting consents thereto, and no minority share aggregate shareholding equals or exceeds one-tenth of the share capital records an objection in the minutes of the meeting. The meeting reaches its decision by a simple majority vote (para 133 *AktG*) and the relevant members of the management board against whom the claim is made have no vote.

The final sentence of paragraph 93(4) *AktG* provides that the foregoing period (of three years) dopes not apply if the person liable for damages is unable to make payments when they become due and enters into a composition with his creditors to avoid insolvency proceedings, or if the liability to pay damages is subject to an insolvency plan.

Paragraph 93(5) AktG and the rights of creditors

Paragraph 93(5) *AktG* sentence 1 provides that the claim of the company for damages may also be asserted by the company's creditors if they are unable to obtain satisfaction from the company. However, the sentence which follows it stipulates that in cases other than those set out in paragraph 93(3) of this rule shall apply only if the members of the management board have grossly violated the duty of care of a diligent and conscientious manager. It also makes it clear that in any litigation by the creditors, the burden of proving that they have acted as diligent and conscientious managers will be placed on the relevant members of the management board.

Creditors are treated as being unable to obtain satisfaction from the company if it cannot pay its debts: there is no need for them to attempt to levy execution against it. It follows from sentence 3 of paragraph 93(3) *AktG* that liability for damages to creditors may not be extinguished as the result of a waiver or compromise by the company, nor by the fact that the act which caused the damage was based on a resolution of the shareholders meeting.

The creditors must require payment to themselves, and not to the company. A member of the management board who has already been sued by the company for damages cannot raise the objection that such a claim is pending in litigation by the company's creditors against him or her. However, if a member of the management board satisfies the claim made against him by the company, his liability to the creditors is extinguished. It is possible for a creditor to bring an action against the company, and also to enforce it by execution proceedings directed against the company's claim for damages against a member of the management board, which have the effect of transferring this claim to the creditor. The use of such proceedings has practical advantages.

The final sentence of paragraph 93(5) *AktG* deals with the effect of insolvency proceedings. It provides that if such proceedings have been instituted in respect of the company's assets, the administrator (*Sachverwalter*) or receiver (*Insolvenzverwalter*) shall exercise the rights of the creditors against the members of the management board during the course of the proceedings. The creditors themselves cannot bring an action against such persons during the course of the insolvency proceedings. The bringing of insolvency proceedings will interrupt any such action which is proceeding. The receiver may bring a claim against a member of the management board whose liability for damages to creditors is not extinguished by a waiver or compromise by the company. Furthermore, the receiver is not bound by the rule contained in paragraph 93(3) sentence 3 *AktG*, and may enter into compromises with creditors.

Expiration of claims under paragraph 93(5) sentences 1-5 Aktg

The expiration of claims under the above provisions is dealt with by paragraph 93(5) sentence 6 *AktG*, which provides that such claims may no longer be made after the expiration of a period of five years. When claims are made under other legal provisions they are subject to the relevant limitation period for such provisions. The limitation period for an action against a member of the management board begins when the plaintiff company has become aware or failed to have become aware of the existence of the wrongful act of the relevant member owing to gross negligence on its part.

COMMENTS ON THE ABOVE PROVISIONS

The provisions of paragraph 93(5) *AktG* are somewhat detailed, and bear little resemblance to those contained in paragraphs 171-77 of the UK Companies Act 2006, which applies both to public and private companies. There is nothing in the *Aktiengesetz* or in the *GmbH Gesetz* which regulates private companies corresponding to the somewhat controversial provisions of section 172 of the Companies Act 2006, which imposes a duty to promote the success of the company on its directors, and there is an imposition of a duty of a pluralistic nature, requiring the directors to promote interests other than that of the company such as those of employees, customers or the environment, in paragraph 93 *AktG*. The existence of employee codetermination at the level of the supervisory board in large German companies having at least 2,000 employees may help to further the employees' interests.

RULES GOVERNING THE PROHIBITION OF COMPETITION BY MEMBERS OF THE MANAGEMENT BOARD

The above rules, which are an important feature of German company law, are contained in paragraph 88 *AktG*. They reflect the fact that the members of the management board of a German public company have fiduciary duties to that company. (See the judgment of the *Oberlandesgericht* of Frankfurt to this effect, reported in *Die Aktiengesellschaft*, 2000, pp 518, 519). The ambit of the rules considered below is rather wide. In some other jurisdictions relevant similar rules may exist or be rendered permissible under the provisions of competition law.

Rules contained in paragraph 88(1) AktG

The above paragraph stipulates that, unless the supervisory board so consents, the members of the management board may neither engage in any trade nor enter into any transaction in the company's area of business on their own behalf, or on that of others. In the absence of such consent they may neither be a member of the management board nor a manager or general partner of another commercial undertaking (for example a public or private company, or a commercial partnership). The consent of the supervisory board may be granted only for a specific trade or business, a specific commercial enterprise, or for specific types of transactions.

Paragraph 88(1) *AktG* is designed to protect the company against certain activities by its directors, and to safeguard it from competition by them. It is appreciable to members of the management board and their deputies (but not to the regulators) of the company whilst they remain in office. The prohibition in pursuing managerial activities in another commercial undertaking is not limited to undertakings in the same field of business, and does not apply to membership of the supervisory boards of such undertakings.

The claim for damages under paragraph 88(2) AktG

The above text provides that if a member of the management board fails to comply with the prohibition contained in paragraph 88(1) *AktG* the company may claim damages from them. It may instead require that such a member treats the transaction made on his behalf as having been made on behalf of the company, and give up any remuneration received from another person, or assign his rights to it, to the company. The latter alternative sometimes has the advantage that no depletion in the company's assets occurs, but its use requires that the company could have carried on the activity by itself, and is not prohibited from doing so. (Hüffer, *op cit*, p 441).

The provisions of paragraph 88(3) AktG concerning limitation

The above provision stipulates that the claims of the company shall be extinguished within three months after the other members of the management and the supervisory board come to know of the act giving rise to damages. Irrespective of such knowledge, such claims are barred upon the expiry of five years after the time when they have arisen. It appears that this rule does not apply

where the supervisory board has not given its consent to the relevant act, or has given it improperly.

Contractual provisions extending the ambit of the statutory rules

It is possible to extend the statutory rules contained in paragraph 88 *AktG* to cover activities of a member of the management board which occur after their retirement. However, limits on competitive activities which occur after such retirement are regulated in paragraph 1 of the Law against Restraints upon Competition (*Gesetz gegen Wettbewerbsbeschränkungen*) and in paragraph 138 of the German Civil Code. Both these provisions require any prohibition of such activities to be required by the legitimate interests of the company and its undertaking, and to be limited in substance, time and extent according to the needs of the company for protection (see Hüffer, *op cit*, p 442 for further details.)

CONCLUDING REMARKS

The specific provisions contained in paragraph 88 *AktG* concerning competitive activities by the directors would not seem to be paralleled in many other jurisdictions. However, the pursuit of such activities will be subject to the relevant rules governing directors' fiduciary duties and of competition law in such jurisdictions. The provisions contained in paragraph 92 *AktG*, which have already been discussed above, appear to be of a more comprehensive and detailed nature than is the case in most other jurisdictions.

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