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Foreword to the First Volume by Lord Hope of Craighead

I offer my warmest congratulations to those whose idea it was to institute the Edinburgh Student Law Review and to everyone who has been responsible for bringing this issue forward to publication. It is the first student-produced law review in Scotland and only the third in the United Kingdom. It is fitting that the Law School at Edinburgh – a city that was in the forefront of publishing political reviews in the age of enlightenment – should lead the way here north of the border.

Ground-breaking though its publication may be in this jurisdiction, the Review follows a tradition that has long been established among the leading law schools in the United States. The editorship of student law reviews in that country is much sought after, as is the privilege of having a paper accepted by them for publication. The stronger the competition for these positions, the higher the standard that is exhibited by those who occupy them. It is well known that their editors are singled out by the Justices of the US Supreme Court and the Federal Appeals Courts when they are recruiting their law clerks. The reflected glory that this produces enhances in its turn the reputation of the reviews. A reference to editorship of this Review will not escape notice if it appears on the CV of someone who is applying to be a judicial assistant to the UK Supreme Court. But participation in its publication will be of benefit in so many other ways too.

This is pre-eminently a publication by and for students. Its aim is to enhance standards of thinking and writing about law and to promote discussion among all those who are studying law, at whatever level this may be. Law is pre-eminent among the professional disciplines in its use of words to convey ideas. Thinking and writing about law is an essential part of legal training. So too is the communication of ideas about law, as each generation has its part to play in the way our law should develop for the future. I wish all success to those who will contribute to this project, whether as writers or as editors, and I look forward to the benefits that will flow from making their contributions available through this publication to the wider legal community.

David Hope
March 2009

Editorial

Since its founding over 15 years ago as Scotland's pioneering student-led law review, the ESLR has acted as a platform for legal scholarship. Its influence now extends beyond the Edinburgh Law School, having set a precedent for similar publications across Scotland, and it continues to nurture community amongst legal minds.

15 years on from our foundation, we are delighted to be re-launching the ESLR with the steadfast support of the students, academic faculty and professional services staff of the Edinburgh Law School. Special recognition must go to our Honorary Secretary, Professor Andrew Steven, and our Honorary President, Lord Hope of Craighead, whose enduring dedication has been invaluable to the Review.

The heart of the ESLR is its student body, and we are particularly proud that the Review remains entirely student-run, with contributors ranging from undergraduates to doctoral candidates. Beyond offering a space for legal writing, the ESLR provides students with invaluable experience in research, editing, and publishing, equipping them with skills that are essential in their future legal careers.

This edition of the ESLR reflects the diversity and depth of legal scholarship, featuring articles that cover a broad spectrum of topics. This issue is a testament to the wide-ranging interests of our contributors. We are especially pleased to have received submissions from institutions across the UK and beyond. To all those who submitted, we thank you for your engagement and encourage you to contribute to future editions of our publication.

Collaboration lies at the core of the ESLR, and we are immensely grateful to all those involved in producing this edition. The adaptability of our office holders, particularly during this re-launching process, has been instrumental to the creation of the 2024 issue. We extend our deepest thanks to everyone for their dedication and resilience.

Looking ahead, the ESLR remains committed to its mission of providing a platform for student voices in legal scholarship. It has been a privilege to oversee this year's edition, and we hope you find it as engaging and thought-provoking as we have throughout its preparation.

We are delighted to introduce the latest edition of the Edinburgh Student Law Review.

Natalie Fowler, Vaishnavi Srikanth and Sukru Kagan Surucu
Co-Editors-in-Chief
2024

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THE STRANGE CASE OF AN AGENT ACTING FOR AN UNIDENTIFIED PRINCIPAL

*Nadia Napieraj**

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A. INTRODUCTION

The strange case of the unidentified principal has so far attracted limited academic attention.[1] The standard case from the external perspective of agency involves a disclosed and identified principal who reveals both his status as an agent and the principal's identity, binding the principal and the third party to an agreement.[2] On the other side of the spectrum lies the "anomalous" concept of undisclosed agency where the third party does not know of the principal's involvement.[3] The orthodox view is that, in undisclosed agency, a contract exists between the agent and the third party, with the principal being able to intervene.[4] The two concepts are to be distinguished from disclosed but unidentified agency which arises where the third party is given notice of the agent's status, but not of the principal's name.[5] The exact contractual relations arising from unidentified agency are unclear,[6] arguably due to limited case law,[7] as well as authorities which confuse unidentified with undisclosed agency.[8]

It will be submitted that in unidentified agency, Scots law should develop the general rule proposed by Professor Macgregor and consistent with the outcome of the nineteenth-century Inner House decision of *Ferrier v Dods*:[9] the agent should be liable 'unless and until the principal is

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[1] Albeit see F M B Reynolds, 'Unidentified Principals in Common Law' in D Busch, L Macgregor, and P Watts (eds), *Agency Law in Commercial Practice* (OUP 2016).
[2] L Macgregor, *Agency Law in Scotland* (1st edn, W Green 2013) para 12.04, relying on Bell, *Commentaries*, I, 536 and I, 539-540; *Miller v Mitchell* (1860) 22 D 833 (IH); *Mackenzie v Cormack*, 1950 SC 183, 187 (IH).
[3] A L Goodhart and C J Hamson, 'Undisclosed Principals in Contract' (1932) 4 Cambridge LJ 320, 346.
[4] Reynolds, 'Unidentified Principals in Common Law' (n 1), para 4.05.
[5] ibid, para 4.01.
[6] Macgregor (n 2), para 12.19.
[7] Macgregor (n 2), para 12.17; Reynolds (n 4), para 4.03.
[8] For example, *Meier v Küchenmeister* (1881) 8 R 642 (IH); *Siu Yin Kwan v Eastern Insurance Co Ltd* [1994] 2 All ER 199 (HKPC).
[9] *Ferrier v Dods* (1865) 3 M 561 (IH).

disclosed'.[10] This solution contrasts with other, more modern, Inner House cases, propounding a "credit" approach:[11] *Lamont, Nisbet & Co v Hamilton*,[12] and *Ruddy v Monte Marco & ors*.[13] This essay will firstly analyse these three cases to demonstrate that there is no established approach to unidentified agency in Scots law (Part B). Then, three different approaches will be evaluated: the absence of a general rule of liability (*Lamont*) (Part C), the general rule of liability against (1) the agent (*Ruddy*), or (2) the principal (cf *Ruddy*) (Part D), and finally, the general rule that the agent is liable, but only unless and until he names the principal (*Ferrier*) (Part E). It will be concluded that the *Ferrier* approach should be developed because it best reflects the third party's expression of consent as being bound to the principal, while adequately addressing the practical difficulty of identifying the latter. Although such intervention is inconsistent with the doctrine of privity, it may be explained by mere practical necessity, or, more persuasively, by the emerging doctrine of good faith in Scots law. It also reflects the approach adopted by the leading civil law instruments including the Principles of European Contract Law ('PECL'),[14] and the Draft Common Frame of Reference ('DCFR').[15]

B. THE SCOTTISH POSITION

(1) The "Election" Approach in *Ferrier*

The facts of *Ferrier v Dods*[16] were simple. F had bought a horse from an auctioneer, D, who had guaranteed that the horse was a 'good worker'. Because the horse did not meet this description, F returned it to D who instructed F to deliver the horse to B, the principal. Both D, and subsequently, B, accepted the horse's return. Yet, F had not been refunded, and thus raised an action against both D and B.[17]

Lord Justice Clerk Inglis held that F could elect to sue either D, 'because the principal [B] had not been originally disclosed' or B, 'now disclosed'.[18] Because F had returned the horse to B, he was held to had elected B, thus could only pursue the action against him.[19] With respect to the analysis in Macgregor's leading textbook,[20] it is not completely apparent from Lord Inglis's judgement that the agent should not be liable once the principal is identified, considering the emphasis placed by Lord Inglis on D electing B by returning the horse to him, as accepted in Macgregor's earlier work.[21] However, the case may be so interpreted considering Lord Cowan's unopposed assertion that the 'statement explanatory of Dods's connection with the transaction', in other words, his position as agent in the transaction, absolved him of liability.[22] The case can thus be interpreted as suggesting that the agent should be liable only unless and until he names the principal. Such a solution finds its support in Lord McLaren's note in Bell's *Commentaries*.[23]

[10] Macgregor (n 2), para 12.21.
[11] Macgregor (n 2), para 12.17-12.19.
[12] *Lamont, Nisbet & Co v Hamilton* 1907 SC 628 (IH).
[13] *Ruddy v Monte Marco & ors* [2008] CSIH 47, 2008 SC 667.
[14] Principles of European Contract Law (PECL) (2000).
[15] Draft Common Frame of Reference (DCFR) (2009).
[16] *Ferrier* (n 9).
[17] ibid 564.
[18] ibid
[19] ibid
[20] Macgregor (n 2), para 12.17.
[21] L Macgregor, 'Agency and Mandate' in *The Laws of Scotland: Stair Memorial Encyclopaedia* (Butterworths; Law Society of Scotland 2001), Reissue 1, paras 139-141.
[22] *Ferrier* (n 9) 564.
[23] See also the position preferred in Bell, *Commentaries* I, 540, Lord McLaren's note.

(2) The "Credit" Approach in *Lamont* and *Ruddy*

Lamont

In *Lamont*, managing owners (M) of a ship named Gordon Castle (GC), and other ships belonging to various owners, contracted with insurance brokers (L), to insure these ships. When M failed to pay the premiums, L raised an action for payment against the GC's owners, Hamilton (H), as principals.[24]

The Inner House upheld the decision of the Lord Ordinary that M, the agent, was solely liable under the contract. The key factor in determining the party to the contract was 'to whom … the credit [had been] originally given'.[25] Because of certain contractual terms, such as M's right to cancel the policies, it was held that the contract existed exclusively between L and M.[26]

Lamont may be a simple application of the general interpretative rule that even an agent for an identified principal may be liable if the contract or the circumstances show that he intended to bind himself personally.[27] In fact, the case echoes the 19th-century "credit" approach to general contractual interpretation in agency upheld in *Millar v Mitchell*.[28] However, as Macgregor suggests, *Lamont* may suggest that there is no general principle in unidentified agency cases: that the contract is entered into with the party on whose "credit" the third party relied.[29]

Ruddy

In *Ruddy*, a 21st-century case, the Inner House identified the parties to an employment contract in an action of reparation for personal injuries suffered by Ruddy (R), a handyman engaged by Marco (M), a director of, and thus agent for, the second defenders, M&H Enterprises Ltd (M&H).[30]

To distil the relevant rules, Lord Eassie relied on two conflicting authorities. Firstly, Professor Walker's textbook on *The Law of Contract and Related Obligations in Scotland* suggested that, as a general rule, the agent should be liable, as the third party usually does not rely on the credit of an unidentified principal.[31] Secondly, *Bowstead and Reynolds*, a leading English authority, suggested that as a general rule, the principal is liable, unless the agent fails to negative his personal liability.[32] Ultimately, a hybrid, "credit" approach was upheld: the agent acting for an unidentified principal will, as a general rule, be liable, unless he can show that he 'negatived personal liability'.[33] This was seen as reflective of the outcome of *Dores v Horne and Rose,*[34] referred to by Gloag as a 'special case' where law agents were held liable under their client's undertaking.[35]

Although the case may be classified as a "credit" approach case,[36] it suggests very limited circumstances in which the principal will be held liable. The fact that the third party had notice from the surrounding circumstances that the agent acted for a principal was insufficient to negative

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[24] *Lamont* (n 12) 628.
[25] *Lamont* (n 12) 635.
[26] *Lamont* (n 12) 636.
[27] Macgregor (n 2) 12.01.
[28] *Millar v Mitchell* (1860) 22 D 833, 850 (IH). See also Bell, *Commentaries* I, 541, note.
[29] Macgregor (n 2), para 12.18.
[30] *Ruddy* (n 13) 667.
[31] D M Walker, *The Law of Contract and Related Obligations in Scotland* (3rd edn, T&T Clark 1995) para 29.7, in *Ruddy* (n 13) [21].
[32] F M B Reynolds (ed), *Bowstead and Reynolds on Agency* (18th edn, Sweet and Maxwell 2006), paras 9.001–9.003, referred to in *Ruddy* (n 13) [14], [22].
[33] *Ruddy* (n 13) [23].
[34] (1842) 4 D 673 (IH).
[35] W M Gloag, *Gloag on Contract* (2nd edn, W Green 1929) 138.
[36] Macgregor (n 1) para 12.19.

the agent's liability. This approach thus holds the agent liable, as a general rule, subject to the latter proving otherwise. It also received some support from Lord McLaren in Bell's *Commentaries*.[37]

(3) An Established Position?

The law in this area is uncertain.[38] *Ruddy* does not refer to, or explicitly overturn *Lamont* or *Ferrier*, but it may do so implicitly. However, the Inner House in *Ruddy* failed to deliver a 'full legal analysis' of unidentified agency.[39] Furthermore, it was a case involving an employment contract, a type of personal contract,[40] in which the standard showing that the agent purported to represent a principal in the contract may be higher. It will thus be considered which, if any, of these three approaches is preferable, assuming that the door to the development of the law by the courts in this area is not closed.

C. NO GENERAL RULE OF LIABILITY

The approach in *Lamont*, by suggesting a "credit" approach in which neither the agent nor the principal is presumed to be liable, may be admired as it reflects the spirit of contract law by necessitating the finding of the intended contractual party in each case.[41] It is also reflected by some common law authorities. In *The Santa Carina*,[42] the Court of Appeal disapproved of an earlier judgement,[43] which supported the general rule that the agent is liable. Instead, the right question was to whom the "credit" was given in the particular case,[44] or, in a more modern vein, what the intentions of the parties, ascertained objectively, were.[45] The latter approach was approved in a modern decision of the Supreme Court of Canada.[46]

However, the leading English,[47] and Canadian,[48] textbooks now uphold a general rule of the principal's liability in unidentified agency, focusing on the parties' intention only to overturn the general presumption.[49] In the international context, as will be shown below,[50] general rules of liability reign supreme. Similarly, even in cases of undisclosed agency, where the setting of a general rule proved difficult, the now "orthodox" approach that the contract arises between the agent and the third party, with the principal having a right to intervene,[51] has been reached. This may reflect the pursuit of legal certainty, traditionally emphasised as crucial for parties to commercial transactions by Lord Mansfield.[52] It thus seems that a more satisfactory rule could be developed.

D. GENERAL RULES OF LIABILITY

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[37] Bell, *Commentaries* I, 542, Lord McLaren's note.
[38] Macgregor (n 2), paras 12.19, 12.23.
[39] Macgregor (n 2), para 12.19.
[40] D Cabrelli, *Employment Law in Context* (4th edn, OUP 2020) 144.
[41] W McBryde, *The Law of Contract in Scotland* (3rd edn, W Green 2007), para 5.01.
[42] *N & J Vlassopulos Ltd v Ney Shipping Co (The Santa Carina)* [1977] 1 Lloyd's Rep 478 (CA).
[43] *Benton v Campbell, Parker & Co Ltd* [1925] 2 KB 410, 414.
[44] *The Santa Carina* (n 41) 481, per Lord Denning MR.
[45] ibid 483, per LJ Roskill.
[46] *Chartwell Shipping Ltd v Q.N.S. Paper Co Ltd* [1989] 2 SCR 683, 745.
[47] P Watts and F M B Reynolds (eds), *Bowstead and Reynolds on Agency* (22nd edn, Sweet & Maxwell 2022), paras 8-001, 9-001.
[48] G H L Fridman, *Canadian Agency Law* (2nd edn, LexisNexis Canada 2012), para. 6.2.
[49] Watts and Reynolds (n 46), para 9-002; Fridman (n 47), para 6.2.
[50] See in particular Parts D(b), and E.
[51] Reynolds (n 4), para 4.05; Watts and Reynolds (n 46) 8-069; *Welsh Development Agency v Export Finance Co Ltd* [1992] BCLC 148 (CA); cf W Muller-Freienfels, 'The Undisclosed Principal' (1953) 16 MLR 299, 306; C-H Tan, 'Undisclosed Principals and Contract' (2004) 120 LQR 480, 486.
[52] *Vallejo v Wheeler* (1774) 1 Cowp 143, 153.

The approach in *Ruddy* suggests that, as a general rule, the agent is liable, unless he negatives his liability by doing something more than naming the principal. This section will thus consider whether a general rule of liability of the agent, or, by contrast with *Ruddy*, the principal, is satisfactory.

(1) Agent

The third party may be seen as consenting to the agent being bound, in line with the approach of Diplock LJ in *Teheran-Europe Co Ltd v S.T. Belton (Tractors) Ltd.*[53] The dicta suggest that the identity of the principal is irrelevant if the third party:[54]

> 'is willing or leads the agent to believe that he is willing to treat as a party to the contract anyone on whose behalf the agent may have been authorised to contract.'

Such willingness is presumed in ordinary commercial contracts,[55] as affirmed by a leading Privy Council case.[56] It may thus be argued that, because the identity of the principal is, in general, irrelevant to the third party, the latter implicitly consents to the agent being bound.[57] This approach is reflected by the *Restatement (Third) of the Law of Agency*, which holds that the agent is, as a general rule, a party to the contract, alongside the principal.[58] As Holmes and Symeonides put it, 'few people would put their complete trust in the creditworthiness of an unidentified person', from which it follows that the agent is 'at least a co-obligor on the contract.'[59] Where the third party expresses or implies his unwillingness to contract with the agent, there would be no contract between the two, due to a lack of consent.[60]

However, this general rule is highly unsatisfactory. As Quinn notes, 'willingness to treat' is not the same as 'willingness to contract' with a party.[61] In other words, just because the third party may not be unwilling to bind the agent does not mean that she consents to contract with him, or even further, as suggested by *Ruddy*, to contract exclusively with him.[62] In construing contracts, the court's task is to 'decide what each [party] was reasonably entitled to conclude from the attitude of the other',[63] and the agent arguably cannot conclude that the third-party consents to contracting with him. Quinn argues, in the undisclosed agency context, that Diplock LJ's dicta in *Teheran-Europe* only apply to merit the intervention of the principal 'by operation of law', rather than enabling a contract to be formed between the principal and the third party.[64] Similarly, in the unidentified agency context, there can be no contract with the agent.

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[53] *Teheran-Europe Co Ltd v ST Belton (Tractors) Co Ltd* [1969] 2 QB 545 (CA).
[54] ibid 555.
[55] ibid 555.
[56] *Siu Yin Kwan v Eastern Insurance Co Ltd* [1994] 2 AC 199, 207-208 (HKPC).
[57] *Schmalz v Avery* (1851) 16 QB 655.
[58] Restatement (Third) of the Law of Agency, §6.02.
[59] W H Holmes and S C Symeonides, 'Representation, Mandate, and Agency: A Kommentar on Louisiana's New Law' (1999) 73 Tul L Rev 1087, 1143.
[60] *Hill SS Co Ltd v Hugo Stinnes Ltd* 1941 SC 324, 337, endorsed by Watts and Reynolds (n 46), para 9-095.
[61] K Quinn, 'Undisclosed Principals' in K Quinn and P Watts (eds), *Contracting with Companies, Trusts, Partnerships and Nominees* (2010) 91, paraphrased in A Lang, 'Unexpected Contracts versus Unexpected Remedies: The Conceptual Basis of the Undisclosed Principal Doctrine' (2012) 18 Auckland U L Rev 114, 125.
[62] Reynolds (n 4), para 4.26.
[63] Gloag (n 34) 7.
[64] Quinn (n 60) 91, as referred to in Lang (n 60) 125.

Furthermore, as discussed below,[65] the approach of holding the agent solely liable seems unrepresented internationally. As argued by Lord Hodge, in the context of commercial law, legal particularism should be minimised.[66]

(2) Principal

Having demonstrated that the approach in *Ruddy* is unsatisfactory, the contrary position will be assessed, namely, whether the unidentified principal should be held liable as a general rule. Although unrepresented in Scots law, this is the position in English law,[67] which could be used to develop our law, as it has often been done in the agency context.[68] Although the Inner House in *Ruddy* relied directly on *Bowstead and Reynolds* to influence its position, the English authors note that the Scottish approach is 'apparently different' as a result of Ruddy,[69] perhaps suggesting a misinterpretation by the court.

This general rule is more aligned with the requirement of consent: the third party is objectively seen as being willing to take the risk to contract with anyone whom the agent might represent,[70] consistently with the *Teheran-Europe* dicta by Diplock LJ.[71] The situation can be analysed under the Krebs' 'offer and acceptance model', with the principal and the third party being seen as exchanging consent, and the agent acting as a 'mere messenger'.[72] The third party, if unwilling to take such risk, can simply refuse to enter into the contract.[73] This approach has been adopted in Canada,[74] South Africa,[75] as well as recognised by the UNIDROIT Principles of International Commercial Contracts ('PICC').[76]

The adoption of such a position in Scotland would also be consistent with case law which suggests that in unidentified agency the third party cannot claim compensation against the principal of debt incurred by the agent.[77] The decision may reflect the court's intuition that it is the principal who should be held be liable. Dalley, writing in the context of the *Restatement (Third) of the Law of Agency*, claims that agency law is explained by the 'cost-benefit internalisation theory', which presupposes that, from a moral and economic perspective, it is the principal, the party primarily benefiting from using agency, who should carry the foreseeable risks of transactions entered on his behalf.[78]

Despite the apparent persuasiveness of this rule, two main challenges may be posed. Firstly, any rule making the principal primarily liable may invite unscrupulous behaviour by the agent, who, acting for multiple principals under the same instructions, may enter into the contract without having any particular principal in mind, enabling him to subsequently allocate contracts

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[65] See in particular Parts D(b), and E.

[66] P S Hodge, 'Does Scotland need its own Commercial Law?' (2015) 19(3) The Edinburgh Law Review 299, 310.

[67] Watts and Reynolds (n 46), paras 8-001, and 9-001 referring to *Montgomerie v UK Mutual SS Assn Ltd* [1891] 1 QB 370, 371.

[68] L Macgregor, 'Empire, Trade, and the Use of Agents in the 19th Century: The Reception of the Undisclosed Principal Rule in Louisiana Law and Scots Law' (2019) 79 La L Rev 985, 1034.

[69] Watts and Reynolds (n 46), para 9-001, footnote 2.

[70] Watts and Reynolds (n 46), para 8-002.

[71] *Teheran-Europe Co Ltd v ST Belton (Tractors) Co Ltd* [1969] 2 QB 545, 555 (CA).

[72] T Krebs, 'Agency Law for Muggles: Why There is no Magic in Agency' A Burrows and E Peel (eds), *Contract Formation and Parties* (OUP 2010) 210.

[73] Working Group for the Preparation of Principles of International Commercial Contracts, 'Summary records of the meeting held in Bolzano/Bozen from 22 to 26 February 1999' (June 1999), para [99]. <https://www.unidroit.org/english/documents/1999/study50/s-50-misc21-e.pdf> accessed 29 April 2023.

[74] Fridman (n 47) para. 6.2.

[75] A J Kerr, *The Law of Agency* (4th edn, LexisNexis South Africa 2006) 209.

[76] The UNIDROIT Principles of International Commercial Contracts (2016), Article 2.2.3.

[77] *Matthews v Auld and Guild* (1873) 1 R 1224; Macgregor (n 2) 12.24.

[78] P J Dalley, 'A Theory of Agency Law' (2011) 72 U Pitt L Rev 495, 498-499.

depending on their success, to the detriment of the third party.[79] The requirement of proof that the agent had actual authority, and subjectively intended to act for a particular principal in English law,[80] could help alleviate this, however, the requirement of proof itself is difficult to overcome.[81] These difficulties may, however, be countered: the third party who has notice of the principal's existence willingly takes the risk of contracting with him and should prepare himself for the risks entailed in that choice.

However, there is no 'proper formal mechanism' for finding the principal's identity,[82] apart from asking the agent, who may be unwilling to reveal the principal's name or has been instructed by the principal not to reveal it.[83] Leaving the third party without any means of finding out whom to sue may be an inequitable result which discourages transactions with agents acting for unidentified principals.

E. AGENT LIABLE UNLESS AND UNTIL THE PRINCIPAL IS DISCLOSED

The approach proposed by Macgregor, inspired by *Ferrier v Dods*, may provide an answer to the issue of there being no formal framework for finding the principal's name. Macgregor interprets *Ferrier* as suggesting that an agent binds the principal, as well as being 'treated as a party' to the contract, with the agent being absolved once he identifies the principal.[84] Thus, the agent may not be a party to the contract: as argued above, the third party does not give true consent to contract with the agent. Rather, the agent should be so "treated", in other words, seen as intervening in his principal's contract *ab initio*, only being absolved once he reveals the latter's name. In parallel with what has been argued by Quinn in the context of undisclosed agency,[85] the agent could intervene 'by operation of law', in the absence of a better alternative for discovering the principal's name.

Such an approach infringes privity of contract: a doctrine which suggests that third parties can have no rights or obligations under a contract, subject to exceptions.[86] In the context of intervention by principal in undisclosed agency,[87] multiple exceptions to privity of contract have been proposed as theoretical justifications, none of them fully successful.[88] The same assessment can fruitlessly be undertaken as respects unidentified agency. For example, the theory of assignation,[89] proves unpersuasive in this context, as even though the third party can, by contrast with undisclosed agency,[90] be seen as consenting to the assignation, burdens still cannot be assigned.[91] Similarly, the agent cannot be seen as a third party who benefits from the contract:[92]

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[79] Holmes and Symeonides (n 58) 1144; Macgregor (n 66) 1028.
[80] *National Oilwell (UK) Ltd v Davy Offshore Ltd* [1993] 2 Lloyd's Rep 582, 597 (Com Ct); Reynolds (n 4), paras 4.07-4.09; Watts and Reynolds (n 46), para 8.072.
[81] Reynolds (n 4), para 4.38.
[82] Watts and Reynolds (n 46), para 9.017.
[83] Watts and Reynolds (n 46), para 8.071.
[84] Macgregor (n 2), para 12.19.
[85] Quinn (n 60) 91, as referred to in Lang (n 60) 125.
[86] H MacQueen, Lord Eassie, and others (eds), *Gloag and Henderson: The Law of Scotland* (15th edn, W Green 2022), para 8.01.
[87] Reynolds (n 4), para 4.05; Watts and Reynolds (n 46) 8-069; *Welsh Development Agency v Export Finance Co Ltd* [1992] BCLC 148; cf W Muller-Freienfels, 'The Undisclosed Principal' (1953) 16 MLR 299, 306; C-H Tan, 'Undisclosed Principals and Contract' (2004) 120 LQR 480, 486.
[88] Lang (n 60) 120; Krebs (n 71) 212.
[89] Goodhart and Hamson (n 3) 352, cf *Siu Yin Kwan v Eastern Insurance Co Ltd* [1994] 2 AC 199 (HKPC).
[90] Macgregor (n 2), para 12.29.
[91] MacQueen, Lord Eassie, and others (n 85), para 8.16.
[92] See Contract (Third Party Rights) (Scotland) Act 2017, section 1. See further on the, now rebranded, *jus quaesitum tertio* doctrine in Scots law: H L MacQueen, 'Third Party Rights in Contract: Jus Quaesitum Tertio' in K Reid and R Zimmermann, *A History of Private Law in Scotland: Volume 2: Obligations* (OUP 2000).

rather they are burdened by it. By defying privity of contract, the doctrine may be seen as another challenge to Krebs' argument that there is 'no magic in agency'.[93]

However, just as 'commercial utility and convenience' is seen as a sufficient justification for the intervention by the undisclosed principal,[94] so too the practical difficulties of identifying the principal may justify the agent's intervention. However, a more persuasive explanation may be made by reference to the 'explanatory and legitimating' doctrine of good faith in Scots law,[95] as, if not for the intervention, the third party would have been left without any remedies. Yet, as recognised in the agency context, 'the reasonable expectations of honest men must be protected'.[96] Furthermore, the approach analogous to *Ferrier* has received approval in the PECL,[97] and the DCFR,[98] which both recognise good faith as a general principle.[99] Drawing from instruments with a civil law pedigree would be consistent with the history of Scots agency law, which has developed out of the Roman concept of mandate.[100]

F. CONCLUSION

The analysis of *Ferrier*, *Lamont*, and *Ruddy*, has demonstrated that the position of the unidentified principal in Scots law is unsettled. The solution preferred by Professor Macgregor, based on *Ferrier*, that the agent should be liable unless and until the principal is disclosed, should be developed. Not only does it recognise where the true consent of the third party lies: it resolves the issue of there being no formal mechanism for identifying the principal by enabling the agent to intervene in the contract between the principal and the third party. Such departure from privity of contract may be explained by mere practical necessity, or, more persuasively, by the emerging doctrine of good faith in Scots law. Finally, the approach has been endorsed by leading European instruments which share a common legal history with Scotland.

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[93] Krebs (n 71) 210.

[94] *Teheran-Europe Co Ltd v ST Belton (Tractors) Ltd* [1968] 2 QB 545, 552 (CA); *Siu Yin Kwan v Eastern Insurance Company Ltd* [1994] 2 AC 199, 207 (HKPC).

[95] *R v Immigration Officer at Prague Airport Ex p. European Roma Rights Centre* [2005] 2 AC 1 (HL) [60]. See also *Smith v Bank of Scotland* 1997 SC (HL) 111, 121.

[96] *First Energy (UK) Ltd v Hungarian International Bank Ltd* [1993] BCC 533, 533. See also J Steyn, 'Contract law: fulfilling the reasonable expectations of honest men' (1997) 113(7) LQR 433, 433.

[97] PECL Article 3:203.

[98] DCFR (2009) II 6:108.

[99] PECL Article 1:201; DCFR (2009) III 1:103.

[100] L Macgregor, 'Defining Agency and Its Scope (I)' in L DiMatteo and M Hogg (eds), *Comparative Contract Law: British and American Perspectives* (OUP 2015) 382–383.

THE SUBTLE ART OF COMPROMISE AND THE INTERNATIONAL FINANCIAL ARCHITECTURE: CAN THE CURRENT FRAMEWORK SUSTAIN THE POLITICS OF GLOBALIZATION?

*Augusto Aquila**

A. INTRODUCTION
B. SOFT LAW, MONITORING AND STANDARD SETTING
C. POLITICAL DISCORDANCE AND AGENDA SETTING
D. CONCLUSION

A. INTRODUCTION

Ever since the Bretton Woods conference, which took place in New Hampshire in July 1944 and revolutionarily sought to establish a solid framework for economic and monetary relationships between countries around the world, politics has played a major role in determining the nature of the international financial architecture. Building on the practical experience developed throughout the New Deal years in America, and on the idea of welfare state that emerged in Britain during the early 1900s, prominent economists, such as Harry Dexter White and John Maynard Keynes, approached the conference with enthusiasm and with the utmost desire to include borderless international development as a fundamental pillar of the common postwar plans.[1] Thus, recent scholarship has indicated how the Bretton Woods negotiations should be applauded for their pioneering incorporation of international development goals into a liberal multilateral financial architecture, and for their considerable acceleration of the dialogue between the rich "Northern" countries and the poorer "Southern" ones.[2] In the decades following Bretton Woods and leading to the 21st century, however, this dialogue did not retain a position of priority in the agenda of the international financial architecture, due to the menace of the Cold War, to the domestic economic troubles suffered by advanced countries, and to the resurgence of "neoliberal" values in the Anglo-American alliance, which rejected both, more generally, governmental interventionism and, more specifically, ambitious concerted schemes such as the New International Economic Order (NIEO).[3] The status quo shifted again only with the rise of China, India, Brazil, Mexico, Indonesia and South Africa as simply unignorable economic powerhouses, with the Global Financial Crisis of 2007-2008, which highlighted the intricate linkages permeating the global economy, and with the ensuing creation of the Group of 20 (G20) as the "premier forum for international economic cooperation," in which Southern countries finally exert significant influence on decision-making.[4]

Analogously, in his analysis of the numerous failures of global financial governance, and thus of the international financial institutions and transnational regulatory networks operating at its basis, Professor Emilios Avgouleas has identified three key historical segments, each reconcilable with a particular worldwide policy that was never comprehensively implemented: firstly, in the Bretton Woods phase (1947-1997), there was a focus on moving from fixed to floating exchange rates; secondly, in the post-Asian Crisis period (1998-2008), loose regulatory structures and free-market tendencies gave way to a tighter framework, called New International Financial Architecture (NIFA); and thirdly, in the aftermath of the Global Financial Crisis (2009-

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[1] Eric Helleiner, *Forgotten Foundations of Bretton Woods: International Development and the Making of the Postwar Order* (Cornell University Press, 2014), 9-13.

[2] Helleiner, *Forgotten Foundations*, 1-4.

[3] Helleiner, *Forgotten Foundations*, 260-276.

[4] Helleiner, *Forgotten Foundations*, 276-277.

present), the causes and consequences of this unprecedentedly seismic event were recognized and tackled with shared reforms.[5] Nevertheless, in light of the lack of success underpinning this evolutionary tale, it has been argued that, even if standard-setters, such as the Basel Committee on Banking Supervision (BCBS) and the International Organization of Securities Commissions (IOSCO), come up with the policies required to fight financial crises, and even if monitoring institutions, such as the International Monetary Fund (IMF) and the World Bank, fulfil their surveillance duties appropriately, effective financial regimes leading to cross-border stability might still prove difficult to achieve, due to the political disagreements inherent to the fundamental agenda-setting body (i.e. the G20).[6]

Therefore, in this essay, progressively expanding on the brief historical accounts given above, it shall be argued that the most serious limitation of the international financial architecture has always been its dubious ability to cope with the everchanging political and diplomatic dimensions of the interconnected economic systems of our contemporaneity. In fact, somewhat paradoxically, the international financial architecture is simultaneously strengthened by the "increasing need for countries to cooperate, given the continuous integration of the global economy," and endangered by the "continuous diminution in the willingness of the international community to surrender sovereignty" to international bodies seemingly dominated by technocratic elites.[7] Concomitantly, another important characteristic of the international financial architecture (i.e. the widespread reliance on soft law by transnational standard-setting and monitoring organizations) will not be viewed as a shortcoming, but rather as the epitome of an aptitude to retain the flexibility needed to address unique and unpredictable challenges, to give audience to a multitude of stakeholders, and to reach unavoidable compromises. This feature will demonstrate how the international financial architecture attempts to guarantee efficient solutions and undisrupted service, notwithstanding the heated political debates that constantly threaten and undermine its very existence.

B. SOFT LAW, MONITORING AND STANDARD SETTING

As mentioned at the end of the introductory section, soft law is the main legal instrument through which the international financial architecture is authorized to propagate its policies across the world, in accordance with the boundaries set by the international treaties signed and ratified by individual countries. One of the considerations naturally stemming from this statement concerns the extent of the powers that are vested in international financial institutions by virtue of international treaties. As argued by Professor Chris Brummer, from Georgetown University, setting standards in international financial regulation, as well as ensuring that there are no gaps in the entire architecture, "is often fraught with misaligned and even antagonistic interests," resulting from individual governments wishing to retain some flexibility in the tailoring of solutions according to their own policy preferences and to the conditions of their domestic markets.[8] The cross-border rules producible, monitorable and enforceable by, for instance, the BCBS, the IOSCO, the IASB (International Accounting Standards Board), the IAIS (International Association of Insurance Supervisors), the IMF, and the World Bank, are constrained by compromises between national financial authorities, each seeking to negotiate harshly, to promote its own national beliefs, and to take advantage of any potential disparity in bargaining power.[9] Thus, it is arguable that the majority of the problems faced by the aforementioned regulating and monitoring institutions are directly caused by the lack of political agreement, coordination and

[5] Emilios Avgouleas, *Governance of Global Financial Markets* (Cambridge University Press, 2012), 157-159.
[6] Avgouleas, *Governance*, 205-206 and 211-212.
[7] Sean Hagan, 'The IMF and the Evolution of International Monetary and Financial Law,' in Margaret McGuinness and David Stewart (eds), *Research Handbook on Law and Diplomacy* (Elgar Publishing, 2022), 123
[8] Chris Brummer, *Soft Law and the Global Financial System: Rule Making in the 21st Century* (Cambridge University Press, 2015), 270-271.
[9] Brummer, *Soft Law,* 273.

commitment that pervades the agenda-setters (i.e. the G20 and the Financial Stability Board (FSB)). If individual countries were more politically predisposed to follow the guidance of the international financial architecture, it would not matter whether this guidance came in the form of soft law, or in the form of hard law, upon an official devolution of powers by means of signing additional international treaties.

Despite the significant constraints deriving from international politics and diplomacy, and namely from the questionable impact of both the G20 and the FSB, it has been pointed out that soft law is still capable of achieving satisfactory results thanks to the often-misunderstood role played by the IMF.[10] In fact, the IMF is created through a constitutive treaty that is "the centerpiece of international monetary law" and, in accordance with that treaty, it does not only fulfil a function of multilateral financial surveillance, but also of indirect enforcement, because, in case a signatory member were not to conform to the rules of the international financial architecture, that member would potentially cease to benefit from the IMF's discretionary power to become a lender of last resort.[11] It flows logically that, if a signatory member anticipates that, in the future, they may need financial assistance in the form of conditional lending from the IMF, that member will be more likely to adjust its financial policies *ex ante* consistently with the cross-border rules that the IMF is officially mandated to surveil.[12]

Another valuable example of how soft law distinctly and substantially influences the worldwide economy is the relationship between the BCBS and participants in the banking market, in both the public and private spheres. The BCBS does not possess any formal supranational authority, it does not possess any legal status at all, and its proposals or decisions do not have any legal force, until they are "separately implemented, whether by hard or soft law, in each separate state" that contributes with member organizations to the activities and the consultations of the committee.[13] Nevertheless, even though the BCBS regulations are informal and must be observed only in a voluntary and self-imposed manner, it is remarkable how often and extensively they are implemented, and that is because of the distinction between implementation (a "factual concept" deriving from considerations of competition in the realm of international business) and enforcement (a "legal concept" deriving from the ability of the competent state authority to impose compliance).[14] It has been argued that the BCBS regulations and, more generally, international financial soft law are "well suited to the changing needs and rapidly evolving structures that characterize the workings of financial markets" and that the "softness" of these rules can become "as compelling as hard law," thanks to the ideas of honor and rigor that permeate the public sector, and thanks to the perception of resilience and strength that private actors in the banking and finance industry wish to instill in potential customers.[15]

However, continuing to examine the case of the BCBS, and more particularly of its third capital accord (commonly known as Basel 3), it becomes clear how political interest is still capable of exerting formal influence on the production of international financial soft law, in light of the establishment by the G20 of the FSB in 2009, and of the BCBS being subject to the approval and directional guidance of the FSB.[16] Looking at both the BCBS's original proposal and the content of the finalized Basel 3 regulatory scheme, it has been argued that regulatory capture by the private

[10] Adam Feibelman, 'Law in the Global Order: The IMF and Financial Regulation,' (2017) 49 New York University Journal of International Law and Politics, 688-689.
[11] Feibelman, 'Law in the Global Order,' 744-745.
[12] Feibelman, 'Law in the Global Order,' 729-730.
[13] Charles Goodhart, *The Basel Committee on Banking Supervision: A History of the Early Years, 1974-1997* (Cambridge University Press, 2012), 542-543 and 546.
[14] Goodhart, *The Basel Committee*, 557-558.
[15] Goodhart, *The Basel Committee*, 553-555 and 559.
[16] Elias Bengtsson, 'The Political Economy of Banking Regulation: Does the Basel 3 Accord Imply a Change?,' (2013) 46 Sociologus, 306-307.

sector (i.e. the most pervasive problem for the first and second capital accords) has decreased in scope, whilst a "tilting of power in favor of emerging markets and publicly accountable authorities has occurred."[17] This interpretation is due to the fact that Group 2 banks (i.e. the more regional ones, with lower overall capital), in comparison to Group 1 banks (i.e. the well diversified, internationally active, and capital-heavy ones), appear less affected by the new definitions of capital ratio (CET1) and by the altered risk metrics for banks' assets, and by the fact that Group 2 banks are more prevalent in countries from the global South.[18] Thus, once again, remembering that the soft law produced by the BCBS has the opportunity to be implemented almost universally and in reasonably strict accordance with its final content, the problem lies with how diverging political sentiments influence this content and how, in turn, this content diverges from the original, data-driven and risk-averse intentions of the BCBS. This leads to a rather oxymoronic situation, whereby, in the "uploading stage," elected officials delegate the making of international financial soft law to standard-setters like the BCBS, which "mobilize extensively and, to a large extent, successfully," but, in the "downloading stage," those same elected officials seek to alter the content of this soft law, in order to avoid "negative distributional implications for domestic constituencies."[19]

Of course, at this stage, it is important to highlight that international financial soft law, besides having merits in terms of pragmatic rule-making and flexible implementation in accordance with the peculiarities of individual jurisdictions, is also transparently defective in many other respects, including the possibilities of inconsistent translation into domestic rules and regulatory arbitrage, which might "induce states to race to the bottom" and "lay the ground for the next financial crisis." [20] One commentator even suggested that the most important aspects of international financial cooperation "either lack any legal dimension, or involve traditional hard-law international organizations," thus implying that soft law does not accomplish any useful objective, including the most obvious (i.e. harmonization of standards), which could be handled equally successfully by "purely private industry organizations."[21] Furthermore, academics have indicated that international financial regulatory cooperation and the ensuing "hardening process" of soft law are accelerated during times of crises, but drastically wane in their aftermath, thus producing dangerous and shortsighted tendencies, such as unilateralism, deliberate discrepancies across national borders, and the overall fragmentation of global financial markets.[22]

However, one could question the adequacy and the accuracy of forming a direct conduit between these complications, each severely contributing to a potential increase in cross-border systemic risk, and the constituent elements of the transnational regulatory networks, including its signature reliance on soft law mechanisms.[23] Indeed, the way in which soft law is utilized by the international financial architecture has been argued to facilitate worldwide regulatory cooperation, to converge norms, consequently improving the experience of both lenders and borrowers within the global financial markets, and to reflect the needs of a globalized economy, where "expertise, speed, cost, flexibility, adaptability and public participation" are not marginal considerations to

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[17] Bengtsson, 'The Political Economy,' 326-327.
[18] Bengtsson, 'The Political Economy,' 319-322.
[19] Lucia Quaglia, 'The Politics of State Compliance with International "Soft Law" in Finance,' (2019) 32 Governance (Oxford), 45 and 57.
[20] Bin Gu and Tong Liu, 'Enforcing International Financial Regulatory Reforms,' (2014) 17 Journal of International Economic Law, 139.
[21] Matthew Turk, 'Reframing International Financial Regulation after the Global Financial Crisis: Rational States and Interdependence, Not Regulatory Networks and Soft Law,' (2014) 36 Michigan Journal of International Law, 124-126.
[22] Gu and Liu, 'Enforcing,' 172-173.
[23] Xun Li, 'How Effective Are the Transnational Regulatory Networks?: A Perspective of International Financial Regulation,' (2021) 18 Manchester Journal of International Economic Law, 392.

make.[24] Through the soft law mechanisms embraced by transnational regulatory networks, national regulators and legislatures have a chance to interact with each other, learn from each other, and "gradually bridge substantive differences, laying foundations for the ultimate creation" of binding international treaties.[25]

Closing this section, therefore, it is proposed that reliance on soft law, in itself, is not necessarily the cause of the failures of financial regulation over the past decades. Rather, it is the underwhelmingly meagre content of this soft law that constitutes a danger for the stability of the global financial markets, and this is determined chiefly by the political discordance among the public parties that dictate the workings of international regulatory and monitoring organizations.

C. POLITICAL DISCORDANCE AND AGENDA SETTING

Referring again to the introductory section, and to the historical context of international financial regulation, it is crucial to stress the importance of the change in the power dynamics of international politics that has gradually taken place since the end of the Cold War (i.e. when globalizing tendencies resurfaced). In the late 1990s, especially, with a period of financial crises (beginning with the 1997 Asian Financial Crisis) spreading quickly and extensively, it was recognized that emerging market countries "were not adequately included in the core of global economic policymaking and governance," especially as they came to represent a higher and higher percentage of the world's economic output.[26] Thus, in 1999, the G20 was established, mimicking certain principles and objectives that had been originally envisioned at Bretton Woods (i.e. promoting constructive discussion between industrial and emerging market countries, considering each party equally important in its contribution, supporting worldwide growth and development, strengthening the international financial architecture, and implementing and monitoring common standards and structures).[27] After the Global Financial Crisis, the G20 (together with its sister institution, the FSB) emerged as the principal coordinating body for the achievement of international financial cooperation, dictating the agenda to be implemented through transnational regulatory networks and to be monitored by the IMF and by the World Bank, but it is arguable that the extreme diversity of its composition makes it too fluid "to play a leadership role in the field of financial stability on a permanent basis."[28]

Nowadays, in fact, the G20 comprises Anglo-American countries (i.e. Australia, Canada, South Africa, United Kingdom and United States), European countries (i.e. France, Germany, Italy), the European Union, the African Union, Latin American countries (i.e. Argentina, Brazil, Mexico), Asian countries (i.e. China, India, Indonesia, South Korea, Japan), Middle Eastern countries (i.e. Saudi Arabia, Turkey) and Russia. Each of these members has its own defining political machineries, economic interests, and financial practices, which leads to conflicting perspectives on the agenda to be agreed at the G20 and FSB levels, to the unwillingness to give rise to formal international financial institutions, and to thinning policies that are ultimately targeted for development at the level of transnational regulatory networks.[29] Additionally, as appropriately pointed out by Daniel Drezner, from Tufts University, even though emerging market countries have obtained better representation in the G20 and in the IMF after the Global Financial Crisis, we have been witnessing a growing "counter-hegemonic order," in opposition to the

[24] Li, 'How Effective,' 412-417.
[25] Li, 'How Effective,' 423.
[26] Emilios Avgouleas, 'Rationales and Designs to Implement an Institutional Big Bank in the Governance of Global Finance,' (2012) 36 Seattle University Law Review, 335-336.
[27] Avgouleas, 'Rationales,' 335-336.
[28] Avgouleas, 'Rationales,' 345-346.
[29] Robert Ahdieh, 'Coordination and Conflict: The Persistent Relevance of Networks in International Financial Regulation,' (2015) 78 Law and Contemporary Problems, 77 and 100-101.

historic system of global economic governance dominated by the West.[30] China, in particular, with its Asian Infrastructure Investment Bank (AIIB), Cross-Border Interbank Payments System (CIPS), and Belt and Road Initiative (BRI), as well as through its *de facto* leadership of the BRICS intergovernmental organization, is signaling itself as a new domineering party within the world economy, capable of guaranteeing fresh diplomatic and financial alternatives to countries that wish to rationally revise, or even fully delegitimize, the current US-fashioned status quo.[31] Thus, a question arises pertaining to the future of the international financial architecture as the world has known it for the past 25 years, considering political disruptors both in counter-hegemonic countries and in the US itself (i.e. Donald Trump, who may or may not secure a second presidential term).

Continuing to analyze the case of China, authors from Australian universities have interestingly explained that this growing superpower is challenging the international financial architecture in three main respects: firstly, it challenges the global system's capacity to absorb a substantial increase in the supply of savings; secondly, it challenges the adequacy of global financial safety nets and their ability to incorporate China, monitor meaningful and rapid changes in capital flow, and increase general financial integration; and thirdly, it challenges the framework for investment and development finance, for which there is an "immense unmet demand."[32] In turn, to tackle these challenges, to account for the changes in the global economic order, and to reform effectively the international financial architecture, China has two options, which are not necessarily mutually exclusive: firstly, China needs to improve its international diplomacy, in order to work with the established powers and to overhaul the established institutions, as it has already happened with the G20 and with the IMF, which now feature better representation of emerging nations; and secondly, it needs to build new institutions that are tailored to "fill important gaps in the existing architecture," even though not singlehandedly, not illiberally, and not through the lens of potentially achieving even greater global influence for itself.[33]

Academics from the University of Oxford seem to be in agreement with the first of these two proposals: in fact, they argue in favor of strengthening the voice of developing countries not only in agenda-setting institutions, but also in standard-setting ones, so that there can be a greater focus on the effects that worldwide policies may have on different jurisdictions and on the goal of those jurisdictions to become more and more involved in the dynamics of the global financial markets.[34] Furthermore, they criticize the current international financial architecture for focusing too much on the promotion of financial stability from the univocal perspective of highly industrialized countries, exemplified by the concerted efforts of the FSB, the BCBS and the IMF to bring to an end the wave of crises that has developed since the late 1990s, whilst forgetting the more ethically relevant pursuit of inclusion and (eventually) equality across the entire financial spectrum, including countries that have historically sit at its "periphery."[35] These ideas resonate with both the Bretton Woods original purpose for the international financial architecture (i.e. widespread development) and the increasingly globalized and diversified source of financial resources that permeates the world. In other words, they are at once fiercely principled and intelligently forward-looking.

In completing this third section, it is fundamental to remark that the G20 was created "at a time when the global financial system was on a precipice," when there was a "very real prospect

[30] Daniel Drezner, 'Counter-Hegemonic Strategies in the Global Economy,' (2019) 28 Security Studies, 505.
[31] Drezner, 'Counter-Hegemonic Strategies,' 508-510.
[32] Peter Drysdale, Adam Triggs, and Jiao Wang, 'China's New Role in the International Financial Architecture,' (2017) 12 Asian Economic Policy Review, 258-259.
[33] Drysdale, Triggs and Wang, 'China's New Role,' 269-271.
[34] Emily Jones E, and Peter Knaack, 'Global Financial Regulation: Shortcomings and Reform Options,' (2019) 10 Global Policy 193.
[35] Jones and Knaack, 'Global Financial Regulation,' 194-195.

of another Great Depression," and when "macroeconomic cooperation" was centered around crisis response and the provision of large-scale fiscal stimuli.[36] In that moment, the creation of a global financial safety net was an urgent and common prerogative of every country in the world, which meant that agreement on the agenda-setting level was easy to reach.[37] On the contrary, the ambitious and more longterm frameworks that set out to reform international financial institutions and to reduce global economic imbalances, which were also constructed in the years following the Global Financial Crisis, have been thoroughly unsuccessful, because of the difficulties to find political agreement during "peace time."[38] In fact, "by its nature, the G20 is a body whose impact depends on what each of its members brings to the table" and, if the G20 is weak due to the weakness of the political will of the countries that underpin it, the whole of the international financial architecture will suffer the effects of this weakness, because the G20 is tasked with agenda-setting and, thus, sits on top of the entire international financial hierarchy.[39]

D. CONCLUSION

In this essay, it has been submitted that the most cumbersome shortcoming of the current international financial architecture is the lack of political agreement at the agenda-setting level, which produces, in turn, pervasive negative effects on both standard-setting transnational networks and monitoring organizations established through international legal treaties (i.e. the IMF and the World Bank). At the same time, it has been highlighted that the reliance on soft law mechanisms by international financial bodies does not represent a shortcoming *per se*, but that the failures concerning the development, implementation and enforcement of policies promoting financial stability and progress are again related to the asymmetry in political goals that affects each individual country. Thus, ultimately, it is proposed that countries, whether belonging to the original hegemonic order, led by the US, or to the new emerging challengers, led by China, set aside their political differences, in order to commit to a truly globalized version of financial regulation, which would induce collaboration, growth and successfulness in both the public and private sectors. For this to happen, excellent diplomacy, an authentic inclination to compromise, and adamant trust in the strategic plans delineated by financial experts are essential. After all, the world ought not to wait for the next great crisis, in order to address the macroscopic flaws that still lie at the basis of its irretrievably interconnected financial systems.[40]

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[36] Adam Triggs, 'Macroeconomic Policy Cooperation and the G20,' (2018) 41 The World Economy, 1309.

[37] Triggs, 'Macroeconomic,' 1335-1336.

[38] Triggs, 'Macroeconomic,' 1337.

[39] Triggs, 'Macroeconomic,' 1337.

[40] Emilios Avgouleas E, and David Donald, *The Political Economy of Financial Regulation* (Cambridge University Press, 2019), 1-2 and 4-5.

REFORMING RESCUE MECHANISMS: A CLOSE EXAMINATION OF PART 26A IN THE COMPANIES ACT 2006

Swati Narayanan[*]

A. INTRODUCTION
B. EXISTING RESCUE MECHANISM FRAMEWORK
   (1) Administration
   (2) CVA
C. MEASURES INTRODUCED UNDER CIGA
D. A NEW SUPER SCHEME IN MAKING?
   (1) Need for a new Plan?
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   (1) Impact of the Plan
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F. CONCLUSIONS AND AREAS FOR IMRPOVEMENT

A. INTRODUCTION

A primary focus for governments globally is to strengthen their insolvency framework by introducing a flexible and versatile mechanism to provide maximum aid to financially distressed businesses with limited disruptions to their operations.[1] Such measures would serve as a pillar for economic and financial stability by fortifying efficiency, maximizing creditors' return, preserving the value of the business, and promoting employment.[2]

The UK has been considered the centre for insolvency and restructuring avenues in the world providing effective insolvency law, an esteemed judiciary, and a hub for business-friendly investment.[3] To strengthen its position amidst the Covid19 crisis, the UK introduced reforms under the Corporate Insolvency and Governance Act, 2020 (**CIGA**)[4]. A key reform introduced is the restructuring plan.

The article will examine the effectiveness of the new scheme against the backdrop of existing rescue mechanisms available in the UK. Primarily, the article will examine the current rescue mechanism and identify the gaps prevalent in the system. Subsequently, the article will identify the measures introduced under CIGA. This will be followed by the need to introduce a new super scheme and its overall effectiveness to achieve the intended purpose of its enactment.

To conclude, this article upholds the notion that a restructuring plan is an efficient instrument in the corporate rescue landscape and provides essential fundamental recommendations to strengthen the plan.

B. EXISTING RESCUE MECHANISM FRAMEWORK

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[1] Felicity Toube and Hilary Stonefrost and Scott Atkins and Ors, 'Evaluation of UK CIGA Reforms: A best practice model for other jurisdiction' (2023) South Square Digest < https://www.nortonrosefulbright.com/-/media/files/nrf/restructuring-touchpoint/2023/evaluation-of-the-uks-ciga-reforms.pdf > accessed 5 January 2024.

[2] Vanessa Finch, *Corporate Insolvency Law: Perspectives and Principles* (Cambridge University Press 2009) 244.

[3] Toube (n 1).

[4] Corporate Insolvency and Governance Act, 2020.

One of the basic tenets in the field of UK insolvency law is to provide distressed yet viable companies the opportunity to be rescued.[5] This can be achieved through restructuring or reorganisation of the business.[6] While it seems like a simple notion, in practice, the mechanism and its success rely on numerous factors such as the value of the business, creditors' interest, the viability of the business to continue, etc., making the process highly complex.[7]

Over the last decade, there has been a growing trend towards the dependence of rescue mechanisms for restoring the *modus operandi* of the Company.[8] In practice, there are broadly two forms of rescue i.e. formal and informal rescue mechanisms.

An informal rescue mechanism implies a restructuring arrangement between debtors and creditors to restore the business of the company through out-of-court procedures.[9] While the process is straightforward, it has gained criticisms due to (i) contractual breach in arrangement, (ii) prejudice towards unsecured creditors, (iii) creditors' pursuing their self-interest, delaying the decision-making process, and (iv) time-consuming and expensive process in obtaining a unanimous consent from all creditors.[10]

Conversely, a formal rescue mechanism involves a statutory process aimed at rehabilitating and reviving the failing business by striking a balance between safeguarding the creditor's interest and enabling the company to reorganise its debts.[11] Presently, there are three forms of formal rescue measures i.e. Scheme of Arrangement,[12] Company Voluntary Arrangement (**CVA**),[13] and Administration.[14] The requirement of each form is different and while the scheme of arrangement is governed under the Companies Act,[15] the remaining two procedures are governed by the Insolvency Act (**IA**).[16]

CVA and Administration form an integral part of the IA's rehabilitation measures, playing a vital role in assisting distressed businesses to mitigate issues of insolvency. CVA was introduced as an attempt to provide a framework for a type of debtor-creditor negotiation, like an informal workout, while administration is a more formal process directed by an administrator.[17]

Despite the long-standing reliance on these measures within the insolvency landscape, there are persistent gaps in the mechanism undermining the rescue process. The determination of the gaps is essential in examining whether a new mechanism could resolve the existing issues.

(1) Gaps in the present mechanism?

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[5] Sir Kenneth Cork, 'Cork Review Committee Report of Insolvency Law and Practice' (Cmmd 8558 1982) (Cork Report).
[6] R Goode, *Principles of Corporate Insolvency Law* (5th edn, Sweet and Maxwell 2010) para 12-01.
[7] Finch, *Principles of Corporate Insolvency Law* (n 2) 243.
[8] Ibid 243-293.
[9] Vanessa Finch, 'Corporate Rescue: A Game of Three Halves' (2012) 32 Legal Stud 302, 307.
[10] Alexandra Kastrinou, 'Comparative Analysis of Informal, Non-Insolvency Procedures of UK and France', (2016) International Insolvency Review 99,100 < https://doi.org/10.1002/iir.1247 > accessed 2 January 2024.
[11] Kastrinou (n 10).
[12] Companies Act 2006 s 26 and s 26A.
[13] Insolvency Act 1986 Part 1.
[14] Insolvency Act 1986 Schedule B 1.
[15] Companies Act 2006 (CA 2006).
[16] Insolvency Act 1986 (IA 1986).
[17] Paul J Omar and Jennifer Grant, 'Corporate Rescue in the UK: Past, Present and Future Reforms' (2016) 24 Australian Insolvency Law Journal 40.

(a) Administration

The Cork Report asserted the need for a rescue procedure that would allow businesses to continue as a going concern. Thus, the administration was introduced by IA and substantially revised by the Enterprise Act 2002[18] pursuant to which an external qualified insolvency practitioner known as an administrator would be appointed[19] to take over the control of the company.[20]

The procedure involves a general requirement, subject to certain exceptions, that a debtor should be unable or likely to be unable to pay debts.[21] On initiation of the process, one of the three hierarchical objectives must be achieved which includes rescuing the business as a going concern,[22] achieving better outcomes for the creditors as a whole than would be likely if the company were to be wound up[23] or, realising the property to be distributed amongst secured or preferential creditors.[24]

To achieve its objective, the administrator is bestowed with the powers[25] to manage the affairs of the company[26] and perform his duties. To do this, there is a displacement of management in the favour of the administrator, where the management cannot exercise their power without the consent of the administrator.[27] A statutory moratorium is imposed suspending any debt enforcement proceedings[28] whilst a survival plan or an orderly wind-down of the affairs of the company is being achieved. Usually, at the end of administration, the company may survive, but often business and assets are sold, and it ends up in liquidation.[29] It is vital to note that administration is not an end but a gateway for a variety of different exit schemes for the company.[30]

Over the years, administration procedure has garnered criticism for its operations due to:

(i) *Lack of early intervention in the process*: The process of administration begins only when the company is insolvent or likely to be insolvent.[31] If the business of the company is not viable, it would make the process of rescuing difficult, and intervention at such a stage is not beneficial. Further, there is a reluctance by qualifying holding charge creditors and the company to initiate administration as it would attract insolvency-related stigma.

(ii) *Creditor in* possession *model:* Unlike other rescue mechanisms, the administration is a not debtor in possession model. The process displaces the managers and empowers an external manager to work in proximity to the creditors.[32] The intent for the displacement was that the company became insolvent owing to the failure of the management and hence they must not be put in charge of the company's rescue.[33] A debtor-in-possession model is beneficial as it encourages directors to tackle a

[18] Enterprise Act 2002.
[19] IA 1986, Schedule B1 s 2.
[20] Ibid s 6.
[21] IA 1986, Schedule B1 s 11.
[22] Ibid Schedule B1 s (3)(1).
[23] Ibid Schedule B1 s (3)(2).
[24] Ibid Schedule B1 s (3)(3).
[25] IA 1986, s 59(1).
[26] Ibid.
[27] Ibid s 64.
[28] Omar (n 17).
[29] Jennifer Payne, *Scheme of Arrangement: Theory, Structure and Operation* (2nd edn, Cambridge University Press 2021) 201, < https://doi.org/10.1017/9781108883672.008 > accessed 3 January 2024.
[30] Ibid.
[31] IA 1986, Schedule B1 s 11.
[32] IA 1986, Schedule B s 64.
[33] Omar (n 17).

company's issue at an early stage, allowing for negotiation with the creditors, particularly where the company's difficulties are not attributed to poor management.[34] Directors who oversee the company have a better understanding of the affairs of the company. Displacing their role with an external administrator, appointed to cater to needs of the creditors rather than rescuing the business as a going concern.

(iii) *Expensive and* time-*consuming process:* Administration is an expensive and time-consuming process in comparison to other debt restructuring mechanisms. The appointment of an external administrator along with multiple creditor meetings and approval of the court for sanctioning the plan can cause delay and increase the costs of the process.[35]

(b) CVA

CVA refers to a mechanism that provides for rescuing or restructuring the company through compromise or arrangement between the company and its creditors.[36] The origins of CVA, like administration date to the Cork Committee Report.[37] Cork recognised the need for a 'quick, user-friendly and inexpensive''[38] procedure that would allow companies to enter a binding arrangement with their creditors to reorganise their debts without engaging in formal procedures.[39] Thus, the CVA mechanism was created under the IA, 1968.[40]

The object of the CVA is to rescue a viable business in financial difficulties from liquidation.[41] The restructuring would enable the company to repay the creditors in full or in part over a period.[42] An essential feature distinguishing CVA from administration is that there is no requirement for the company to be 'insolvent' or show its 'inability to pay its debts' to commence this procedure and the company can continue trading with its current management team.

Presently, the process of a voluntary arrangement is initiated either by a director, liquidator, or administrator. An insolvency practitioner is nominated to oversee the process to ensure the arrangement has a 'reasonable prospect of being approved and implemented'[43] between the members and creditors of the company. Where a CVA proposal is made in respect of a "small" company, the company can obtain a temporary moratorium.[44]

Approval of CVA requires a majority positive vote from its creditors and shareholders to become binding on them.[45] The effect CVA has on its stakeholders is substantial and the binding nature extends to all creditors entitled to vote including dissenting creditors. However, secured, and preferential creditors are excluded unless they have provided their consent.[46]

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[34] Ibid.
[35] Ibid.
[36] IA 1986, Part 1.
[37] Cork Report (n 5).
[38] Ibid.
[39] Ibid.
[40] IA 1986, Part 1.
[41] Ibid.
[42] Lorraine Conway, 'Briefing Paper: Company Voluntary Arrangements' (House of Commons No. 6411, 11 June 2019) < https://researchbriefings.files.parliament.uk/documents/SN06944/SN06944.pdf > accessed 3 January 2024.
[43] IA 1986, Part 1 s(2)(a).
[44] IA 1986, Part 1.
[45] Ibid.
[46] IA 1986, Part 1 s 4(3).

The number of CVAs has remained at an all-time low since its introduction in 1986.[47] Recent studies have claimed that 65% of CVAs are terminated without achieving their intended purpose.[48] The growing decline in the use of CVA can be attributed to:

(i) Lack of Automatic Moratorium: The IA 2000[49] introduced a moratorium period only for small businesses. While the government contemplated extending the moratorium obligations to larger companies, the lack thereof has imposed a big detriment for practitioners and companies in using this rescue mechanism.[50]

(ii) Long Duration of the Process: CVA typically lasts anywhere between 3 -5 years.[51] This increases the pressure on distressed companies to continue their trading, increasing their risk of failure. Further, the process of CVA is cumbersome as it requires approval from various parties, making it expensive and complex for small businesses.

(iii) Binding nature of CVA: Secured lenders such as banks are not bound by the CVA proposal and hence can initiate proceedings against the company or proceed with other forms of rescue mechanism, undermining the process as a whole.[52] Additionally, majority creditors with 25% or more may dictate the terms of the CVA drafting it in their favour rather than for rescuing the business.[53]

(iv) Limited credit trading: While CVA allows businesses to continue trading, suppliers may be unwilling to extend credit in the short run, amounting to cash flow problems and subsequently affecting the goodwill of the company.[54]

Thus, there is a dire need for government intervention to mitigate these issues in the system and introduce a more flexible, robust, and debtor-friendly model aimed at rescuing financially distressed yet viable businesses without disruption to their operations.

C. MEASURES INTRODUCED UNDER CIGA

The UK is considered one of the leading restructuring hubs owing to its good governance and insolvency laws.[55] The existing legislation on insolvency rescue system is a creditor-centric system established under the Cork Committee.[56] Nevertheless, the aftermath of the financial crisis witnessed a transformation in the debt landscape marked by a fragmented debt structure.[57] The

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[47] Adrian Walters and Sandra Frisby, 'Preliminary report to the Insolvency Service into outcomes in company voluntary arrangements' (2011) < https://dx.doi.org/10.2139/ssrn.1792402 > accessed 4 January 2024; Peter Walton, Chris Umfreville and Lezelle Jacobs, 'Company Voluntary Arrangements: Evaluating Success and Failure (Report commissioned by R3, May 2018).
[48] Walters (n 47).
[49] Insolvency Act 2000.
[50] Walters (n 47).
[51] Conway (n 42).
[52] Walters (n 47)
[53] Ibid.
[54] Ibid.
[55] Kelly Tolhurst MP, 'Insolvency and Corporate Governance: Government Response' (Department of Business and Trade 26 August 2018)(Government Response) < https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/736163/ICG_-_Government_response_doc_-_24_Aug_clean_version__with_Minister_s_photo_and_signature__AC.pdf > accessed 3 January 2024.
[56] Cork Report (n 5).
[57] John M. Wood, *The Interpretation and Value of Corporate Rescue* (Edward Elgar Publishing, 2022) 180 < https://doi.org/10.4337/9781839101403 > accessed 3 January 2024.

apparent gaps in the system, coupled with the absence of proactive measures to resolve them prompted the government to initiate consultation into the framework. [58]

The Insolvency Services recommended the addition of the four elements into the system mainly moratorium, restructuring plan, prohibition of suppliers to terminate contracts, and rescue finance.[59] While these features were available in combination with various rescue mechanisms, however, it was not an ideal measure as it involved the transfer of the business of the company which is expensive and cumbersome, tax implications, and further caused issues in the event the creditor arrangement impose impediments to such transfer.[60] It was envisioned that a single mechanism that would combine all these benefits would mitigate the current issues in the framework. Although the introduction of the first three elements received broad support, there was pushback from stakeholders on rescue funding.[61] The availability of market-based solutions and the complexity of rescue financing caused an adverse impact on the lending market which prompted the government to drop this measure.[62]

In addition to these deficiencies and consultations conducted by the Parliament, the outbreak of the Covid-19 pandemic proved to be a pivotal moment, not only due to the emergence of a deadly virus but also to the unparalleled challenges it brought to business across various sectors.[63] Disrupting the normal operations of businesses, imposing challenges to the supply chain of goods, and altering consumer behaviour patterns, created challenges for companies to continue their trade and meet their legal obligations.

Recognising the need to support financially distressed yet viable businesses, the UK Parliament in consultation with the Department of Business, Energy & Industrial Strategy in 2016[64] and 2018[65] fast tracked the Corporate Insolvency and Governance Bill to introduce measures to reform the insolvency law and corporate governance structure. Subsequently, the House of Commons enacted CIGA with the overreaching objectives to offer flexibility and relief to businesses on the brink of insolvency by reducing their burden through permanent and temporary measures amid rising economic uncertainty.[66] An essential permanent measure introduced was the introduction of a 'restructuring plan' which revolutionised the rescue mechanism.

D. A NEW SUPER SCHEME IN MAKING?

CIGA introduced various reforms to transform the insolvency landscape in the UK. A significant mechanism is the 'restructuring plan' introduced under Part 26A of the Companies Act. This plan was enacted alongside the existing scheme of arrangement[67] and CVA.[68] A new plan was envisaged

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[58] Insolvency Service, 'A review of the Corporate Insolvency Framework: A consultation on options for reforms.' (Department of Business, Innovation and Skills May 2016) < https://assets.publishing.service.gov.uk/media/5a816394ed915d74e33fdef9/A_Review_of_the_Corporate_Insolvency_Framework.pdf > accessed 3 January 2024.

[59] Government Response (n 55) para 5.

[60] Government Response (n 55) para 5.

[61] Government Response (n 55).

[62] Ibid para 5.186.

[63] Insolvency Service, 'A review of the Corporate Insolvency Framework: A consultation on options for reforms.' (Department of Business, Innovation and Skills May 2016) < https://assets.publishing.service.gov.uk/media/5a816394ed915d74e33fdef9/A_Review_of_the_Corporate_Insolvency_Framework.pdf > accessed 3 January 2024.

[64] Ibid.

[65] Department of Business, Energy & Industrial Strategy, 'Insolvency and Corporate Governance: Government Response', (20 March 2018) < https://assets.publishing.service.gov.uk/media/5b826986e5274a4a77e83ebd/ICG_-_Government_response_doc_-_24_Aug_clean_version__with_Minister_s_photo_and_signature__AC.pdf > accessed 3 January 2024.

[66] Ali Shalchi, 'Corporate Insolvency and Governance Act 2020', (House of Commons Library 6 April 2022) < https://researchbriefings.files.parliament.uk/documents/CBP-8971/CBP-8971.pdf > accessed 3 January 2024.

[67] CA 2006, Part 26.

[68] IA 1986, Part 1.

under the CIGA to provide restructuring assistance to viable companies struggling with debt obligations.[69] However, a question for determination is whether a new plan was required. To understand its importance, it is essential to examine the current scheme of arrangement.

(1) Need for a new Plan?

Prior to the introduction of a restructuring plan in CIGA, the scheme of arrangement provisions dominated the restructuring landscape which was incorporated in UK Companies' legislation.[70] This rescue package provided a compromise or arrangement between a company and its members or creditors (or any class of them) to bring about a solvent reorganisation of the company or group structure as well as effect insolvent reorganisation through a wide variety of debt restructuring strategies.[71]

Essentially, the scheme involves a three-stage process, commencing from an application to the court to convene a relevant meeting of creditors or members of the company,[72] followed by the scheme being approved by 75% in value of the relevant class[73] and a majority in number within each class and lastly, sanctioning of the scheme by the court's approval.[74] The court's approval is contingent on adherence to statutory provisions, fair representation of the majority,[75] and the bonafide intent of the statutory majority.[76]

The reliance on the scheme increased due to the flexibility in the nature of the statutory provisions, imposing no restrictions on the nature of the arrangement while also providing court oversight with creditor protection.[77] It proved to be adaptable and effective in restructuring for highly leveraged companies.[78] Further, it proved its global dominance to effect restructurings provided the companies can satisfy the 'sufficient connection' test.[79]

However, the scheme faced criticism for catering to investment banking sectors and 'restructuring boutiques', side-lining the insolvency practitioners.[80] In consonance, there were three main glaring deficiencies in the process which reduced its dependency:

(i) Absence of cross-class clam down: One of the principal criticisms is the lack of the court's power to impose a scheme on the dissenting class of creditors.[81] While the English court forcibly bound dissenting stakeholders within a class, there was no scope for a cross class cram down mechanism as available under Chapter 11 of the US Bankruptcy Code.[82]

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[69] Lorraine Conway, 'Common Library Analysis of the Corporate Insolvency and Governance Bill: Briefing Paper', (House of Commons 1 June 2020) 10 para 1.3 (CIGA Bill) < https://researchbriefings.files.parliament.uk/documents/CBP-8922/CBP-8922.pdf > accessed 4 January 2024.
[70] CA 2006, Part 26.
[71] CIGA Bill (n 64).
[72] CA 2006, Part 26 s 896.
[73] CA 2006, Part 26 s 899.
[74] Ibid.
[75] Gerard Cormack, *The European Restructuring Directive* (Edgar Elgar Publishing Limited 20 April 2021) 336, para 3.24 < https://doi.org/10.4337/9781789908817.00010> accessed 4 January 2024.
[76] *British Aviation Insurance Co Ltd* [2005] EWHC 1621, para [71] – [75].
[77] CIGA Bill (n 69).
[78] CIGA Bill (n 69).
[79] *Drax Holdings Ltd Re; InPower Ltd, Re*, [2003] EWHC 2743 (Ch).
[80] Sarah Paterson and Mike Pink, 'Wrangling reform into the insolvency toolbox', (R3 Recovery publication 2019); CIGA Bill (n 64).
[81] Wood, *The Interpretation and Value of Corporate Rescue* (n 57).
[82] US Bankruptcy Code Title 11, Chapter 11 (§§ 1101 – 1195) (Chapter 11).

(ii) Lack of Moratorium: The process lacked a wide-ranging moratorium period to allow companies a breathing space for restructuring. While a limited moratorium through judicial development was available, there was an inherent lack of statutory moratorium on enforcement proceedings.[83]

(iii) Failure as a rescue mechanism: Rather than a rescue mechanism, the scheme remained as a debt restructuring mechanism. It lacked essential aspects of US Chapter 11 restructuring[84] such as the executory contract regime.[85] Further, various contracts contained 'ipso facto' clauses allowing suppliers the right to terminate or modify their supply contract if the counterparty enters an insolvency regime or experiences financial difficulties.[86] There was a lack of sufficient provisions to protect the interest of the debtor company in such circumstances.

The existing gaps in the rescue mechanism the backdrop of the changing debt landscape, prompted the government to introduce a 'restructuring plan' which would provide a standalone mechanism to mitigate these concerns.[87]

(2) Notable features of the 'Restructuring Plan'

The introduction of the restructuring plan has been considered the proverbial jewel of the UK restructuring regime.[88] This flexible statutory procedure is a powerful tool that enables companies to bind their creditors to a restructuring proposal. The plan has been introduced to mitigate the key issues prevalent in other rescue mechanisms. The four key objectives of the plan are:

(i) Address scenarios where secured creditors could block the company's rescue despite receiving support;

(ii) Enable courts to sanction restructuring plans where it is fair and justifiable;

(iii) Enable companies to meet their debt obligations with limited disruptions; and

(iv) Provide alternative measures to schemes where agreement of all classes of creditors is not possible.[89]

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[83] CIGA Bill (n 69).
[84] Chapter 11 (n 82).
[85] Vern Countryman, 'Executory Contracts in Bankruptcy' (1972) 57 Minnesota Law Review 439, 479 < https://scholarship.law.umn.edu/cgi/viewcontent.cgi?article=3458&context=mlr> accessed 4 January 2024; See Gerard Cormack, *The European Restructuring Directive* (Edgar Elgar Publishing Limited 20 April 2021) 336, para 3.32 < https://doi.org/10.4337/9781789908817.00010> accessed 4 January 2024.
[86] Walters (n 47).
[87] Government Response (n 55).
[88] Philip Wells and Luke Sampson, 'UK corporate insolvency reforms: the nuts and bolts of the future UK restructuring toolkit' (2019) 9 JIBFL 589 < https://plus.lexis.com/uk/analytical-materials-uk/uk-corporate-insolvency-reforms-the-nuts-and?crid=a4affb18-4b3a-4856-a5ac-2727c3a9ac9e&pdproductcontenttypeid=urn:pct:241&pdiskwicview=false&pdpinpoint=> accessed on 6 January 2024.
[89] Professor Peter Walton and Dr Lézelle Jacobs, 'Corporate Insolvency and Governance Act 2020 – Final Evaluation Report' (Insolvency Service November 2022) (Final Report) < https://www.gov.uk/government/publications/corporate-insolvency-and-governance-act-2020-evaluation-reports/corporate-insolvency-and-governance-act-2020-final-evaluation-report-november-2022 > accessed 3 January 2024 para 2.1.

While drawing its insights from the scheme of arrangement for convening and sanctioning hearings,[90] class composition,[91] and court jurisdiction[92] the plan has the following key differences aiding in resolving the existing issues:

(a) Financial Difficulty Threshold

A key characteristic of the restructuring plan is its availability to companies. Unlike the scheme of arrangement, the plan can be utilised provided the company satisfies two conditions i. e.

(i) The company must have "encountered or is likely to encounter financial difficulties that affect or will affect its ability to carry on the business as a going concern;"[93] and

(ii) the purpose of the plan is to "eliminate, reduce, prevent, or mitigate the effect of such financial difficulties."[94]

It is noteworthy that the right to exercise this provision is extended to a company with 'financial difficulties'[95] yet there is no statutory definition behind this term. In the absence of a clear definition, there is a likelihood of abuse of these provisions.

The term 'financial difficulty' has been broadly interpreted to align with the intent of the legislator to 'ensure businesses can maximise their chance of survival.[96] The legislators have expanded the applicability of the provisions to solvent as well as insolvent companies. By doing so, the government aims to reduce the stigma and encourage directors to take immediate actions leading to better outcomes for the creditors, unlike in the administration process.

(b) Disenfranchisement

A major change introduced under the restructuring plan is the ability to alter the rights of 'out of money' stakeholders in a restructuring plan. Presently, every creditor, or member whose rights are affected must participate in a meeting convened by the court to approve the plan via voting.[97] However, the new legislation has carved out an exception where the court on being reasonably satisfied that the stakeholders have no 'genuine economic interest' in the company can exclude them from the plan.[98]

While the statutory provisions allow for the disapplication of the right to vote on the plan by a class of stakeholders having no genuine economic interest, it does not state that such class shall not be bound by the Plan.[99] To bind the creditors, the court needs to provide a reasonable test for satisfaction that there was no economic interest.[100]

[90] CA 2006, Part 26 s 899.
[91] CA 2006, Part 26 s. 869
[92] CA 2006, Part 26 s. 900.
[93] CA 2006, Part 26A s 901A(2).
[94] CA 2006, Part 26A s 901A(3).
[95] CA 2006, Part 26A.
[96] Alexander Wood, Michael Scargill and Helen Walsh, 'Financial Restructuring and Insolvency Finance: A New Restructuring Plan' (Sherman and Sterling 16 September 2020) < https://www.shearman.com/-/media/files/perspectives/2020/09/shearman--sterling--a-new-restructuring-plan--further-notes--september-16-2020.pdf > accessed 3 January 2024.
[97] CA 2006, Part 26A s 901C(3).
[98] CA 2006, Part 26A s 901C(4).
[99] Wood (n 96).
[100] Wood (n 96).

Further, the term 'genuine' would suggest that the creditors have a substantial interest in the company and not mere hope of an economic return.[101] The court would likely apply a similar test for cram down and the consideration for relevant alternatives while applying the test for genuine economic interest. It would be surprising to see if the court develops different thresholds as that could lead to inconsistency.

Although there is no apparent provision, the application for disenfranchisement must be made during the convening meeting, to provide the creditors with adequate notice to present their case and raise objections, if any. This would allow for enforcing cram down during the sanction stage if the majority votes against it.[102]

Overall, the incorporation of disenfranchisement provisions has safeguarded the restructuring plan from the ingenuous creditor's attempt to disrupt the proceedings, making it a just and equitable process.

(b) Cram Down Provision

The most novel and awaited feature in the restructuring plan was the introduction of cross class cram down. Borrowed from Chapter 11 Bankruptcy Code,[103] the provision allows for approval of the plan by cramming down dissenting creditors. In comparison to the scheme where majority approval from each class of stakeholders was required, under the new legislation, the plan would be approved regardless of failure to procure majority approval from one or more classes.[104]

The provision imposes an obligation for a whole class of creditors to accept and be bound by the sanctioned plan irrespective of the class approving it.[105] However, two conditions are required to be met:

a. None of the dissenting class would be "worse off than they would be in the relevant alternative"[106] and

b. Plan is approved by "at least one class who received a payment or has a genuine economic interest under the relevant alternative."[107]

For this section, the relevant alternative refers to the conditions that the court considers would be most likely to occur if the plan is not sanctioned.[108]

The court has the discretion to determine a 'relevant alternative test'. The test of relevant alternative would be fact specific and the court could draw similarities from the fairness and class test available under the existing scheme of arrangement.[109] To determine alternatives, the court could examine the alternative rescue mechanism available while also undertaking valuation-based evidence to determine the return that the dissenting class of creditors might receive in the absence of the plan.[110] Such measures would enable the court to sanction the plan only when no relevant alternative scheme for the benefit of the creditors exists as asserted in Hurricane Energy PLC.[111]

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[101] Ibid.
[102] Wood (n 96).
[103] Chapter 11(n 82).
[104] CA 2006, Part 26A s 901G.
[105] CA 2006, Part 26A s 901G.
[106] CA 2006, Part 26A s 901G(3).
[107] CA 2006, Part 26A s 901G(5).
[108] CA 2006, Part 26A s 901G(4).
[109] Mark Lawford, Andrew J Wilkinson and Matt Benson, 'The New Restructuring Plan – in Depth', (European Restructuring Watch 19 June 2020) < https://eurorestructuring.weil.com/reform-proposals-and-implementations/the-new-restructuring-plan-in-depth/ > accessed 4 January 2024.
[110] Wood (n 96).
[111] *Hurricane Energy plc* [2021] EWHC 1759 (Ch).

The court in the process of determining of 'no worse' off scenario may anticipate disputes around valuation and rights available to the parties, which might slow down the process. Given such a scenario, the companies should prepare to provide robust evidence in support of the 'relevant alternative' as well as arguments against stakeholders with no genuine interest, to fast-track the restructuring of the business.

(c) Possibility of Cram Up

Unlike in Chapter 11, the plan does not include an absolute priority rule which provides that the claims of the dissenting creditors must be satisfied in full prior to a junior class makes recovery.[112] The absence of this provision might result in the possibility of senior creditors cramming up. The possibility of such a measure is meniscal as the court would need to be satisfied that the senior class is no worse off in relevant alternatives and junior class has a genuine economic interest.[113]

The introduction of these provisions provides a layer of support to creditors to flush out or dilute existing stakeholders without any economic interest in rescuing the business while ensuring that they are not worse off than the relevant alternative, thereby attesting that all stakeholders are working towards devising the best plan to rescue the business.

(d) Voting Requirement

The voting requirement has undergone a transformative change under CIGA. The legislator intended to retain a similar threshold for voting as provided under the scheme of arrangement.[114] However, it was pointed out that the 'numerosity' threshold was a key criticism and served a limited purpose.[115] Hence the legislator modified this threshold, and the present restructuring plan requires only a single 75% majority in value threshold from its stakeholders for sanctioning the plan.[116] This enhances the appeal of the plan, as it avoids the complexity of procuring consent from multiple parties as evident in CVA.

E. IS IT A WELCOME ADDITION?

The introduction of the restructuring plan has caused an uproar, sparking debates about its impact and desirability. With the three-year mark approaching since its enactment, it is pertinent to examine its effectiveness.

(1) Impact of the Plan

To assess the overall impact of the CIGA, the government took a proactive step by commissioning independent research[117] with a primary objective to provide evidence-based data to determine

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[112] § 1129(b)(2), Chapter 11.

[113] Matthew Czyzyk and ors, 'England and Wales: Restructuring Reforms Put Into Practice' (2022) Global Restructuring Review < https://globalrestructuringreview.com/review/europe-middle-east-and-africa-restructuring-review/2022/article/england-and-wales-restructuring-reforms-put-practice#footnote-002> accessed 5 January 2024.

[114] Government Response (n 55).

[115] Government Response (n 55).

[116] CA 2006, Part 26A s 901F(1).

[117] Professor Peter Walton and Dr Lézelle Jacobs, 'Corporate Insolvency and Governance Act 2020 – Interim Evaluation Report' (Insolvency Service March 2022) < https://www.gov.uk/government/publications/corporate-insolvency-and-governance-act-2020-evaluation-reports/corporate-insolvency-and-governance-act-2020-interim-report-march-2022> accessed 3 January 2024 (Interim Report).

whether the policy objectives, in line with Better Regulations Principles,[118] were achieved and identify areas for improvements.

On evaluation, the restructuring plan received a positive outlook.[119] The effectiveness of the provisions can be attributed to their versatile and adaptable nature. Cramming down was a pivotal aspect of Part 26A which set it apart from other rescue mechanisms. Approximately 54% of the stakeholders rely on a restructuring plan as an effective tool in cramming down creditors. [120] Further, the fact that 66% of stakeholder restructuring plans over schemes indicates the existing gaps in the system which precluded distressed businesses from utilising rescue mechanisms. [121]

Additionally, there has been a rise in the adoption of the UK rescue reforms by other nations to strengthen their local restructuring process.[122] Drawing insights from the restructuring plan, particularly the provisions around cram down and the ability to establish a 'sufficient connection' test indicates the widespread acceptance of the plan globally.[123]

Overall, the resounding and unequivocal acceptance of the restructuring plan indicates its effectiveness as a robust tool in rescuing businesses and mitigating areas of concern within the rescue framework.

(2) Judicial Discretion

The effectiveness of a restructuring plan from the lens of the court's approval forms a critical element in the restructuring plan's recognition and acceptance. Approximately 58% of stakeholders rely on court-sanctioned plans, considering it as just and equitable.[124]

The reliance of stakeholders on the plan has grown due to the court's oversight, adding a second layer of scrutiny to prevent misuse of the provisions. This was evident in the case of Deep Ocean[125] where the English Court for the first time utilised cram down provisions to bind unsecured creditors. Despite 64.4% favouring the approval of the plan, the court's decision to bind the creditors was on the ground that they failed to demonstrate a 'worse off' scenario in the event of a relevant alternative to the plan i.e. liquidation.[126] While the case was straightforward and did not require canvassing complex issues, it was able to demonstrate the applicability of the new restructuring plan in the UK and the implications of cross clam down mechanism to achieve a positive outlook with multiple entities which would not have been possible without the enactment of CIGA reforms.[127]

Further, the widespread acceptance of the plan can be attributed to its versatile nature which extends its utilisation to creditors as witnessed in Goodbox Co Labs.[128] In this case, the court asked creditors to propose a successful part 26A plan showcasing that the tool can be an effective arsenal for creditors in distressed businesses where there is a strained relationship between stakeholders and insolvency practitioners.[129]

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[118] Department for Business, Energy and Industrial Strategy, 'Better Regulation Framework: Interim guidance' (2020) <https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/916918/better-regulation-guidance.pdf> accessed 6 January 2024.

[119] Final Report (n 89) para 4.2.

[120] Final Report (n 89) para 4.2.

[121] Final Report (n 89) para 4.2.

[122] Toube (n 1).

[123] Ibid.

[124] Final Report (n 89) para 4.2.

[125] *Re DeepOcean 1 UK Ltd and other companies* [2021] EWHC 138 (Ch).

[126] Ibid.

[127] Toube (n 1).

[128] *Re The Good Box Co Labs Ltd (in administration); NGI Systems & Solutions Ltd v The Good Box Co Labs Ltd (in administration)* [2023] 2 BCLC 397.

[129] Ibid.

Despite its prominence, a crucial factor that caused a stir within the insolvency community is the interpretation of 'just and equitable' in the court's exercise of absolute discretion. The absence of guidelines has resulted in varying approaches adopted by the courts. In the landmark case of Virgin Active,[130] the court dismissed the idea of establishing a fairness test, challenging the parliamentary intent in the explanatory statement. However, subsequent cases have shown a clear departure from the court's initial stance as witnessed in the case of Prezzo Investco[131] where the court guided the interpretation of fairness, emphasizing the need for the development of a definitive test.

Tracing back to the Parliamentary intent, it is evident that the discretion was granted to expand the court's role in sanctioning the plan beyond statutory prerequisite and voting thresholds.[132] This is apparent in the explanatory statement of CIGA where the court has 'absolute discretion' to sanction the plan and can refuse in instances where it is not 'just and equitable'.[133]

As the court tackles the evolving cases in Part 26A, there is a pressing need for legislative intervention in providing a substantive test to determine the extent of discretion to prevent interpretational issues and mitigate issues in judicial activism.

Overall, the restructuring plan has emerged as a vital tool utilised by the courts in creating a legal framework to expedite corporate rescue while preserving economic value and business continuity.

F. CONCLUSIONS AND AREAS FOR IMRPOVEMENT

The restructuring plan has emerged as a transformative tool, providing impactful solutions to the prevalent challenges in the rescue mechanism by providing a nuanced and robust framework for restructuring proceedings. The widespread acceptance of the process attests to its efficacy in providing viable solutions to blocked proposals, providing a fair and equitable framework and an avenue for business to continue as a going concern.

A noteworthy contribution to the plan is the introduction of the cross-class cram down procedure. Modelled after Chapter 11 Code,[134] this procedure provides a fundamental element that circumvents issues around securing creditor's consent. This mechanism has proven to be instrumental in procuring a unanimous consent from all genuine creditors with economic interest which would have been tedious in the traditional model. The adaptability of the restructuring plan to various scenarios and its versatility in balancing the interests of all stakeholders while aiding financially distressed businesses in business continuity has secured its position as a prominent rescue tool.

Despite its prominence, there are certain shortcomings in the procedures that warrant revisions. A foremost concern is regarding the high costs associated with the procedure, particularly for small and medium-sized enterprises.[135] The need for a more streamlined process with a single court hearing mechanism for less complex cases is demanded.[136] This would alleviate the burden on the business seeking restructuring and would increase the accessibility of the plan.[137]

Additionally, a lack of transparency and disclosure requirements has emerged as a critical issue in the process.[138] Stakeholders have emphasised that there is a need for clear channels of communication and timely dispensation of information to allow the stakeholders to make an

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[130] *Virgin Active Holdings Ltd and other companies Re*, [2021] EWHC 1246 (Ch) [219]-[221]
[131] *Re Prezzo Investco Ltd* [2023] EWHC 1679 (Ch).
[132] Toube (n 1).
[133] CA 2006, Part 26 Explanatory Statement.
[134] Chapter 11 (n 82).
[135] Final Report (n 89) para 4.2.5.
[136] Ibid
[137] Ibid.
[138] Final Report (n 89) para 4.2.5.

informed decision.[139] It is vital to strike a balance between confidentiality and transparency in optimising the efficiency of the process.[140]

Thus, in essence, the restructuring plan has proven itself to be a welcome addition to the existing rescue mechanism. A restructuring plan has demonstrated sustained effectiveness since its introduction and is a valuable tool for navigating the complexities arising in a financially distressed business. However, to make the process more comprehensive and robust, it is imperative to fine-tune the process by adopting transparent, cost-effective, and equitable provisions within the plan.

[139] Ibid.
[140] Ibid.

TRUSTS: IN SEARCH OF THE CORE FEATURES

*Diego Montecino Díaz**

"The idea of a trust is so familiar to us all that we never wonder at it. And yet surely we ought to wonder. If we were asked what is the greatest and most distinctive achievement performed by Englishmen in the field of jurisprudence I cannot think that we should have any better answer to give than this, namely, the development from century to century of the trust idea."

Frederic W. Maitland[1]

A. INTRODUCTION
B. PRELIMINARY CONSIDERATIONS
C. THE IRREDUCIBLE CORE FEATURES OF THE TRUST
  (1) First Element: Absence of the Settlor's Control over the Trust Asset(s)
  (2) Second Element: Standard of Conduct and Fiduciary Duties for the Trustee
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D. CONSEQUENCES OF THE LACK OF THE CORE FEATURES.
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A. INTRODUCTION

As the previous quotation shows, the trust has been conceived as one the biggest achievements of the common law tradition, and particularly, the English law. It is true that the trust has its roots in England, and that it has also been developed in other jurisdictions that belong to the common law family. Nevertheless, since the last century until now it is possible to see how trust has been widely recognized and incorporated in civil-law countries and mixed legal jurisdictions.[2] This phenomenon has arisen several inquiries regarding the legal nature of the trust, and whether these worldwide adoptions have changed or not the original purpose or structure of the common-law trust. In this environment, several scholars have proposed that there are some core-shared elements of the trust that can be found in any nation that have admitted said institution.[3] Obviously, legal scholars have not agreed regarding a unique list of essential elements, therefore, there are some differences in the proposals of each author.

This article aims to contribute a general catalogue of the so-called "essentials" of a trust, taking the relevant propositions and developments that the trust has had around different

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[1] Frederic W. Maitland, 'The Unincorporate Body' in Herbert A. L. Fisher (ed), *The Collected Papers of Frederic William Maitland* (Volume 3, Cambridge, University Press 1911) 271, 272.

[2] Frederick Henry Lawson & Bernard Rudden, *The Law of Property* (3rd ed., Oxford: Clarendon Press 2002) 86.

[3] See, e.g., Marius J. De Waal, 'A European Law of Trust', in Antoni Vaquer (ed), *European Private Law Beyond the Common Frame of Reference* (Europa Law Publishing 2008) 167, 171; Tony Honoré, 'On Fitting Trust Into Civil Law Jurisdictions' (2008) Oxford Legal Research Paper Series Nº 27/2008 < https://ssrn.com/abstract=1270179> accessed 30 November 2023; Donovan WM Waters, 'The Institution of the trust in civil and common law' (1995), 252 Collected Courses of the Hague Academy of International Law 347, 427 ff.; Maurizio Lupoi, *Trust: A Comparative Study* (Cambridge University Press 1999) 269ff.

jurisdictions. Trust's evolution has implicated many changes and diverse types of trust that may confuse someone who is entirely new on this field. Considering this, in the next section we will shape and narrow the scope of our essay by making some preventions regarding the kind of trust that we are going to refer to, the jurisdictions that we will allude during this work, the use of the word 'trust' when making references to a non-speaking English country, and the methodology use to make the relevant comparisons.

In the next segments of this contribution, we will analyse the core irreducible features of the trust proposed, namely, the inexistent control over the trust assets by the settlor (Subsection C(1)), the existence of a general standard of conduct and fiduciary duties imposed to the trustee (Subsection C(2)), and the benefit to someone or the existence of a purpose (Subsection C(3)). Despite that every feature has its own motives to be considered as an elemental characteristic of a trust, all of them share one main reason: if lacks at least one of them, its existence or validity may be seriously jeopardized (Section D). At the end, the main ideas and conclusions of this work will be summarized (Section E).

B. PRELIMINARY CONSIDERATIONS

As we have stated above, the trust's history has involved many developments that has resulted in a wide typology of trusts. For instance, we may find statutory trusts, discretionary trusts, *mortis causa* trusts, spendthrift trust, and bare trusts, among others. These examples set up a vast variety of structures, functions, and parties, hence, it is quite challenging (almost impossible) to treat all these trusts as they were just one category. For this reason, and in order to develop and explain the proposed essentials features, we will take into account the most elemental and basic idea of trust, i.e., where the settlor expressly declare and allocate asset(s) to a trustee, who manages it (them) for the benefit of someone (i.e., beneficiary) or to fulfil a particular purpose. Hereinafter, therefore, when we make a mention to a 'trust' this is the scheme that we are referring to.

On the other hand, it is also necessary to mention and discard any confusion regarding the translation of the word 'trust'. Different non-English speaking jurisdictions that have adopted the trust do not refer it by its English name. Instead, they use a different name, for example, *fideicomiso*, *fiducia*, *fiducié, treuhand*, etcetera. To avoid any confusion, when referring to a trust recognized in a non-speaking English country, we will use 'trust' as a synonym of these concepts.

Furthermore, we also consider important to declare that this work will fundamentally take a functionalist approach.[4] In this sense, our aim is to justify the essential features of a trust, first, by analysing the function that they perform and its main characteristics, and second, if that function is fulfilled in the jurisdictions that we have chosen for these purposes, then we can affirm that it is part of the elemental features of a trust. Obviously, and since we are going to make references to countries of different legal systems, the means whereby they achieve these functions are dissimilar. However, that is precisely the value of this perspective, because it allows us to make a proper comparison between common-law, civil-law and mixed jurisdictions without a deeper explanation of the rules, history, and logic behind each legal system.

Last but not least, as this comparison involves references regarding the abovementioned legal taxonomy, we have chosen one jurisdiction of each system to prove how these features are recognized. First, from the common law side, we will refer to England, as this country was the place where this legal device was born and developed for centuries; second, from the civil law

[4] For the popularity of this approach, its advantages and disadvantages see Alexandra Braun, 'The state of the art of comparative research in the area of trusts' in Michele Graziadei and Lionel D. Smith (eds), *Comparative Property Law: Global Perspectives* (Edward Elgar Publishing 2017) 121, 132 – 133.

world, we have selected Argentina.[5] Recently, this country has enacted a new civil code where explicitly regulates the trust (in Spanish "*contrato de fideicomiso*") through several provisions that determine its content, requirements, effects, etcetera; and third, from the mixed legal jurisdictions, we will refer to Scotland due to its patrimonial approach of trusts, which has remarkable consequences in this matter.

C. THE IRREDUCIBLE CORE FEATURES OF THE TRUST

In so far, we have constantly spoken about the 'core irreducible features' or 'essential elements' of the trust. However, what do we mean with these concepts? By using these notions, we aim to identify two ideas: firstly, those basic elements or factors that intrinsically belong to the trust and can be found in every nation that has incorporated this legal device, no matter its legal background; and secondly, the idea that if you do not have one of these features, you do not have a trust any more[6] or it is not valid in accordance with the relevant legal norms in force within a particular jurisdiction.

Having said that, in the next subsections we will take a closer look with respect of the essential elements proposed by this work.

(1) First Element: Absence of the Settlor's Control over the Trust Asset(s)

As the reader may notice from the scheme of trust that we described in our 'Preliminary Considerations', each of the parties plays a specific role in a trust. The settlor represents the original owner of the trust property, the trustee is in control of those assets, and the beneficiary is whom receives the benefits of the trustee's management or, in case that a purpose has been established, the trustee must fulfil a particular cause. Hence, for being in presence of a trust there must be a genuine separation of said features and roles.[7]

In a trust, the control and management of the trust property lies solely in the trustee. The role of settlor is simply that of creator, hence, once creation has taken place, there is no evident role for the settlor in the operation of the trust in his capacity as settlor.[8] Consequently, the settlor drops from the picture absolutely and has no rights, in his capacity, to direct the trustee in how to deal with the trust property.[9] This settlor's role in a trust is just an effect of what professor Lupoi calls "entrusting", that is, 'the loss by the settlor of any power over the trust assets is a natural consequence of their transfer to the trustee.'[10] Of course we need to be careful when talking about a 'transfer' of assets to the trustee, since in common-law jurisdictions this concept may have a different meaning in respect with civil-law or mixed legal countries. However, the remarkable aspect is that the settlor when "transferring" her assets is, on the one hand, dispensing her from them, and on the other hand, giving them to another person for its management. Therefore, when creating a valid trust, the law is essentially saying that 'the trustee is not only a holder but, if

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[5] Regarding the reception and development of trusts in Latin America see Nicolás Malumian, 'Trusts in Latin America' (2010) 16 *Trust & Trustees*, 143, and Nicolás Malumian, 'Conceptualization of the Latin American *Fideicomiso*: is it actually a trust?' (2013) 19 *Trust & Trustees*, 720.
[6] Lionel D. Smith, 'Give the People What they Want? The Onshoring of the Offshore' (2018) 103 Iowa Law Review 2155, 2157.
[7] Jonathan Garton, Graham Moffat, Gerry Bean & Rebecca Probert*, Moffat's Trusts Law: Text and Materials* (6th ed., Cambridge University Press 2015) 15.
[8] Geraint Thomas & Alastair Hudson*, The Law of Trusts* (2nd ed., Oxford University Press 2010) 25.
[9] ibid 25
[10] Lupoi (n 3) 271.

administration is to be done, he is the administrator. It is the trustee who essentially is the administrator',[11] and not the settlor (or the beneficiary).

What would it happen if the settlor had control over the trust asset(s)? Suppose, for example, that my father set up in a trust two different lands that he owns in Scotland and £5,000 and appoints his best friend ('John') as trustee of these assets for the benefit of my youngest brother, until 2040. My father, however, does not permit that John transfers or administers properly the lands and the money, being the latter always compels to ask for my father's authorization in order to enter into any juridical act regarding those assets. Let us say, moreover, that this limitation to John's job is not only factual but also it is stipulated in the trust deed. Are we facing a real trust? It is unlikely to conclude that. The facts described certainly do not allow us to consider said legal instrument as a trust, since *de jure* and *de facto* the settlor is exercising powers of management whence there are two clear results: the settlor is taking the position of the trustee and, therefore, the latter turns into an irrelevant party within a trust scheme.

It is true that different jurisdictions of each legal systems may vary this principle giving more or less options to the settlor to interfere in the trustee's performance. Nevertheless, and as we are finding the basic elements of a trust, the trustee's position is generally described as an office that 'implies some degree of outside control over the arrangement made by the settlor. The settlor may be the constituent of the trust, but the trust instrument is its constitution. In administering the trust, the trustee cannot be the mere agent of the settlor or subject to his orders.'[12]

How is this core element recognized in the countries chosen for this work? Let us begin with Scotland. In this jurisdiction, trusts are conceived from a patrimonial conception whereby the trust assets originate a separate patrimony from the truster (the Scottish way to refer to the settlor) and the trustee.[13] In Scotland, the trustee is 'the owner of the trust property which is in a separated patrimony distinct from his own patrimony'.[14] Furthermore, the Trusts (Scotland) Act 1921 barely refers to the truster and her rights or duties regarding this separate patrimony. In fact, Section 4 of said act provides a generous list of powers conferred to the trustee, which demonstrates the lack of control of the truster regarding this new patrimony. This is an immediate consequence of 'entrusting', where the truster is precisely the "entruster", since the property which he transfers to the trustee 'can hardly be recovered from him, but by his faithfulness in following that, which he knows to be the true design of the Truster'.[15] Thus, the patrimonial approach followed by Scots law denies to the settlor any chance to administer o manage this separate patrimony.

In Argentina, the patrimonial conception of trust is also followed. The new Commercial and Civil Code of Argentina enacted in 2015 (hereinafter "CCCA")[16] recognize the trust in its Third Book, Title IV, Chapter 30 (article 1666 et seq.). Two provisions in this matter are relevant: first, article 1685 CCCA establishes in its first paragraph that the trust assets form a separate

[11] Waters (n 3) 435.
[12] Honoré (n 3) 6.
[13] Regarding the patrimonial approach dominating in Scotland see George L. Gretton, 'Trust without Equity' (2000) 49 International and Comparative Law Quarterly, 599, and Kenneth G C Reid, 'Patrimony not Equity: The Trust in Scotland", in Remus Valsan (ed), *Trust and patrimonies* (Edinburgh University Press 2015) 110.
[14] Alexandra Popovici, 'Trusting Patrimonies", in Remus Valsan (ed), *Trust and patrimonies* (University Press 2015) 199, 207. Confirming this idea, it has been said that "The trustee is the full, civil law owner, with *usus*, *fructus* and *abusus*". See Lionel D. Smith, 'Trust and Patrimony', in Remus Valsan (ed), *Trust and patrimonies* (Edinburgh University Press 2015) 42, 58.
[15] Lupoi (n 3) 293.
[16] In Spanish *Código Civil y Comercial de la Nación, 2015*.

patrimony from the settlor, the trustee, the beneficiary and the *fideicomisario*;[17] second, article 1688 also in its first paragraph, expresses that the trustee do not need the settlor's authorization to perform any act of disposition or encumbrance regarding the trust property.[18] These provisions show us that in Argentina the settlor has any role in the management and control over the trust property because, on the one hand, these assets are out of the settlor's patrimony, and on the other hand, the trustee do not need any settlor's approval to dispose or administer said assets.

In England, this patrimonial conception does not apply.[19] However, that does not imply that we cannot see the settlor's lack of control over the trust property. 'By placing property on trust, a settlor arranges for control of the property to be separated from the right to benefit from it. The trustee has legal title, which confers control of the property, and the beneficiary or beneficiaries have an equitable interest, which is a right to an actual or possible benefit from the property in the way specified in the terms of the trust.'[20] This quote represents in a clear way how trust works in the common law, and most importantly for our purpose, it shows that the settlor order to the trustee to have control over the trust assets, therefore, the former has no management faculties. As we have said before, once the settlor has transferred the assets to the trustee, he has no further interest in this affair.[21]

One may say that in England, the settlor can reserve for himself some powers or faculties, such as the appointment of a new trustee, change the beneficiaries or the purpose of the trust. However, and for our purposes, this reserved powers are limited by 'the effectiveness of the grant and consequently the exercise of the powers of administration and, where relevant, of transfer which result naturally in favour of the trustee and which the settlor may not appropriate for himself: even in a case of genuine doubt as to how to act, the trustee must turn to a court and not to the person who created the trust.'[22]

(2) Second Element: Standard of Conduct and Fiduciary Duties for the Trustee

In the last section we stated that the trustee is entitled with powers of management over the trust property since the settlor had entrusted his assets in benefit of the beneficiary or to achieve a purpose. These powers, nevertheless, put the beneficiaries (or the achievement of a cause) to the peril of mismanagement or misappropriation by the trustee, thus, from an economic analysis of

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[17] 'Article 1685. Separate patrimony. Insurance. The trust property constitutes a separate patrimony from the patrimony of the trustee, the settlor, the beneficiary and the *fideicomisario*'. Please note that this is an unofficial translation. As the lector may note, the word '*fideicomisario*' has not been translated. The reason is twofold: firstly, it is common to translate said word in English as 'trustee', but the same occurs with the word '*fiduciario*'; secondly, and most important, it has been said by the Argentinian doctrine that the '*fideicomisario'* is considered as the 'residual beneficiary' of the trust who can be the trustee, the beneficiary or a third party. See Facundo M. Bilvao, 'El contrato de fideicomiso a la luz del nuevo Código Civil y Comercial' (2015) Dirección Nacional del Sistema Argentino de Información Jurídica, 2 <http://www.saij.gob.ar/facundo-martin-bilvao-aranda-contrato-fideicomiso-luz-nuevo-codigo-civil-comercial-dacf150449-2015-07-30/123456789-0abc-defg9440-51fcanirtcod> accesed 5 December 2023. For these reasons, and when referring to Argentinian Law, we will refer the *fiduciario* as the trustee. Furthermore, an when applicable, we will assume that the '*fideicomisario*' is also the beneficiary.

[18] 'Article 1688. Acts of disposition and encumbrances. The trustee may dispose of or encumber the trust property when required for the purposes of the trust, without the consent of the settlor, the beneficiary or the *fideicomisario* being necessary'. Please note that this is an unofficial translation.

[19] Smith, *Trust and Patrimony* (n 14) 57.

[20] Peter Jaffey, 'Explaining the Trust' (2015) 131 Law Quarterly Review 377, 377.

[21] Paul Matthews, 'From Obligation to Property, and Back Again? The Future of the Non-Charitable Purpose Trust' in DJ Hayton (ed), *Extending the Boundaries of Trusts and Similar Ring-fenced Funds* (Kluwer Law International 2002) 203, 220.

[22] Lupoi (n 3) 165.

law perspective, this generates a problem of agency costs.[23] How does trust law solve or try to address this pitfall? By subjecting fiduciary duties in the trustee's exercise or non-exercise of his powers.[24]

As the law of trusts imposes fiduciary duties to the trustee, we may conclude that the trustee takes a fiduciary position within a trust. In the language of the law of trusts this idea is almost universally expressed in that way or by saying that the relationship between the trustee and the beneficiary is a fiduciary relationship.[25] Accordingly, 'the fiduciary position of the trustee obliges him to act in a very specific manner with regard to the trust property and *vis-à-vis* the trust beneficiary.'[26] This essential feature leads us to a fundamental question: how the trustee shall act? In other words, what is the content of these fiduciary duties?

As we are addressing a general question regarding the core elements of a trust, it would be audacious to attempt in generating and examining an exhaustive list of fiduciary duties, since each legislation defines which obligations have said characteristic. In general, and from an economic perspective, the main trustee's duty is not to profit from the trust property and all profits he obtains from it belong to the beneficiaries.[27] Nonetheless, when we refer to these fiduciary duties, there is a common and general standard that lies behind all the specific obligations. This standard, as we will see in the next paragraphs, although it has been conveyed in diverse ways by the jurisdictions that we are analysing, we can say that the trustee must act always, as far as possible, considering the beneficiary's interest or the achievement of the purpose. This standard proposed has two advantages: on the one hand, it highlights the idea that trustee's duty is not strict, that is, the content of this position does not involve achieving a particular result, but acting with the intention to benefit the beneficiary[28] or accomplish a particular purpose; on the other hand, it gives to each jurisdiction freedom to define and use their own concepts regarding how the trustee must behave when managing the trust assets.

In England and Scotland it is required that a trustee, in the execution of all these duties, employs the same degree of diligence that a man of ordinary prudence would exercise in the management of his own affairs.[29] Besides, particularly in England, the terms "reasonableness" and "prudence", despite their differences, are often expressed in different statues or trust instruments.[30] In this sense, the discharge of a trustee's duty to act with due diligence and prudence is flexible and changes with economic conditions and contemporary thinking,[31] therefore, in order to judge

[23] Robert H. Sitko, 'Fiduciary Principles in Trust Law' in Evan J. Criddle, Paul B. Miller & Robert H. Sitkoff (eds), *The Oxford Handbook of Fiduciary Law* (Oxford University Press 2019) 41, 42.
[24] ibid 42.
[25] Marius J. De Waal, 'The Core Elements of the Trust: Aspects of the English, Scottish and South African Trusts Compared' (2000) 117 South African Law Journal 548, 557.
[26] Marius J. De Waal, 'In search of a model for the Introduction of the Trust into a Civilian Context' (2001) 12 Stellenbosch Law Review 63, 67.
[27] Lupoi (n 3), 313 – 314.
[28] Lusina Ho, 'Trust: The Essential' in Lionel D. Smith (ed) *The Worlds of the Trust* (Cambridge University Press 2013) 1, 15.
[29] De Waal, *The Core Elements of the Trust: Aspects of the English, Scottish and South African Trusts Compared* (n 25) 559. Please note that the author, when stating this idea, refers to the decision given by Lord Herschell (House of Lords) in *Rae and another v Meek* (1889) 16 R (HL). In Scotland, this idea is also support in W.A Wilson and A.G.M Duncan, *Trusts, Trustees and Executors* (2nd ed., Green for the Scottish Universities Law Institute 1995) 454-455. These last authors refer to difference cases, such as, *Knox v Mackinnon* (1888) 15 R. (H.L), *Kennedy v Kennedy* (1884) 12 R. 275, *Buchanan v Eaton* (1911) S.C (H.L), and *Tibber v McColl* (1994) SLT.
[30] Thomas & Hudson (n 8) 292. For example, in England the Trustee Act (2000) in its Part I, section (1), recognize the famous "duty of care", which implies that when applying this duty, the trustee 'must exercise such care and skill as is reasonable in the circumstances (…)."
[31] David Pollard, 'The 'Prudence' Test for Trustees in Pension Scheme Investment: Just a Shorthand for 'Take Care' (2021) 34 Trust Law International 215, 233

his performance it is important to apply the standards of the relevant period. Furthermore, and regarding discretionary powers given to the trustee, it has been stressed that these powers 'must be exercised in a reasonable manner'.[32] Finally, in Argentina this standard it is established in the first paragraph of the article 1674 CCCA: the trustee must fulfil his obligations 'with the prudence and diligence of a good businessman.'[33]

It exceeds the purpose of this work to explain how each country has applied and interpreted said standards. However, what is relevant is that we can see a general guideline of conduct expressed for the trustee, which inspires and justify further rules and court decisions, and shapes the trustee's behaviour.

As we mentioned before, each jurisdiction has also admitted other fiduciary duties that are influenced by these standards, and therefore, these obligations complement the main duty expressed above. In England, for instance, it also exists the duty of safeguard assets, the duty to invest, the duty to keep and render accounts, the duty to provide information,[34] the duty to inform beneficiaries of their status, and the duty to give reasons.[35] In Argentina, for example, the trustee cannot be exempted of her duty to render accounts or the negligence or deceit she may incur.[36] Lastly, in Scotland has been recognized other duties such as the duty to keep the estate under control, the duty to keep proper accounts of their intromissions with the trust estate, and the duty to insure against normal risks to the estate, among others.[37]

(3) Third Element: The Benefit to Someone or the Fulfilment of a Purpose

In the last part, on some occasions we mentioned that the trustee must manage the trust assets for the benefit of someone. Well, this "someone" is the so-called beneficiary, which his existence is the last core element of the trust.

There is a wide consensus regarding the existence of a beneficiary when setting up a trust. 'When there is a trust in the narrow sense, (….), the trustee is obliged to hold the trust property for the benefit of one or more persons. They are called beneficiaries: the persons who are entitled to the trust property.'[38] Similarly and reinforcing the idea of a beneficiary within a trust scheme, it has been said 'that for a valid private trust there must be someone with a beneficial interest, a beneficiary'[39] and that 'the beneficiary is necessary for the existence of the trust'.[40]

The reader may note that the title of this section also refers as a core requirement for trust 'the fulfilment of a purpose'. Undoubtedly, both ideas are opposed to each other. Nevertheless, and following professor Lupoi, it would be unfair not paying attention to purpose trusts, since

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[32] Wilson & Duncan (n 29) 400.
[33] 'Article 1674. Standard of conduct. Solidarity. The trustee must fulfil the obligations imposed by law and by the contract with the prudence and diligence of a good businessman acting on the basis of the confidence placed in him). Please note that this is an unofficial translation.
[34] Thomas & Hudson (n 8) ch 10.
[35] David Fox, 'Non-excludable trustee duties' (2011) 17 *Trust and Trustees*, 17, 20 – 22.
[36] 'Article 1676 CCCA. Forbidden dispensations. The contract may not exempt the trustee from the obligation to render accounts, nor from the fault or deceit which he or his dependants may incur, nor from the prohibition to acquire for himself the property held in trust.' Please note that this is an unofficial translation.
[37] Wilson & Duncan (n 29) 359 – 361.
[38] Lionel D. Smith, 'Massively Discretionary Trusts' (2017) 70 Current Legal Problems 17, 21. Please note that for this author the 'narrower sense' of a trust is an 'an obligation with respect to the benefit of property (…) This is the sense that is used when someone examines a particular provision within a trust structure, and asks, does it create a trust or a power?'. Ibid., 19.
[39] Matthews (n 21) 222.
[40] Smith, *Massively Discretionary Trusts* (n 38) 51.

they have had an enormous expansion around jurisdictions no matter which legal system they belong.[41] Therefore, as think variety of trusts have gained a vast ground within different countries, it has been added as one of the core elements of a trust.

How is this basic feature recognized in the jurisdictions under analysis? In Argentina, the requisite of beneficiary is expressed in various provisions of the CCCA. First of all, when conceptualizing the trust, article 1666[42] expressly mention the beneficiary. Then, regarding the requirements of the trust, article 1667(d))[43] establishes as requisite the beneficiary's identification or the way to identify him, in case there is uncertainty regarding his identification. Finally, article 1671 in its first paragraph says that the beneficiary could be a legal or natural person that might exist or not when setting up a trust, and in this last case, the instrument that create the trust must contain the relevant data that allow the parties to identify him.[44] There are not any reference to purpose trusts in the new CCCA.

In England, the generally accepted rule is that a trust, to be valid, must have an ascertainable beneficiary (individual or corporate) in whose favour performance of the trust may be decreed.[45] This general rule is closely related with the so-called 'beneficiary principle'[46]: this principle is concerned with the enforceability of a trust, thus it requires that during the existence of a trust exists some person who has a sufficient interest to enforce it.[47] The main exception of these general rule and principle are the trusts for charitable purposes, regulated by a statue,[48] whose validity has been justified because they are enforceable by the Attorney-General.[49]

What is the situation in Scotland? When creating a trust, the truster must define with sufficient certainty the trust beneficiaries or the trust objective, otherwise, the purported trust is void.[50] As England, the purpose trusts are only limited to those for charity.[51] Nevertheless, Scottish Parliament has recently enacted the Trusts and Succession (Scotland) Act 2024, where its Chapter 6 incorporates the so-called 'private purpose trusts'. Undoubtedly, the inclusion of the private purpose trusts will signify a serious change not only in Scotland, but also in all the onshore jurisdiction where this matter has been debated.[52]

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[41] Lupoi (n 3)

[42] 'Article 1666. Definition. There is a contract of trust when one party, called the settlor, conveys or undertakes to convey the ownership of property to another person called the trustee, who undertakes to exercise it for the benefit of another person called the beneficiary, who is designated in the contract, and to convey it on the fulfilment of a term or condition to the *fideicomisario*.'

[43] 'Article 1667. Content. The contract must contain: (...) d) the identification of the beneficiary, or the way of determining him in accordance with Article 1671'.

[44] 'Article 1671. Beneficiary. The beneficiary may be a natural or juridical person, who may or may not exist at the time of the execution of the contract; in the latter case, the information enabling the beneficiary to be identified in the future must be stated. The beneficiaries may be the settlor, the trustee or the *fideicomisario*.'

[45] Thomas & Hudson (n 8) 137.

[46] For a brief explanation regarding how this principle has evolved in the last three centuries up to now, see Sam Chandler, 'The beneficiary principle in the 21st century' (2023) 29 *Trust & Trustees* 38.

[47] Thomas & Hudson (n 8) 142. Even, it has been said that a 'a core requirement of the trust is the presence of someone to enforce it'. See Jason Fee, 'Trust-owned companies and the irreducible core of the trust' (2020) 26 *Trust and Trustees*, 826, 835.

[48] Charities Act 2011.

[49] Thomas & Hudson (n 8) 138.

[50] Marius J. De Waal and Roderick R.M. Paisley, 'Trusts' in Reinhard Zimmermann et al (eds) *Mixed Legal Systems in Comparative Perspective* (Oxford University Press, 2004) 819, 832.

[51] Charities and Trustee Investment (Scotland) Act 2005.

[52] For a critical perspective regarding the introduction of 'private purpose trusts' in Scotland see Alexandra Braun, 'Private Purpose Trusts: Good for Scotland?' (2023). University of Edinburgh School of Law Legal Studies Research Paper Series 2023/05 <https://ssrn.com/abstract=4444542> accessed 10 December 2023. For a critical approach in

D. CONSEQUENCES OF THE LACK OF THE CORE FEATURES.

As we stated above, these core elements can be found in every legal system that has recognized trusts, no matter the legal family they belong. So far, we have seen how in different jurisdictions these elemental features have been incorporated. However, we believe that this aspect is not enough to demonstrate why these elements are core to a trust, since is only one side of the coin. These features are core for also another reason: without one of these elements, the trust's existence and validity would be seriously threatened.

Different institutions may help us to prove the aforementioned consequences. Let us begin with both the illusory trusts and the doctrine of sham trusts. On the hand, the classic definition of a sham given by Diplock LJ in *Snook v London and West Riding Investments Ltd* reflects the essential features of this doctrine that refers to 'acts done or documents executed by the parties to the "sham" which are intended by them to give to third parties or to the court the appearance of creating between the parties legal rights and obligations different from the actual legal rights and obligations (if any) which the parties intend to create.'[53] An illusory trust, on the other hand, 'purports to be a trust but the nature of the obligations identified are inconsistent with those which operate in a trust and so what has been created is not a trust.'[54] The main difference between both lies in the presence of a subjective intention to mislead, while in the former that is an essential requirement, that is not true for the latter.[55]

The opposite to our first element would be that the settlor retains for himself broad powers that allow him to do whatever he wants with the trust assets. In this case, if sham cannot be established because a dishonest intention is not found, courts have decided that the trust was illusory.[56] In a similar sense, what would happen if the trust does not contemplate a beneficiary? In Scotland, as stated above, it would be void: in Argentina, it would lead to a simulation[57] that if it causes damages to third parties, then this juridical act would be void.[58] English law takes another route: as no one would be able to enforce the trust, and the obligations owed by the trustee to the beneficiaries are fundamental to the concept of a trust, it has been held that if the beneficiaries have no rights enforceable against the trustees there are no trust.[59] In the case of a purpose trust,

England see Kelvin F.K. Low, 'Non-Charitable Purpose Trusts. The Missing Right to Forego Enforcement' in Richard Nolan et al (eds), *Trusts and Modern Wealth Management* (Cambridge University Press, 2018) 486-509.

[53] [1967] 2 QB 786, 802.

[54] Graham Virgo, 'Abuse of Trust' in Richard Nolan et al (eds) *Trust and Private Wealth Management* (Cambridge University Press 2022) 285, 294. In this work, it is also highlighted that 'despite the rejection of the phrase 'illusory trust', this is actually a useful descriptor of the doctrine. For, if what the settlor has purported to create cannot be considered to satisfy the core requirements of a trust, then it is not a trust which has been created: the trust is an illusion and the attempt to create can be considered to be an abuse'. ibid 295 – 296.

[55] ibid 296. Supporting the idea of the necessity of an intention to mislead and its main features see also Matthew Conaglen, 'Sham Trusts' (2008) 67 Cambridge Law Journal 176, 183 – 192.

[56] Lusina Ho, 'Breaking Bad' in Richard Nolan et al (eds), *Trusts and Modern Wealth Management* (Cambridge University Press 2018) 34, 43 – 44.

[57] 'Article 333. Characterization. Simulation occurs when the legal nature of an act is concealed under the appearance of another, or when the act contains clauses that are not sincere, or dates that are not true, or when by it rights are constituted or transmitted to interposed persons, who are not those for whom they are in fact constituted or transmitted' (our emphasis added). Please note that this is an unofficial translation.

[58] 'Article 334. Licit and illicit simulation. Illicit simulation or that harms a third party causes the nullity of the ostensible act. If the simulated act conceals a real act, the latter is fully effective if it meets the requirements of its category and is neither unlawful nor prejudicial to a third party. The same provisions apply in the case of simulated clauses.' (Emphasis added). Please note that this is an unofficial translation.

[59] Virgo (n 54) 296.

particularly a charitable trust, the relevant rules in Scotland[60] and England[61] define when we are facing a trust with these characteristics, therefore, if the trust does not comply with these elements, it cannot be treated as charitable trust.

What would it happen then if the trustee acts in a dishonest way, or his acts do not benefit the beneficiary? The standards of conduct and fiduciary duties are consequences of the fiduciary trusteeship between trustee and beneficiary: if a 'trustee exercises a trust power for an improper purpose, that exercise will be invalid by virtue of the doctrine of fraud on the power.'[62] For instance, this would happen if in exercising the power, the trustee secures a benefit for himself or a third party who is not an object of the power'[63] or the trust scheme, situation that, as we stated above, would be contrary to the main duty of the trustee which is act in benefit of the beneficiary. What is the effect of the doctrine of fraud on the power? As its very definition states, 'the exercise of the power will be void since it is as though the power had not been exercised'.[64]

E. CONCLUSION

In this contribution we have proposed and examined what we think are the essential elements of a trust. After some preliminary considerations made to limit and clarify the scope of our proposal, we found three irreducible cores of a trust: the first element, represented by the nonexistence of control over the trust property by the settlor; the second feature expressed by the presence of a general standard of conduct followed by different fiduciary duties imposed to the trustee; and the third and last element symbolized by the existence of a beneficiary or a purpose.

As finding essential features involves taking into account all the jurisdictions around the world, we concentrated in the classical taxonomy that differentiate countries that belong to the common law tradition, the civil law tradition and the mixed legal systems, where England, Argentina and Scotland, respectively, were the representatives of each legal family. We found that the abovementioned core features, by different means, were recognized in each of these nations. The framework that we have proposed allows us to conclude that the proposed elements can be placed in every jurisdiction that has adopted the trust within its legal system regardless the legal family that belongs.

Nonetheless, the fact that these features can be encountered in any country does not provide a complete explanation regarding why these elements are core in a trust. Some might say that is just a coincidence that these aspects are recognized in these jurisdictions, therefore, we need a further justification with respect to this matter. This legitimate inquiry and explanation were addressed in section D: besides the existence of these core elements in the analysed countries, the lack of any of these features would lead to a non-trust or a voidable trust. For this point, the doctrines of sham, illusory trusts, simulation, and fraud of the power gave us a general picture regarding the consequences of an omission of any of these core features when setting up a trust.

To sum up, regarding the question whether there are core irreducible features of the trust across common-law, civil-law and mixed legal jurisdictions, we are in the position to support an affirmative answer to this inquiry. We suggested three irreducible cores, and we demonstrated that

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[60] Charities and Trustee Investment (Scotland) Act 2005, s 7.
[61] Charities Act 2011, s 2.
[62] Virgo (n 54) 304. For a critical perspective regarding the doctrine of fraud on the power see Joel Nitikma, 'Goodbye and good riddance to the doctrines of "fraud on a power" and "the entire substratum"—now if only we could figure out the "proper purpose" rule' (2023) 29 *Trust & Trustees*, 248.
[63] Virgo (n 54) 304.
[64] ibid 305.

they are essential for creating a trust not only because these features can be found across these legal families, but also because their non-inclusion would lead to its inexistence or nullity.

A COMPARATIVE CRITICAL ANALYSIS OF THE FINANCIAL REMEDIES FOR COHABITING COUPLES UPON RELATIONSHIP BREAKDOWN IN SCOTLAND AND GERMANY*

*Leonard Lusznat***

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B. MOST APPROPRIATE LEGAL MEASURES IN GENERAL
(1) Default Statutory or Voluntary Legal Measures
(2) Legal Framework for Cohabiting Couples
(3) General Principles Applicable Across Jurisdictions
(4) Contracting out of the Legal Measures and its Limitations
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(1) Legal Measures Assimilated to or Distinguished from Marriage
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A. INTRODUCTION

In autumn 2022, the Scottish Law Commission published its recommendations to enhance the provisions of the Family Law (Scotland) Act 2006 (asp 2) (hereinafter: FL(S)A 2006) regulating cohabitation.[1] This statute created for the first time a financial remedy upon separation of the couple within Scots family law, rendering the inadequate resort to general private law mostly redundant.[2] The German legislature has, in contrast, resisted similar reforms, despite numerous proposals from German academics and practitioners,[3] most notably of the *Deutscher Juristentag* (German Jurists Forum) – a highly-esteemed association devoted to giving impetus for the

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[1] Scottish Law Commission, *Report on Cohabitation* (Scot Law Com No 261, 2022).
[2] Elaine E Sutherland, *Child and Family Law*, vol 2 (*Intimate Adult Relationships*) (3rd edn, W Green/Thomson Reuters 2022) para 6-450.
[3] See Marina Wellenhofer in Franz Jürgen Säcker and others (eds), *Münchener Kommentar zum Bürgerlichen Gesetzbuch* (9th edn, CH Beck 2022) Anh § 1302 BGB Paras 29f, 67.

development of the law – in 1988[4] and 2008.[5] Cohabitation (*nichteheliche Lebensgemeinschaft*) is instead governed predominantly by the case law of the *Bundesgerichtshof* (German Federal Court of Justice) in the field of general private law.[6]

The article will take these distinct approaches as an opportunity to assess which financial remedies are across jurisdictions most appropriate once cohabitation – that is, for the purposes here, only a non-registered enduring intimate (heterosexual or homosexual) adult relationship between two persons (see also C(1) below for the definition of cohabitation in both Scots and German law) –[7] breaks down as well as to critically and comparatively analyse the existing legal measures in both Scotland and Germany. The main focuses will be placed on how to balance protecting the more vulnerable cohabitant with private autonomy and on which inspirations both jurisdictions might draw from each other.

The analysis is necessarily limited in scope and of a non-exhaustive nature. Issues of legal uncertainty – most of them are (eventually) resolvable by case law (and legal literature) –[8] and the effects of cohabitation on third parties (especially children) will generally not be addressed. For the purposes of the article, financial remedies are only those that permanently reallocate assets between the partners without consideration. Hence, temporary legal measures, especially regarding the family home,[9] and presumptions of ownership, particularly for household goods,[10] are excluded. Pension sharing will, as a specialised subject, equally not be considered.[11]

The article will begin by assessing which legal measures are across legal systems most adequate to balance the interests of the economically weaker partner with private autonomy (B) before comparatively analysing the existing financial remedies upon relationship breakdown in Scots and German law (C). Subsequently, the article will – building upon those deliberations – critically evaluate whether the legal situation in both jurisdictions is appropriate while identifying potential for reform (D). At the end, the main conclusions will be summarised (E).

B. MOST APPROPRIATE LEGAL MEASURES IN GENERAL

Cohabitation is nowadays a socially accepted way of living together,[12] confronting many jurisdictions with the challenge of how to regulate it best. The spectrum of possible legal

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[4] Ständige Deputation des Deutschen Juristentages, *Verhandlungen des Siebenundfünfzigsten Deutschen Juristentages Mainz 1988* (CH Beck 1988), vol II (*Sitzungsberichte*), Resolutions of the Department Cohabition I., II., I 233f.

[5] Ständige Deputation des Deutschen Juristentages, *Verhandlungen des Siebenundsechzigsten Deutschen Juristentages Erfurt 2008* (CH Beck 2008), vol II/1 (*Sitzungsberichte – Referate und Beschlüsse*), Resolutions of the Department Private Law A. IV. 3., B. I. 6. b), I 68f.

[6] Anatol Dutta and Charlotte Wendland, 'De Facto Relationships in Germany' in Andy Hayward and Jens M Scherpe (eds), *De Facto Relationships: A Comparative Guide* (Edward Elgar 2025, forthcoming, manuscript of March 2024) 1.2, 4.; compare also Dieter Henrich, 'Rechtsregeln für nichteheliches Zusammenleben – Zusammenfassung' in Inge Kroppenberg and others (eds), *Rechtsregeln für nichteheliches Zusammenleben* (Ernst und Werner Gieseking 2009) 341f.

[7] Consequently, polyamorous (see for example, Sutherland (n 2) paras 1-147ff) and platonic (see for example, Scottish Law Commission, *Aspects of Family Law: Discussion Paper on Cohabitation* (Scot Law Com DP No 170, 2020) paras 3.102ff) relationships are beyond the scope of the article.

[8] Compare Niamh Rodgers, '"Should have put a Ring on it?" A Comparative Analysis of the Law of Cohabitation in Ireland, Scotland and England and Wales' (2012) 11 HLJ (Hibernian Law Journal) 122, 146, 166.

[9] See for Scots law Matrimonial Homes (Family Protection) (Scotland) Act 1981, ss 18f (see Katy Macfarlane, *Thomson's Family Law in Scotland* (8th edn, Bloomsbury Professional 2022) 213ff) and for German law Wellenhofer (n 3) Anh § 1302 BGB para 66.

[10] See for Scots law FL(S)A 2006, ss 26f (see Sutherland (n 2) paras 3-074, 3-079) and for German law Wellenhofer (n 3) Anh § 1302 BGB paras 47f, 98.

[11] See for Scots law Scottish Law Commission (n 1) paras 5.73ff and for German law Wellenhofer (n 3) Anh § 1302 BGB para 95.

[12] Dutta and Wendland (n 6) 1.1 (text with fn 3); compare also Sutherland (n 2) paras 1-123f.

approaches ranges from treating cohabitants akin to strangers to equating them to spouses.[13] This section will contemplate which legal measures are, in general, most appropriate in light of the competing[14] policy aims of protecting the more vulnerable partner and materialising private autonomy, between which lawmakers have to strike a balance.[15] The article will argue that jurisdictions should not rely on voluntary legal measures but instead implement a default statutory regime (1), that the nature, requirements and legal effects of financial remedies are questions which each legal system has to address individually (2) but that nevertheless, two general principles apply across them (3) and that there should be the possibility of opting out, subject to formal and substantive limitations (4).

(1) Default Statutory or Voluntary Legal Measures

Legislators could draft their law of cohabitation solely on a voluntary basis, that is, adopting an opt-in system, be it either in the form of cohabitation contracts or of registered partnerships (including marriage). While this approach would maximise private autonomy – even sparing those who oppose any kind of state regulation for their intimate adult relationship from the effort and expense to contract out of the default statutory regime –[16] it is evidently an inadequate solution for the whole of society. Instead of balancing both policy aims, private autonomy would be absolutely upheld and protecting the more vulnerable party completely neglected.[17] A default statutory regime is, in this regard, superior to mere voluntary legal measures:

First of all, the legal framework for intimate adult relationships, which applies in the absence of any agreement between the partners, should provide what is just and fair for the majority of them (insofar as the interests of all affected groups of cohabitants are irreconcilable): Those who oppose any kind of state regulation for their relationship are – at least nowadays – in the minority.[18] Considerably more frequent in the overall very heterogenous[19] group are couples who treat cohabitation as 'trial marriage'[20] intending, or at least being open, to tie the knot in the future.[21] It is also regularly the case that one partner (typically the female) would like to formalise their relationship but not the other (typically the male).[22] Exactly for those (as well as other) types of cohabitation, the protection of the economically weaker partner has significant weight,[23] particularly with regard to the fundamental value of gender equality since it is the female who

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[13] Macfarlane (n 9) 207; Anna Stępień-Sporek and Margaret Ryznar, 'The Consequences of Cohabitation' (2016) 50 USFL Rev (University of San Francisco Law Review) 75, 96, 98, 100.
[14] Rodgers (n 8) 127.
[15] Stępień-Sporek and Ryznar (n 13) 87; Elaine E Sutherland, 'Unmarried Cohabitation' in John Eekelaar and Rob George (eds), *Routledge Handbook of Family Law and Policy* (2nd edn, Routledge 2021) 72.
[16] Compare Anatol Dutta, 'Paarbeziehungsregime jenseits der Ehe: Rechtsvergleichende und rechtspolitische Perspektiven' (2016) 216 AcP (Archiv für die civilistische Praxis) 609, 659.
[17] Compare Joanna Miles, 'Unmarried cohabitation in a European perspective' in Jens M Scherpe (ed), *European Family Law* (Edward Elgar 2016), vol III (*Family Law in a European Perspective*) 95f.
[18] Compare Martin Löhnig in Julius von Staudinger (fd), *J. von Staudingers Kommentar zum Bürgerlichen Gesetzbuch mit Einführungsgesetz und Nebengesetzen* (Otto Schmidt and De Gruyter 2023) Anh §§ 1297ff BGB para 7; Jonathan Herring, Rebecca Probert and Stephen Gilmore, *Great Debates in Family Law* (2nd edn, Palgrave 2015) 183.
[19] Dagmar Coester-Waltjen, 'Die Lebensgemeinschaft – Strapazierung des Parteiwillens oder Staatliche Bevormundung?' [1988] NJW (Neue Juristische Wochenschrift) 2085, 2085; Miles (n 17) 87f, also 96 and 110; compare also the four psychological types identified by Anne Barlow and Janet Smithson, 'Legal assumptions, cohabitants' talk and the rocky road to reform' (2010) 22 CFLQ (Child and Family Law Quarterly) 328, 335.
[20] Sutherland (n 15) 65.
[21] See Wellenhofer (n 3) Anh § 1302 BGB paras 11f; Dutta and Wendland (n 6) under heading 1.1 (text with fn 5); Herring, Probert and Gilmore (n 18) 184.
[22] See Löhnig (n 18) Anh §§ 1297ff BGB paras 7, 20.
[23] Compare Nina Dethloff, *Unterhalt, Zugewinn, Versorgungsausgleich – Sind unsere familienrechtlichen Ausgleichssysteme noch zeitgemäß? Gutachten A für den 67. Deutschen Juristentag* (CH Beck 2008) A 141.

predominantly suffers economic disadvantages in the course of them,[24] whereas private autonomy only plays a minor role.

What is more, the notion of private autonomy is misleading in terms of intimate adult relationships (compared to commercial settings) because cohabitants are not (well-informed)[25] individuals who only pursue their own interests:[26] Cohabiting couples are generally emotionally committed to each other and, hence, considerate of their partner's position in the way they regulate their (financial) affairs.[27] They are also frequently affected by optimism bias, that is, the overly optimistic assumption that their relationship will not break down, rendering any voluntary protective legal measures (erroneously) unnecessary.[28] In addition, some of them are inert without additional incentives to change the *status quo*,[29] unaware of the legal effects of both marriage and cohabitation or even have misconceptions about them.[30]

These considerations justify a default statutory regime – taking into account the possibility of contracting out of it discussed below (see detailed B(4)) –[31] instead of mere voluntary legal measures since it strikes the best balance between private autonomy and protecting the economically weaker partner.[32] Otherwise, the law would abandon the – always existing –[33] cohabiting couples who do not conclude cohabitation contracts or register their relationship.[34] Private autonomy is not a legal value which trumps everything else. On the contrary, legislators are entitled to impose legal provisions (even of a generalising nature)[35] which restrict basic freedoms if they pursue – like here – a legitimate aim and are proportionate.[36]

(2) Legal Framework for Cohabiting Couples

There is no general answer to the question which nature, requirements and legal effects financial remedies for cohabiting couples should have. Each and every legal system has to work out its individual legal framework against the background of its specific culture, economy, history, politics and religion while having regard to the (ideally by research corroborated) expectations of the cohabitants.[37]

This is particularly true in terms of whether the legal measures should be assimilated to those of spouses or be distinguished from them since there are compelling arguments in favour of both:[38]

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[24] Dethloff (n 23) A 140f; Marina Wellenhofer, 'Gesetzlicher Unterhaltsanspruch für nichteheliche Lebensgemeinschaften?' [2015] FamRZ (Zeitschrift für das gesamte Familienrecht) 973, 973.
[25] See Sutherland (n 15) 65f.
[26] Coester-Waltjen (n 19) 2087; Wellenhofer (n 24) 974.
[27] Coester-Waltjen (n 19) 2087; Marina Wellenhofer 'Regelungslücken bei der nichtehelichen Lebensgemeinschaft? Freiheit der Lebensformen im Lichte des Artikel 6 GG' [2008] AnwBl (Anwaltsblatt) 559, 559, 565; compare also Wellenhofer (n 3) Anh § 1302 BGB para 86 fn 433.
[28] Miles (n 17) 98; Sutherland (n 15) 67; see also Manfred Lieb, *Empfiehlt es sich, die rechtlichen Fragen der nichtehelichen Lebensgemeinschaft gesetzlich zu regeln? Gutachten A für den 57. Deutschen Juristentag* (CH Beck 1988) A 12.
[29] Dutta (n 16) 655f.
[30] Miles (n 17) 97; Sutherland (n 15) 65, 70.
[31] See also Sutherland (n 2) para 1-134.
[32] Agreeing, for example, Herring, Probert and Gilmore (n 18) 183; Miles (n 17) 96, 110; Rodgers (n 8) 129, 160, 165.
[33] Mustafa El-Mumin, 'A Comparative Study of Cohabitation: UK, Scotland, France and Australia' (2016) 7 QMLJ 44, 69f; Rodgers (n 8) 128.
[34] Sutherland (n 15) 69f.
[35] Compare Dethloff (n 23) A 151; compare also BVerfG NJW 2023, 1494 para 169 in relation to the protection of minors, exemplified by the provisions on legal capacity (§§ 107ff *Bürgerliches Gesetzbuch* (hereinafter: BGB)).
[36] Compare, for example, Angela Schwerdtfeger in Jürgen Meyer and Sven Hölscheidt (eds), *Charta der Grundrechte der Europäischen Union* (5th edn, Nomos, Stämpfli and Facultas 2019) Art 52 GRCh paras 27, 35ff.
[37] Miles (n 17) 87, 96.
[38] Agreeing Scottish Law Commission (n 1) para 2.36.

Functionally, cohabiting couples are very similar to married ones in the way they lead their lives (even though both are diverse groups),[39] particularly how they support each other emotionally and economically as well as care for their children.[40] There is also no persuasive evidence that being married is more beneficial for the well-being and stability of the relationship than cohabiting.[41] Moreover, legal systems generally conceive marriage as the optimal legal framework for intimate adult relationships; hence, the argument against restricting it to married couples is strong.[42]

At the same time, equating cohabitation with marriage would restrict the fundamental rights of cohabitants significantly,[43] especially the right to respect for private and family life and the negative dimension of the freedom to marry.[44] In addition, it seems doubtful whether the principle of equal sharing, which characterises financial remedies in many jurisdictions, particularly the default property regimes of civil law jurisdictions,[45] reflects the expectations of cohabitants adequately.[46] Moreover, the start and end dates of cohabitation are – in the absence of registration – difficult to ascertain,[47] making the necessary calculations for any award even more challenging than for marriage.

Regarding the eligibility requirements for the default statutory regime to apply at all (especially minimum duration and existing children),[48] it is similarly true that there is no general answer.[49] However, subject to the specific characteristics of each legal system as well as the nature and legal effects of the financial remedy in question, it seems to be generally preferable to refrain from imposing them (except possibly, for public policy reasons, in relation to forbidden degrees or underage couples)[50] since they categorically exclude some cohabitants who are worthy of protection in the individual case.[51] Above all, minimum duration periods are arbitrary.[52] The more favourable approach is to build these periods into the substantive requirements for the financial remedies: For instance, where they presuppose that the relationship results in advantages gained or disadvantages suffered, the duration of the cohabitation – having considerable influence over both – naturally becomes a significant factor.[53]

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39 Compare Stępień-Sporek and Ryznar (n 13) 101.

40 Compare Scottish Law Commission (n 1) para 2.36; Sutherland (n 2) para 1-133.

41 Dutta (n 16) 662f; Jonathan Herring, *Family Law* (11th edn, Pearson 2023) 143ff.

42 Compare Dutta (n 16) 668.

43 Compare Wellenhofer (n 24) 974f.

44 Eva Schumann in Hans-Theodor Soergel (fd), *Bürgerliches Gesetzbuch mit Einführungsgesetz und Nebengesetzen* (13th edn, W Kohlhammer 2013) NehelLG para 24; Ingeborg Schwenzer, 'Gesetzliche Regelung der Rechtsprobleme nichtehelicher Lebensgemeinschaften?' [1988] JZ (JuristenZeitung) 781, 782.

45 See Jens M Scherpe, 'The financial consequences of divorce in a European perspective' in Scherpe (ed) (n 17) 153, 156f, 158f, 161, 163f, 168ff, 192.

46 See for Scotland Scottish Law Commission (n 1) paras 2.23, 2.38, 5.69.

47 See Wellenhofer (n 3) Anh § 1302 BGB para 7; Scottish Law Commission (n 1) para 2.36.

48 Miles (n 17) 96.

49 Compare Stępień-Sporek and Ryznar (n 13) 100.

50 Compare Katharina Boele-Woelki and others, *Principles of European Family Law Regarding Property, Maintenance and Succession Rights of Couples in de facto Unions* (Intersentia 2019) 61f; Scottish Law Commission (n 1) paras 3.31ff; Rodgers (n 8) 137f.

51 Compare Rodgers (n 8) 136.

52 Scottish Law Commission, *Report on Family Law* (Scot Law Com No 135, 1992) para 16.4; El-Mumin (n 33) 57; Jo Miles, Fran Wasoff and Enid Mordaunt, 'Reforming family law – the case of cohabitation: 'things may not work out as you expect'' (2012) 34 JSWFL (Journal of Social Welfare and Family Law) 167, 174f.

53 Compare Scottish Law Commission, *The Effects of Cohabitation in Private Law* (Scot Law Com DP No 86, 1990) para 5.14; Rodgers (n 8) 134, 164.

(3) General Principles Applicable Across Jurisdictions

Even though each legal system has to develop its legal framework for cohabitation individually (see B(2) above), two general principles have universal validity:

Firstly, the default statutory regime for cohabitating couples should have no stronger legal effects than the one for married ones[54] – except if there are valid reasons which apply only to cohabitation: Legal systems usually envision marriage as the optimal legal framework for intimate adult relationships because they have balanced the interests of both partners in the best possible way.[55] Hence, there is generally no justification to go further for cohabitants.

Secondly, the legal measures for cohabitation have to be compatible with the structure of each legal system.[56] Otherwise, contradictions of values and inconsistencies of doctrine, both complicating the practical application of the law, will be the consequence. For example, it would be highly problematic if England and Wales, which grants the courts discretion in a case of divorce, would opt for the Spanish[57] community of property regime once cohabitants separate.[58]

(4) Contracting out of the Legal Measures and its Limitations

Creating a default statutory regime for cohabitation to protect the economically weaker party – as advocated here (see B(1) above) – does not disregard private autonomy completely but instead embraces it if it allows couples to contract out of it. Giving the possibility to opt out is particularly important since the default legal provisions will, because of the heterogeneity of cohabitating relationships (see B(1) above), not be equally suitable for all.[59] In line with the principle that legal measures governing cohabitation should, in general, not go further than those for marriage (see B(3) above), an opt-out mechanism is, in addition, indispensable for jurisdictions which recognise it regarding matrimonial contracts.[60]

The possibility to contract out of the default statutory regime should nevertheless be limited by formal and substantive safeguards to ensure the protection of the more vulnerable partner.[61] Even though an opt-out system shifts the effort and expense (compared to an opt-in system) to those who envision another legal framework for their relationship (see B(1) above),[62] it does not on its own guarantee that cohabitants are (well-informed) individuals who pursue their own interests effectively (see B(1) above). Depending on the structure of the legal system, formal requirements might entail the written form or notary authentication as well as independent legal advice (by a solicitor or civil law notary).[63]

Substantive safeguards have to take into account both the initial agreement and any subsequent change of circumstances: A cohabitation contract should – apart from not allowing to contract out of legal provisions which exist for reasons of public policy –[64] be invalid if it is manifestly

[54] Compare Coester-Waltjen (n 19) 2088; Rodgers (n 8) 125, 140.
[55] Dutta (n 16) 614, 668.
[56] Compare El-Mumin (n 33) 62f.
[57] See for both England and Wales as well as Spain Scherpe (n 45) 151ff, 167ff.
[58] Miles (n 17) 93; compare also Henrich (n 6) 340f.
[59] Compare Dethloff (n 23) A 151.
[60] Dethloff (n 23) A 151; Wellenhofer (n 24) 976.
[61] Agreeing Rodgers (n 8) 161 regarding formal safeguards; Scottish Law Commission (n 1) para 7.20 regarding substantive safeguards.
[62] See also Sutherland (n 2) para 1-146.
[63] Compare Rodgers (n 8) 161; Scherpe (n 45) 199.
[64] Compare Miles (n 17) 93.

unfair regarding its content or the circumstances of its conclusion.[65] In addition, if there has been an unanticipated change of circumstances – which happens regularly because of the dynamic nature of intimate relationships –[66] it is just and fair that legal systems grant their courts the power to modify the cohabitation contract or even to set it aside.[67] The paradigmatic example are cohabitants who initially assumed to contribute to childcare equally while working both full-time but of whom subsequently one becomes – with (tacit or express) consent of the other – the primary carer of their children while working only part-time or not at all.[68]

C. FINANCIAL REMEDIES IN SCOTS AND GERMAN LAW

Having contemplated legal frameworks for cohabiting couples in general, the article will now turn to a comparative analysis of the available financial remedies in the specific jurisdictions of Scotland and Germany. This section will examine how both legal systems define cohabitation (1), which legal remedies – focusing on the general characteristics instead of the details – exist within them (2), what time limits and periods of prescription apply (3) and to what extent contracting out of the default statutory regime is allowed (4) – while contrasting the legal situation of cohabitants to those of spouses.

Apart from these remedies, couples in both legal systems are able to arrange their relationships by voluntary partnership contracts,[69] either extending, modifying or limiting (see, however, C(4) below about the limitations of contracting out) their rights and duties. The additional choice of entering into a registered partnership other than marriage is only offered in Scotland, even though the legal effects[70] of its civil partnership are essentially (with minor distinctions) identical to marriage.[71]

(1) Definition of Cohabitation

The definitions for cohabiting couples are quite similar in both jurisdictions: Neither of them has eligibility requirements (especially no minimum duration) (see B(2) above);[72] instead, both require an overall assessment of each individual relationship, taking all relevant facts into account:[73] The Scottish legislation defines cohabitants as opposite-sex or same-sex couples who are living together as if they were spouses (FL(S)A 2006, s 25(1)(a) and Marriage and Civil Partnership (Scotland) Act 2014 (asp 5) (hereinafter: MCP(S)A 2014), s 4(2)(b), (3))[74] while expressly stipulating to have regard to the nature and length of their relationship and any financial arrangements (FL(S)A 2006,

[65] Compare The Law Commission, *Cohabitation: The Financial Consequences of Relationship Breakdown* (Law Com No 307, 2007) para 5.51; Scherpe (n 45) 203.
[66] Compare Dutta (n 16) 636f.
[67] Compare The Law Commission (n 65) para 5.53; Rodgers (n 8) 163.
[68] See Dutta (n 16) 636; Scherpe (n 45) 203.
[69] See for Scots law Susie Mountain, *A Practical Guide to Cohabitation and the Law in Scotland* (Law Brief 2020) 78f and for German law detailed Herbert Grziwotz in Klaus Schnitzler (ed), *Münchener Anwaltshandbuch Familienrecht* (5th edn, CH Beck 2020), § 30 paras 1ff.
[70] What sets the civil partnership apart from marriage is, in essence, its name, which leaves the cultural, religious and social connotations of marriage behind it (see Jens M Scherpe and Brian Sloan, 'Reformen im Familienrecht von England und Wales in 2013: Gleichgeschlechtliche Ehen, Kindschaftsrecht und Todesvermutung' [2013] FamRZ (Zeitschrift für das gesamte Familienrecht) 1469, 1470; compare Dutta (n 16) 627f; Miles (n 17) 103).
[71] See Jane Mair, 'Informal Relationships – National Report: Scotland' (*Commission on European Family Law February* 2014) 1 <http://ceflonline.net/wp-content/uploads/Scotland-IR.pdf> accessed 14 June 2024.
[72] See for both Scots and German law Boele-Woelki and others (n 50) 58f.
[73] See for Scots law Macfarlane (n 9) 208f and for German law Wellenhofer (n 3) Anh § 1302 BGB paras 5, 7.
[74] FL(S)A 2006, s 25(1)(b) has ceased to have effect according to MCP(S)A 2014, s 4(4) (see Macfarlane (n 9) 208ff fn 1, fn 11, 210f fn 1).

s 25(2)). German jurisprudence and literature, in the absence of a statutory definition,[75] generally regard them as two persons of the opposite or same sex not being married who live together with the intention that their relationship is enduring and exclusive as well as are committed to responsibility for each other.[76] Criteria are in both legal systems, among others, whether the partners live in the same house or flat and are in a sexual relationship,[77] although both are on their own neither essential nor conclusive.[78]

(2) Existing Financial Remedies

First of all, it has to be highlighted that cohabitation does neither in Scotland[79] nor in Germany[80] affect the separation of property between the partners, which is also true for Scottish (Family Law (Scotland) Act 1985 (hereinafter: FL(S)A 1985), s 24(1)(a))[81] and German (§ 1363(2)1 *Bürgerliches Gesetzbuch* (hereinafter: BGB))[82] spouses. Moreover, both jurisdictions do not recognise maintenance obligations during cohabitation,[83] which is in contrast to the legal situation of married couples (FL(S)A 1985, ss 1ff and §§ 1360f BGB).[84] Where cohabitation ends otherwise than by death, Scots law provides, however, a special statutory financial remedy in the realm of family law by virtue of the FL(S)A 2006 (see A above), which gives the courts broad discretion[85] to make orders for payments to achieve fairness between the parties.[86] The orders are – in simplified terms (without going into the details) – based, on the one hand, on the extent to which both partners have derived economic advantages from the contributions of the other and have suffered economic disadvantages in the interest of the other or their children (FL(S)A 2006, s 28(2)(a), (3)–(6))[87] and, on the other hand, on the (future) economic burden one partner has to bear because of caring for their children (FL(S)A 2006, s 28(2)(b)).[88]

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[75] Dutta and Wendland (n 6) 2. (text after fn 24).
[76] Löhnig (n 18) Anh §§ 1297ff BGB paras 11ff; Nina Dethloff, Dieter Martiny and Mirjam Zschoche, 'Informal Relationships – National Report: Germany' (*Commission on European Family Law* April 2015) 4 <http://ceflonline.net/wp-content/uploads/Germany-IR.pdf> accessed 14 June 2024.
[77] See for Scots law Mair (n 71) 6 and for German law Wellenhofer (n 3) Anh § 1302 BGB para 5.
[78] See for living in the same house or flat for Scots law Scottish Law Commission (n 1) paras 3.6f, 3.24ff; Macfarlane (n 9) 208f fn 4 and for German law Dethloff, Martiny and Zschoche (n 76) 5; Dutta and Wendland (n 6) 2.1 (text with fn 33) and for being in a sexual relationship for Scots law Sutherland (n 2) paras 2-027, 6-462 and for German law Schumann (n 44) NehelLG para 1; Dutta and Wendland (n 6) 2.3 (text with fn 41).
[79] Anne Griffiths, John Fotheringham and Frankie McCarthy, *Family Law* (4th edn, W Green/Thomson Reuters 2015) para 12-01; Mair (n 71) 19f.
[80] Wellenhofer (n 3) Anh § 1302 BGB para 47; Dutta and Wendland (n 6) 3.1 (text with fn 48).
[81] Catriona Laidlaw, 'Schottland' in Jürgen Rieck and Saskia Lettmaier (eds), *Ausländisches Familienrecht: Eine Auswahl von Länderdarstellungen* (23rd supp, CH Beck August 2022) para 10; Jane Mair, 'Property Relationship Between Spouses – National Report: Scotland' (*Commission on European Family Law* August 2008) 2, 11 <http://ceflonline.net/wp-content/uploads/Scotland-Property.pdf> accessed 14 June 2024.
[82] Dieter Martiny and Nina Dethloff, 'Property Relationship Between Spouses – National Report: Germany' (*Commission on European Family Law* August 2008) 11 <http://ceflonline.net/wp-content/uploads/Germany-Property.pdf> accessed 14 June 2024.
[83] See for Scots law Scottish Law Commission (n 1) para 5.47 and German law Dethloff, Martiny and Zschoche (n 76) 14.
[84] See detailed for Scots law Griffiths, Fotheringham and McCarthy (n 79) paras 10-24ff and detailed for German law Regina Bömelburg in Philipp Wendl and Hans-Joachim Dose (eds), *Das Unterhaltsrecht in der familienrichterlichen Praxis: Die neueste Rechtsprechung des Bundesgerichtshofs und die Leitlinien der Oberlandesgerichte zum Unterhaltsrecht und zum Verfahren in Unterhaltsprozessen* (10th edn, CH Beck 2019) § 3 paras 1ff.
[85] *Whigham v Owen* [2013] CSOH 29, 2013 SLT 483 [10]; Macfarlane (n 9) 222.
[86] *Gow v Grant* [2012] UKSC 29, 2013 SC (UKSC) 1 [31ff]; Sutherland (n 2) paras 6-497ff, 6-507f.
[87] Detailed Sutherland (n 2) paras 6-485ff.
[88] Detailed Sutherland (n 2) paras 6-507ff.

This legal remedy is in line with the approach of Scots law in relation to marriage, where the courts have a similar discretion[89] and where – contrary to civil law jurisdictions including Germany – there is equally no fundamental distinction between matrimonial property regimes and maintenance obligations.[90] What sets the FL(S)A 2006 apart, however, is that its financial remedy is only based on the two considerations described above instead of the five principles which are applicable to married couples:[91] Most notably, the principle that spouses should share the value of their matrimonial property fairly (FL(S)A 1985, s 9(1)(a)), which generally means equally (FL(S)A 1985, s 10(1)), does not apply.[92] In addition, in exercising their discretion, courts have neither to take into account whether one cohabitant is substantially financially dependent on the other nor whether one of them would suffer serious financial hardship as a result of the separation.[93] Moreover, their judicial powers are more limited for cohabiting couples: Courts are neither enabled to order the transfer of property and periodical payments (instead of capital sums) nor to make incidental orders.[94]

German law, in contrast, has no special remedy within family law: Cohabitating couples are – unlike their married counterparts – not subject to a community of accrued gains[95] (the default matrimonial property regime, § 1363(1) BGB); it requires the spouse whose accrued gains exceed those of the other to pay half of the surplus on divorce (§§ 1372ff, particularly § 1378(1) BGB). Equally, cohabitants, who are financially able, are generally free from maintenance obligations towards an indigent partner if the relationship breaks down; the only exception[96] is the claim of the mother or father regarding (future) childcare (§ 1615l(2)–(4) BGB), which applies, however, regardless of whether the parents were cohabiting.[97] Because of marital solidarity,[98] spouses are, by contrast, entitled to maintenance after divorce in the following situations: (future) childcare (§ 1570 BGB), old age (§ 1571 BGB), illness or infirmness (§ 1572 BGB), unemployment (no appropriate employment available) (§ 1573(1) BGB), topping-up ((appropriate) employment unable to provide for the marital standard of living) (§ 1573(2), § 1578(1) BGB), education, training or retraining (§ 1575 BGB) or gross inequity (§ 1576 BGB). Together these maintenance claims are able to compensate for economic disadvantages suffered because of the marriage.[99]

The *Bundesgerichtshof* has, nevertheless, developed in its case law[100] default statutory financial remedies in the areas of contract (doctrine of frustration, § 346(1), (2), § 313 BGB), partnership (§ 738(1)2 BGB) and unjustified enrichment (§ 812(1)2(2) BGB) law, although they have a limited scope: Only contributions between partners, which surpass what is needed for the ordinary way of living and which still enrich the beneficiary at the time of separation, have to be compensated.[101]

[89] *Little v Little* 1990 SLT 785, 787; Felix Odersky, 'Das Unterhaltsrecht in Großbritannien' [2013] FPR (Familie Partnerschaft Recht) 72, 74; Sutherland (n 2) paras 6-191, 6-193.
[90] Odersky (n 89) 72; compare also regarding England and Wales as well as Ireland Scherpe (n 45) 165.
[91] El-Mumin (n 33) 56; Rodgers (n 8) 141.
[92] Macfarlane (n 9) 222.
[93] Compare FL(S)A 2006, s 28(2)(a), (b) for cohabitation with FL(S)A 1985, s 9(1) for marriage (compare also Scottish Law Commission (n 7) para 5.6).
[94] Compare FL(S)A 2006, s 28(2) for cohabitation with FL(S)A 1985, s 8(1), s 12, s 13, s 14 for marriage and see Sutherland (n 2) paras 6-475, 6-511 who herself argues in favour of the opposite with regard to periodic payments (see also Elaine E Sutherland, 'Still left holding the baby' (2023) 68 (3) JLSS (Journal of the Law Society of Scotland) 22, 24).
[95] Wellenhofer (n 3) Anh § 1302 BGB para 95.
[96] Löhnig (n 18) Anh §§ 1297ff BGB paras 80f; Dutta and Wendland (n 6) 3.2.1 (text after fn 53).
[97] Dethloff (n 23) A 131; Dutta and Wendland (n 6) 3.2.1 (text after fn 53).
[98] Dieter Martiny and Dieter Schwab, 'Grounds for Divorce and Maintenance Between Former Spouses – Germany' (*Commission on European Family Law* October 2002) 23 <http://ceflonline.net/wp-content/uploads/Germany-Divorce.pdf> accessed 14 June 2024.
[99] Compare Beate Heiß and Hans Heiß in Winfried Born, *Unterhaltsrecht: Ein Handbuch für die Praxis* (54th supp, CH Beck July 2018) Kap 1 para 1; Bömelburg (n 84) § 4 paras 103f.
[100] BGH NJW 2008, 3277 paras 18, 29 (see Dethloff, Martiny and Zschoche (n 76) 25ff).
[101] Wellenhofer (n 3) Anh § 1302 BGB paras 99ff.

Consequently, cohabitants will, for example, be reimbursed regarding payments they made for acquiring the family home of which the other partner is the sole owner[102] but not those made for childcare or rent.[103] This mirrors the legal situation of spouses who have opted out of the community of accrued gains (by concluding a marriage contract) in favour of the separation of property.[104] Scots law equally recognises unjustified enrichment claims besides its statutory financial remedy,[105] possibly even for spouses.[106]

(3) Time Limit and Period of Prescription

Applications for the financial remedy of the FL(S)A 2006 are only possible within one year after the cohabitation ceased (FL(S)A 2006, s 28(8)); there is no judicial discretion to accept later submitted claims.[107] In contrast, both the Scottish unjustified enrichment claim is and the German remedies generally are governed by the ordinary rules of prescription: They are time-barred, in the case of the former, five years after becoming enforceable[108] and, in the case of the latter, typically three years after separation (§ 195, § 199(1) BGB);[109] however, maintenance obligations are principally excluded for the past (§ 1615l(3)1, § 1613 BGB). With regard to spouses, Scots law integrates the orders for financial remedies into the divorce proceedings (see FL(S)A 1985, s 8(1), s 12(1), s 13(1)), which is why no provisions regarding their time limits exist; in German law, the legal position is identical to the one for cohabitants (see above; however, § 1578b BGB applies instead of § 1615l(3)1 BGB).

(4) Contracting out of the Financial Remedies and its Limitations

The FL(S)A 2006 does not address the question whether cohabiting couples are permitted to contract out of the financial remedy.[110] Scottish legal literature, nevertheless, concurs that cohabitation contracts, which, in principle, do not have to observe formal requirements,[111] are able to deviate from the default statutory regime.[112] In this regard, the general limitations of contract law to their effectiveness apply, among others, error, extortion and fraud.[113] Marriage contracts are treated the same way (including their form), but courts have the additional power to vary unreasonable or unfair terms (or contracts) or set them aside (FL(S)A 1985, s 16).[114] What is crucial to be aware of is, however, that only the time of entering into them but not any subsequent change

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[102] Löhnig (n 18) Anh §§ 1297ff BGB para 87.
[103] Wellenhofer (n 3) Anh § 1302 BGB para 100.
[104] Löhnig (n 18) Anh §§ 1297ff BGB para 66; Dutta and Wendland (n 6) 4.3 (text after fn 101); Henrich (n 6) 342.
[105] See detailed Sutherland (n 2) paras 6-469ff.
[106] See Scottish Law Commission (n 1) para 8.12.
[107] Scottish Law Commission (n 1) para 6.5.
[108] *Pert v McCaffrey* [2020] CSIH 5, 2020 SC 259 [24]; Scottish Law Commission (n 7) para 8.33; Hector MacQueen, 'Cohabitants, unjustified enrichment and law reform: Part 1' (2019) 160 FamLB (Family Law Bulletin) 1, 4.
[109] Wellenhofer (n 3) Anh § 1302 BGB para 124; Dutta and Wendland (n 6) 4.3.5 (text with fn 139).
[110] Rodgers (n 8) 160.
[111] Mair (n 71) 35.
[112] See, for example, Scottish Law Commission (n 1) paras 7.6f; Mair (n 71) 32; Rodgers (n 8) 160; Sutherland (n 2) para 6-513.
[113] Scottish Law Commission (n 1) para 7.7.
[114] Kenneth McK Norrie, 'Marital Agreements and Private Autonomy in Scotland' in Jens M Scherpe (ed), *Marital Agreements and Private Autonomy in Comparative Perspective* (Hart 2012) 304, 305f; see also Macfarlane (n 9) 201ff.

of circumstances is of relevance for both cohabitation[115] and marriage[116] agreements since unilateral hardship is, on its own, not sufficient for the doctrine of frustration.[117]

German law allows cohabitants and spouses to modify and exclude their financial remedies in a similar way, although the restrictions are stronger: Whereas for marital contracts notary authentication is prescribed (§ 1410, § 1585c(2), § 128 BGB),[118] cohabitational contracts are only governed by the limited formal requirements of general contract law.[119] In terms of substantive safeguards, according to the predominant view,[120] cohabitation agreements are, in principle, treated identically to marriage agreements: They are void if – at the time of their conclusion – one party has objectively to bear a unilateral burden which is evidently unreasonable and the other party acted subjectively reprehensible;[121] they have to be varied or set aside if – at the time of divorce – such a burden has occurred because of a change of circumstances.[122]

D. COMPARATIVE CRITICAL EVALUATION OF SCOTS AND GERMAN LAW

Having contemplated which legal measures are generally most appropriate for cohabitation upon relationship breakdown and having comparatively analysed the financial remedies available in Scotland and Germany, the article is now in the position to critically evaluate the legal framework in both jurisdictions. This section will – after the preliminary remarks below – assess whether the situation of cohabitants in Scots and German law should be identical to or distinct from those of spouses (1) and whether and in what respect the existing legal rules should be reformed (2). The time limit and the prescription of the financial remedies (3) as well as the possibility of contracting out of them (including applicable limitations) (4) will be evaluated separately. Where appropriate, it will be contemplated what the jurisdictions are able to learn from each other.

That both Scots and German law have settled for statutory default regimes (see C(2) above) – even if their scope, particularly in Germany, is limited (see C(2) above and D(2) below) – instead of voluntary legal measures corresponds with what the article advocates (see B(1) above). Equally positive is that both legal systems have abstained from imposing eligibility requirements (see B(2) and C(1) above), which has not caused any major issues – in contrast to other legal systems which took the opposite path.[123] Even having no statutory definition at all and leaving the matter to the judiciary is an acceptable way, as German law demonstrates (see C(1) above).[124]

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[115] See Mair (n 71) 39; Scottish Law Commission (n 7) para 7.36.
[116] Scottish Law Commission (n 1) paras 7.3, 7.17, 7.26.
[117] Hector L MacQueen, *MacQueen and Thomson on Contract Law in Scotland* (5th edn, Bloomsbury Professional 2020) paras 5.72, 5.86.
[118] Anatol Dutta, 'Marital Agreements and Private Autonomy in Germany' in Scherpe (ed) (n 114) 172, 173f.
[119] Wellenhofer (n 3) Anh § 1302 BGB para 86.
[120] Marina Wellenhofer in Beate Gsell and others (eds), *beck-online.GROSSKOMMENTAR zum Zivilrecht* (CH Beck 1 April 2024) § 1297 BGB para 96; Herbert Grziwotz, *Nichteheliche Lebensgemeinschaft* (5th edn, CH Beck 2014) § 8 para 9; Wellenhofer (n 3) Anh § 1302 BGB para 87; Herbert Grziwotz in Christof Münch (ed), *Familienrecht in der Notar- und Gestaltungspraxis* (4th edn, CH Beck 2023) § 10 para 32; Herbert Grziwotz, 'Möglichkeiten einer vertraglichen Regelung' [2021] NZFam (Neue Zeitschrift für Familienrecht) 410, 411; Herbert Grziwotz, 'Auseinandersetzung einer faktischen Lebensgemeinschaft: Arbeitshilfe und Rechtsprechungsübersicht' [2015] NZFam (Neue Zeitschrift für Familienrecht) 543, 545.
[121] BGH NJW 2014, 1101 paras 14, 39; Alexander Stöhr, 'Die Inhaltskontrolle von Eheverträgen' [2022] JuS (Juristische Schulung) 805, 807f.
[122] BGH NJW 2015, 52 para 22; Stöhr (n 121) 808f.
[123] Miles, Wasoff and Mordaunt (n 52) 175; Rodgers (n 8) 133.
[124] Agreeing Wellenhofer (n 24) 976; compare also Jan Busche, 'Unterhaltsansprüche nach Beendigung nichtehelicher Lebensgemeinschaften – Eine kritische Bestandaufnahme' [1998] JZ (JuristenZeitung) 387 <396>.

(1) Legal Measures Assimilated to or Distinguished from Marriage

Whether the financial remedies for cohabitants should be assimilated to or distinguished from those of spouses is a question each jurisdiction has to respond to individually (see B(2) above). Treating cohabitation like marriage would entail that the couple is, in Scots law, subject to the principle of sharing their cohabitational property fairly, that is, equally, and, in German law, subject to the default property regime, where the accrued gains are distributed equally (see B(2) and C(2) above). These legal provisions go beyond protecting the economically weaker partner[125] and would significantly reshape how cohabitants arrange their financial affairs without them having voluntarily chosen them.[126] Unless those rules reflect the expectation of the majority of cohabiting couples, which is doubtful (see B(2) above), neither Scotland nor Germany should adopt them.[127]

(2) Existing Financial Remedies

While both legal systems provide financial remedies for the (future) burden of childcare (see C(2) above), German law – unlike Scots law, which protects the more vulnerable partner in this regard – fails to provide any redress for cohabitants who suffered economic disadvantages because of the relationship, particularly for upbringing children or housekeeping (see C(2) above):[128] Only contributions which exceed what is needed for the ordinary way of living are compensated (see C(2) above). Unsurprisingly, the legal situation in Germany has, for this reason, been criticised for decades, and various proposals to improve it have been made.[129] An extension is justified because the other partner regularly has accepted the division of responsibilities, which has led to the disadvantages, and has generally profited from it.[130] Here, German law is able to draw inspiration from Scots law.

However, transplanting the Scottish financial remedy is – in line with the principle that legal measures have to be compatible with the structure of each legal system (see B(3) above) – highly problematic[131] as Scottish family law does not distinguish between relationship property regimes and maintenance obligations as German law does (see C(2) above). Because the Scottish broad judicial discretion (see C(2) above) is generally unfamiliar to German matrimonial property law but established within maintenance law,[132] reform should, instead of the former, focus on the latter, where provisions which remedy economic disadvantages caused by the relationship already exist for spouses (see C(2) above).

Scots law is, however, not without shortcomings either. In particular, the available orders are too limited: There is no persuasive justification for why the transfer of property and incidental orders (see C(2) above) should be reserved for spouses, which is why the Scottish Law

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[125] Compare Stephan Szalai in Beate Gsell and others (eds) (n 120) (1 May 2024) § 1363 BGB para 6.
[126] Scottish Law Commission (n 1) para 2.38.
[127] Agreeing, for example, Scottish Law Commission (n 1) para 2.38; Löhnig (n 18) Anh §§ 1297ff BGB para 20; Lieb (n 28) A 107; Stępień-Sporek and Ryznar (n 13) 100f.
[128] Dethloff (n 23) A 140f; Wellenhofer (n 24) 973.
[129] See Wellenhofer (n 3) Anh § 1302 BGB paras 29f, 67; see also A above.
[130] Wellenhofer (n 24) 975; see also Dethloff (n 23) A 141.
[131] Compare Henrich (n 6) 340f; Miles (n 17) 93.
[132] Scherpe (n 45) 159f; compare, on the one hand, § 1381 and § 1383 BGB (equity) for the community of accrued gains as well as, on the other hand, § 1570(1)2, 3, (2), § 1574(2), § 1576, § 1577(2)2, (3), § 1578b, § 1579, § 1581, § 1585(2), § 1585a(1)2, § 1615l(2)4, 5, (3), § 1611, § 1613(3)1 BGB (equity) and § 1573(1), § 1574, § 1578(2), (3), § 1578b(1), § 1581(1), § 1585a(1)3, § 1615l(3)1, § 1603(1), § 1610 BGB (appropriateness) for maintenance obligations (see in relation to the non-binding guidelines of the Higher Regional Courts Werner Reinken in Wolfgang Hau and Roman Poseck (eds), *BeckOK BGB* (70th edn, CH Beck 1 May 2024) § 1610 BGB paras 8ff; Hans-Joachim Dose in Wendl and Dose (n 84) § 1 paras 16ff).

Commission has recommended their introduction.[133] Without the possibility of conveying ownership of the family home, there is a risk that the property has to be divided and sold, depriving both partners (and their children) of its benefits.[134] Equally, orders for periodical payments (instead of capital sums), which the Scottish Law Commission only has discussed in passing,[135] should be allowed because there is likewise no valid reason for divergence,[136] in particular, since Scots law favours a clean break not only in the financial relationship of cohabitants[137] upon their separation but also in those of spouses.[138]

Whether financial remedies should also be available where one partner suffers economic disadvantages unrelated to the relationship or otherwise financial hardship, for example, because of being of old age, ill or infirm, is less straightforward. However, cohabiting and married couples are functionally similar, in particular, emotionally committed to each other (see B(1) above), and a remedy would serve the protection of the more vulnerable partner (unlike the principle of equal sharing) (see D(1) above). Hence, German law should extend the principle of solidarity from marriage to cohabitation and equalise its corresponding maintenance obligations,[139] unless there is evidence that this approach would be contrary to the expectation of the majority of cohabitants. For the very same reasons, Scots law should expand the considerations on which the financial remedy of the FL(S)A 2006 is based to include – as recommended by the Scottish Law Commission –[140] serious hardships suffered as a result of the separation and – going beyond its recommendations –[141] substantive financial dependence of one cohabitant to the other. The absence of maintenance obligations during the relationship (see C(2) above) is on its own not an argument against these extensions, even if it was the main substantive one the Scottish Law Commission used in 1992 to reject both extensions advocated above:[142] The legal situation in the course of and upon breakdown of cohabitation has not (necessarily) to be the same, which is already demonstrated by the financial remedy of the FL(S)A 2006, being applicable only in the latter but not the former case.

[133] Scottish Law Commission (n 1) paras 5.72, 5.77f, 5.79 with recommendation 8(a), (c), (e) (also 112f), 121f (especially FL(S)A 2006, s 28(3)(c), (d), (4), s 28A in the recommended amended version).
[134] Compare Scottish Law Commission (n 1) para 5.64.
[135] See Scottish Law Commission (n 1) paras 5.47, 5.49, 5.66, 5.68, 5.75, 5.85, 7.3 fn 3 ('we do not recommend that that position should change'); however, orders to make payments for up to six months are recommended in relation to serious hardships suffered as a result of the separation (Scottish Law Commission (n 1) paras 5.75f, 5.79 with recommendation 8(b) (also 112), 121ff (especially FL(S)A 2006, s 28(3)(b), s 28A(3)(a) in the recommended amended version).
[136] Agreeing in relation to future childcare Sutherland (n 2) para 6-512; Sutherland (n 94) 24.
[137] Sutherland (n 2) para 6-504.
[138] Griffiths, Fotheringham and McCarthy (n 79) para 13-03; Michael Meston, 'Grounds for Divorce and Maintenance Between Former Spouses: Scotland' (*Commission on European Family Law* October 2002) 13 <http://ceflonline.net/wp-content/uploads/Scotland-Divorce.pdf> accessed 14 June 2024.
[139] Apparently agreeing in principle Dutta (n 16) 667f; partially agreeing Henrich (n 6) 343; however, disagreeing, for example, Lieb (n 28) A 88f, A 112; Rodgers (n 8) 149ff; Wellenhofer (n 24) 975f.
[140] See Scottish Law Commission (n 1) paras 5.46f, 5.52, 5.58 (recommendation 6(b)) (also 111), 5.76, 123f (especially FL(S)A 2006, s 28B(1)(b) in the recommended amended version).
[141] The Scottish Law Commission recommends financial dependence only as a factor for the consideration of serious hardship suffered as a result of the separation but not as an independent consideration (see Scottish Law Commission (n 1) paras 5.46f, 5.52, 5.58 (recommendation 7(2)(b)) (also 111f), 124ff (especially FL(S)A 2006, s 28C(2)(b) in the recommended amended version).
[142] Scottish Law Commission (n 52) para 15.16; see, however, more nuanced Scottish Law Commission (n 53) paras 5.11f, 5.19; possibly still in this direction Scottish Law Commission (n 1) para 5.47.

(3) Time Limit and Period of Prescription

Since the German law of prescription is identical for both cohabitation and marriage (see C(3) above), and its generally three-year period (see C(3) above) gives the economically weaker partner sufficient time to assert any claims, there is no scope for improvement.

In comparison, the Scottish time limit to apply for the financial remedy of the FL(S)A 2006 causes hardships,[143] with the result that it has been heavily criticised:[144] One year is simply insufficient to deal, in many cases, with the significant consequences of relationship breakdown[145] and fails to protect the more vulnerable partner appropriately.[146] In particular, accommodation, benefits, childcare and employment are regularly more pressing issues after separation for the economically weaker cohabitant.[147] Moreover, the provision has unnecessarily burdened the court system as actions are typically raised and immediately sisted to avoid the claim becoming time-barred.[148] With regard to possible reform, replicating the time limit for marriage is of no avail since there is none (see C(3) above). Adopting the five-year prescription period for unjustified enrichment claims (see C(3) above) would align with the German approach. However, – corresponding with the principle that any reform has to be compatible with the structure of the legal system (see B(3) above) – this solution comes into conflict with the principle of a clean break, which Scots law favours for both marriages and cohabitations (see above). A conceivable middle way might be a two-year time limit with a judicial discretion to allow later claims within two further years, which goes beyond the recommendations of the Scottish Law Commission of a one-year time limit and one further year.[149]

(4) Contracting out of the Financial Remedies and its Limitations

That both Scotland and Germany allow cohabiting couples to opt out of the default statutory regime is the right approach since this possibility is indispensable to appropriately balance protecting the economically weaker partner with private autonomy; contracting out has, nevertheless, to be subject to formal and substantive safeguards in the interest of the more vulnerable cohabitant (see B(4) above).

Whereas the absence of formal requirements in German law is excused in light of the nature of its financial remedies and their limited scope (see C(2) above) – if maintenance obligations are, however, extended, notary authentication should be mandatory for corresponding agreements –[150] the same approach of Scots law neglects the protection of the economically weaker partner, for whom the remedy of the FL(S)A 2006 is of great significance. The minimum requirement should be the written form[151] – even notary authorisation could be a possibility, which is compatible with Scots law (see Matrimonial Homes (Family Protection) (Scotland) Act 1981, s 1(6), (5)) –[152] while

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[143] See *Simpson v Downie* [2012] CSIH 74, 2013 SLT 178 [14].
[144] See Fran Wasoff, Jo Miles and Enid Mordaunt, 'Legal Practitioner's Perspectives on the Cohabitation Provisions of the Family Law (Scotland) Act 2006' (January 2011) University of Cambridge Faculty of Law Research Paper No 11/03, 55f, 71, 74, 126f <https://papers.ssrn.com/sol3/papers.cfm?abstract_id=1736612> accessed 14 June 2024.
[145] Scottish Law Commission (n 1) para 6.12.
[146] Compare Sutherland (n 2) para 6-466.
[147] Scottish Law Commission (n 1) para 6.12 fn 27.
[148] Scottish Law Commission (n 1) paras 6.3f, 6.12; Wasoff, Miles and Mordaunt (n 144) 54, 57, 72ff, 115f, 126f.
[149] Scottish Law Commission (n 1) paras 6.25 with recommendation 10 (also 113), 6.33ff, 6.42 with recommendation 12 (also 113), 127 (especially FL(S)A 2006, s 28E in the recommended amended version).
[150] Agreeing Wellenhofer (n 24) 976.
[151] Disagreeing Scottish Law Commission (n 1) para 7.24.
[152] See for its protective purpose Earl of Mansfield (Minister of State in the Scottish Office), HL Deb 9 April 1981, vol 419 (5th series), col 686 and Malcolm Rifkind (Parliamentary Under-Secretary of State for Scotland), HC Deb 30 June 1981, vol 7 (6th series), col 769.

independent legal advice by solicitors might impose undue efforts and expenses.[153] Since cohabitation should, in principle, not have stronger legal effects than marriage (see B(3) above), it would, however, be inconsistent to enhance only the legal situation of cohabitants but not the identical one (see C(4) above) of spouses.

In terms of substantive safeguards, both Scots and German law provide basic protection for the more vulnerable partner at the time of entering into a cohabitation contract (see C(4) above). Given the functional similarity of cohabiting and married couples (see B(2) above) and the unlikeness of contrary expectations of cohabitants, both legal systems should extend their protective framework for marriage to cohabitation, which Germany does, but Scotland does not (see C(4) above). Scottish courts should – in line with the recommendation of the Scottish Law Commission – have the power to vary unreasonable or unfair terms (or contracts) or set them aside.[154]

In contrast, regarding unanticipated changes of circumstances – a regular situation for both cohabiting and married couples (see the paradigmatic example under B(4) above) – Scots law practically abandons the economically weaker partner since there is no remedy available (see C(4) above). German law, which ensures adequate protection in this respect, could serve as an inspiration for reform – but again, to avoid inconsistencies, any improvement of the legal situation of cohabitants has to be replicated for spouses.[155]

E. CONCLUSION

Across jurisdictions, the most appropriate way to balance the protection of the more vulnerable party with private autonomy while regulating financial remedies upon cohabitation breakdown is by providing a default statutory regime, from which the partners are able to contract out subject to formal and substantive requirements; mere voluntary legal measures are insufficient (see B(1) and B(4) above). Whereas both Scots and German law principally conform with these legal benchmarks, only the latter but not the former ensures adequate safeguards in case of unanticipated changes of circumstances (see D and D(4) above).

The nature, requirements and legal effects of the financial remedies, particularly whether they should be assimilated to those of marriage, have to be determined for each jurisdiction independently with regard to the expectations of cohabiting couples (see B(2) above). Two general principles apply, nevertheless: Default statutory regimes for cohabitation should not have stronger legal effects than those for marriage and legal measures have to be compatible with the structure of each legal system (see B(3) above).

While Scotland and Germany are right in distinguishing the legal effects of cohabitation from marriage (see D(1) above) and in abstaining from imposing eligibility requirements (see D above), their protection of the more vulnerable partner has to be expanded: German law, on the one hand, should introduce maintenance obligations where one partner suffers economic disadvantages or financial hardships – regardless of whether they are related to cohabitation (see D(2) above). Scots law should, on the other hand, reform its financial remedy not only to extend the available court orders and the considerations on which they are based (see D(2) above) but also to prolong the time limit to apply for it (see D(3) above).

[153] Compare Rodgers (n 8) 161.
[154] Scottish Law Commission (n 1) paras 7.20, 7.25, 7.27 with recommendation 14(c) (also 114), 126f (especially FL(S)A 2006, s 28D in the recommended amended version).
[155] Compare Scottish Law Commission (n 1) paras 7.17f, 7.26.

AN IN-DEPTH EXAMINATION OF THE INTERNATIONAL CLIMATE REGIME: SPOTLIGHT ON NATIONALLY DETERMINED CONTRIBUTIONS AND PARIS AGREEMENT COMPLIANCE

*Margaux Bouniol**

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A. INTRODUCTION

The purpose of this essay is to determine whether the international climate regime has failed and is not fit for purpose by critically assessing two aspects of the climate regime. Initially, I will clarify the terms of the question and establish the context for the paper (Section 2). This will include the identification of the criteria that will be used to assess the success/failure of the regime (Section 2.3). Next, I will identify the two specific aspects of the climate regime that will be scrutinized: namely, the concept of nationally determined contributions (NDCs) and compliance under the Paris Agreement. I will then provide a rationale for their selection as the focal points of my analysis (Section 3). Following this, I will present an overview and analysis of the first identified aspect (Section 4), employing a parallel structure for the analysis of the second aspect (Section 5). The subsequent section will entail an overall analysis of the impact of both aspects on the international climate regime (Section 6). Ultimately, the essay will conclude by asserting that in its current state, the international climate regime is not fit for purpose and is therefore a failure; however, there is potential for the regime to evolve and become more successful in the future (Section 7).

This essay was written during the 28th Conference of the Parties (COP) to the United Nations Framework Convention on Climate Change (UNFCCC) and was therefore unable to include updates from this conference in the analysis. This essay will consider the updates of the international climate regime up until November 2023, with the publication of the most recent Adaptation Gap and Emissions Gap Reports by the United Nations Environment Programme (UNEP).[1]

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Furthermore, to differentiate among the various groups of states with distinct responsibilities within the framework, the terminology of "developed" and "developing" countries will be employed, aligning with the language used in the legal documents studied in this paper.

B. DEFINITIONS

(1) Defining "Regime"

Regimes are social institutions comprising principles, norms, rights, rules, legal instruments, decision-making processes, initiatives, and/or institutions.[2] These elements facilitate the alignment of interests and social practices, either accepted or created by actors, to direct or coordinate interactions within specific issue areas.[3]

(2) Defining "International Climate Regime"

The international climate regime refers to the current global framework that aims to govern the behaviour of states with the overarching goals of preventing the progression of human-induced climate change at a catastrophic rate and implementing adaptation measures to prepare for the consequences of the changing global climate.[4] The international climate regime was primarily developed through the UNFCCC in 1992.[5] Since then, there have been several developments within the regime, most notably the creation of the Kyoto Protocol and the Copenhagen Accord, ultimately culminating in the adoption of the 2015 Paris Agreement.[6] The Paris Agreement is widely regarded as an attempt to synthesize the structures of the Kyoto Protocol (a top-down, legally binding instrument with targets and timetables) with the Copenhagen Accord (a diplomatic agreement of a bottom-up architecture consisting of NDCs).[7] As of this writing, the Paris Agreement is the primary instrument at the heart of the international climate regime, affecting all other institutions and instruments within the regime,[8] and will therefore be the primary focus of this paper.

Although the UN climate regime is widely regarded as the heart of international climate change law,[9] it is important to acknowledge that general international law, other treaty regimes, regulations and institutions at all levels of government, and judicial decisions by domestic and international courts can and do all contribute to the international climate regime.[10] Some notable

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[1] UNEP, 'Adaptation Gap Report 2023: Underfinanced. Underprepared. Inadequate Investment and Planning on Climate Adaptation Leaves World Exposed' (2023) <https://www.unep.org/resources/adaptation-gap-report-2023> accessed December 2023; UNEP, 'Emissions Gap Report 2023: Broken Record – Temperatures Hit New Highs, yet World Fails to Cut Emissions (Again) ' (2023) <https://www.unep.org/resources/emissions-gap-report-2023> accessed December 2023.

[2] Marc A Levy, Oran R Young, and Michael Zürn, 'The Study of International Regimes' (1995) 1 Sage Publications 267, 274.

[3] Ibid.

[4] Benoit Mayer, 'Construing International Climate Change Law as a Compliance Regime' (2017) 7 Transnational Environmental Law 115, 123.

[5] Daniel Bodansky, Jutta Brunnée and Lavanya Rajamani, *International Climate Change Law* (Oxford University Press 2017) 352.

[6] Ibid, 351.

[7] Ibid, 23, 351.

[8] Bodansky, Brunnée, and Rajamani (n 5) 189.

[9] Lavanya Rajamani, 'Ambition and Differentiation in the 2015 Paris Agreement: Interpretive Possibilities and Underlying Politics' (2016) 65 International and Comparative Law Quarterly 493, 494.

[10] Bodansky, Brunnée, and Rajamani (n 5) 10-11.

overlaps exist with the human rights regime,[11] the law of the seas regime,[12] and the world trade regime.[13] However, the scope for these regimes regarding climate change law is much more limited compared to the UN regime,[14] so they will not be included as a focus of this paper.

(3) Defining "Failed" and "Fit for Purpose"

The purpose of the international climate regime is made evident in the primary objectives of the Paris Agreement. By building off of the original goals of the UNFCCC, the Paris Agreement clearly states the aim of Parties to (1) "[hold] the increase in the global average temperature to well below 2 °C above preindustrial levels and [pursue] efforts to limit the temperature increase to 1.5 °C above pre-industrial levels."[15] This is followed by the objective to (2) "[increase] the ability to adapt to the adverse impacts of climate change and foster climate resilience and low greenhouse gas emissions development."[16] Throughout the essay, these objectives will be referred to as (1) mitigation and (2) adaptation. It is widely recognized that these are the primary objectives of the international climate regime, with all other general objectives focusing on the financing or implementation of these goals.[17]

Determining whether the international climate regime is fit for purpose requires determining whether the current regime is conducive to achieving these objectives. In the context of this essay, two specific aspects of the climate regime, namely NDCs and the Paris Agreement's compliance mechanism, will be analysed in terms of their ability to facilitate reaching these goals. If they are ineffective in doing so, it can then be concluded that the current regime has failed, as it cannot fulfil its ultimate purpose. Although these are just two of the numerous components of the international climate regime, I will argue that they wield substantial influence over the overall success or failure of the regime.

C. JUSTIFICATION OF FOCI AND FURTHER DEFINITIONS

(1) Nationally Determined Contributions

The first aspect of the international climate regime considered in this essay is the concept of NDCs. NDCs are action plans focused on how to address climate change crafted by individual states for their specific national contexts.[18] The rationale behind this approach is rooted in the belief that states possess the most detailed and accurate knowledge of their national circumstances, enabling them to customize NDCs according to their capacities and needs.[19] The mandate for all states to formulate NDCs provides flexibility, allowing states the freedom to determine their contributions

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[11] Alan Boyle and Navraj Singh Ghaleigh, 'Chapter 2: Climate Change and International Law beyond the UNFCCC' in Kevin R Gray, Richard Tarasofsky and Cinnamon P Carlarne (eds), *The Oxford Handbook of International Climate Change Law* (Oxford University Press 2016) 40-43.
[12] Ibid, 46-49.
[13] Ibid, 49-51.
[14] Ibid, 53.
[15] Paris Agreement (adopted 12 December 2015, entered into force 4 November 2016) [2016] UNTS 54113, Article 2.1(a).
[16] Ibid, Article 2.1(b).
[17] Bodansky, Brunnée, and Rajamani (n 5) 11-12.
[18] Daniel Bodansky, 'The Paris Climate Change Agreement: A New Hope?' (2016) 110 The American Journal of International Law 288, 304.
[19] Ibid.

while ensuring that a commitment is made to developing plans that align with the objectives of the Agreement.[20]

Originating from the 2013 Warsaw Conference, the idea of NDCs emerged as Parties were tasked with formulating their intended NDCs for the year 2015.[21] This marked a departure from Kyoto's less successful top-down, prescriptive approach, embracing a more bottom-up, facilitative method.[22] Further guidance on the content of NDCs was provided during the 2014 Lima Conference.[23] Ultimately, the Paris Agreement integrated NDCs as a key component.[24] The agreement established binding procedural obligations for Parties to prepare and submit NDCs, striking a balance between a top-down and bottom-up approach by allowing individual Parties the freedom to create their own NDCs.[25] Parties are not legally bound to achieve their NDCs.[26]

The use of NDCs is a primary reason why the Agreement was able to achieve such widespread ratification.[27] It additionally resolved a key weakness of the Kyoto Protocol by including developing states as Parties required to develop plans for intended contributions.[28] However, the question of whether the NDCs possess the capacity to fulfil the goals of the Agreement and the broader climate framework remains a subject of debate and will be further investigated in subsequent sections of this paper.

Due to their integral role in the Paris Agreement, NDCs have substantial influence over the success of the Agreement.[29] This influence extends to the broader international climate regime as NDCs delineate the actions that states plan to undertake as their primary response to the threat of climate change.[30] Consequently, the success of NDCs is intertwined with the success of both the Paris Agreement and the international climate regime as a whole.

(2) Compliance

The next aspect that this essay will consider is the role of compliance instruments in the international climate regime. Compliance, in this context, pertains to the mechanisms or procedures established within regimes to address breaches of obligations by actors or Parties.[31] The purpose of compliance mechanisms is to deter the violation of treaty objectives and obligations.[32] They are particularly useful in securing compliance in global environmental treaties that involve a multiplicity of actors.[33]

Compliance mechanisms can take on a variety of forms, ranging from purely facilitative approaches to more sanction-based enforcement approaches.[34] The more common approach

[20] Ibid.
[21] Rajamani (n 9) 495.
[22] Ibid.
[23] Ibid.
[24] Ibid, 496.
[25] Ibid, 497.
[26] Bodansky (n 18) 304.
[27] Bodansky (n 18) 289.
[28] Ibid, 289-290.
[29] Frauke Röser and others, 'Ambition in the Making: Analysing the Preparation and Implementation Process of the Nationally Determined Contributions under the Paris Agreement' (2020) 20 Climate Policy 415, 416.
[30] Ibid, 417.
[31] Sebastian Oberthür, 'Chapter 6: Compliance under the Evolving Climate Change Regime' in Kevin R Gray, Richard Tarasofsky and Cinnamon P Carlarne (eds), *The Oxford Handbook of International Climate Change Law* (Oxford University Press 2016) 121.
[32] Ibid.
[33] Ibid.
[34] Ibid.

often prioritizes non-punitive measures, emphasizing facilitation and assistance for states encountering challenges in meeting their obligations.[35] Compliance mechanisms often rely on monitoring, reporting, and verifying (MRV) information, making it closely linked to provisions on transparency.[36] This essay will analyze transparency and corresponding MRV measures as components of compliance.

Within the UN climate regime, the Paris Agreement established its most recent compliance mechanism, which has been further elaborated through the Katowice climate package.[37] This compliance mechanism is extremely wide-reaching, covering the 195 Parties to the Paris Agreement, and will therefore be the compliance mechanism of the international climate regime that is subject to analysis.

The choice to focus on compliance in this essay stems from its pivotal role as the primary method of ensuring adherence to obligations by all Parties.[38] Determining whether the international climate regime is fit for purpose depends on how cases of non-compliance are addressed within the regime.[39] Without a robust compliance mechanism, there is the dangerous potential for states to evade their duties, either deliberately or due to incapacity.

D. NATIONALLY DETERMINED CONTRIBUTIONS

(1) Overview

As previously explained, the NDCs are the primary instrument of the Paris Agreement.[40] They are properly introduced in Article 4 paragraph 2, where it is stated that each Party is obliged to "prepare, communicate and maintain successive nationally determined contributions that it intends to achieve," and implement such contributions through domestic measures.[41] A key characteristic of NDCs is that they are meant to become more ambitious over time.[42] There are additional rules in place to ensure that all Parties properly communicate the progress made regarding their NDCs.[43] Transparency provisions and the global stocktake are also implemented to enhance the effectiveness of the NDCs.

The latest updates from COP27 at Sharm el-Sheikh do not provide many significant implications for NDCs. Calls for further prioritizing the 1.5 °C temperature goal over the 2 °C temperature goal, which was introduced at COP26 in Glasgow, were reaffirmed.[44] There was also a restatement of the imperative to attain the funding goal of US$100 billion per year, a target that

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[35] Ibid, 248-249.
[36] Chrysa Alexandraki, 'MRV of Emissions and Mitigation Action: The Paris Agreement and Financial Support for Transparency Related Capacity Building in Developing Countries' (2020) 10 Climate Law 308, 309.
[37] Lavanya Rajamani and Daniel Bodansky, 'The Paris Rulebook: Balancing International Prescriptiveness with National Discretion' (2019) 68 International and Comparative Law Quarterly 1023, 1024.
[38] Oberthür (n 31) 121.
[39] Ibid; Christina Voigt, 'The Compliance and Implementation Mechanism of the Paris Agreement' (2016) 25 Review of European, Comparative & International Environmental Law 161, 161-162.
[40] WP Pauw and others, 'Conditional Nationally Determined Contributions in the Paris Agreement: Foothold for Equity or Achilles Heel?' (2019) 20 Climate Policy 468, 469.
[41] Paris Agreement (adopted 12 December 2015, entered into force 4 November 2016) [2016] UNTS 54113, Article 4.2.
[42] Ibid, Article 4.3.
[43] Ibid, Articles 4.8, 4.9, 4.12, 4.16.
[44] UNFCCC, 'Government Ministers at COP27 Call for More Ambitious Climate Action' (*unfccc.int* 15 November 2022) <https://unfccc.int/news/government-ministers-at-cop27-call-for-more-ambitious-climate-action> accessed December 2023.

has not been met since its intended commencement in 2020.[45] The call for more ambitious NDCs has been reiterated in virtually every COP since the 2015 Paris Agreement, a sentiment mirrored in the title of the latest Emissions Gap Report, "Broken Record."[46] Still, the current NDCs are insufficient for achieving the objectives of the Agreement.[47]

(2) Mitigation

As the NDCs primarily embody a commitment of conduct rather than result, the Parties have the discretion to decide how to integrate mitigation measures into their NDCs and there is no obligation to achieve them.[48] The binding obligations on states necessitate the preparation and communication of NDCs, along with a commitment to progressively enhance their goals.[49] Developed country Parties are advised to adopt economy-wide absolute emission reduction targets while developing countries are urged to reinforce their mitigation efforts.[50] Least developed countries and small island developing states are granted more flexibility, with the recommendation to formulate action plans for mitigation.[51]

It is specified that "Parties shall pursue domestic mitigation measures with the aim of achieving the objectives of [NDCs]."[52] This does appear to create a binding obligation on states to implement domestic measures and suggests an obligation to achieve NDCs. Given the qualifying phrase "the aim of achieving," it is highly unlikely that this can serve as a justification for asserting that states can be held accountable for meeting their NDCs.[53] There are no legally binding provisions regarding the substantive content of NDCs for any of the Parties.[54]

While the provisions related to transparency and the imperative for Parties to continually elevate the ambition of their NDCs hold considerable potential for effectiveness, they are constrained by the fact that the overall success in achieving mitigation targets relies on the willingness of individual states. States have the autonomy to determine the extent of their actions and there is a persistent tendency to prioritize national interests.[55] This is evident from the original set of NDCs which were not aligned to reach the 2 °C goal.[56]

Since the Paris Agreement's adoption, there have been limited advancements in terms of updates on mitigation actions under NDCs. As of November 2023, the full implementation of unconditional NDCs would lead to a projected temperature increase of 2.9 °C.[57] On the other hand, implementing conditional NDCs, which necessitate additional financial resources and

[45] OECD, 'Climate Finance Provided and Mobilised by Developed Countries in 2013-2021: Aggregate Trends and Opportunities for Scaling up Adaptation and Mobilised Private Finance' (OECD Publishing 2023) 8.
[46] UNEP (n 1).
[47] Ibid, 31.
[48] Bodansky (n 18) 300, 304; Alexander Zahar, 'The Nature of Climate Law' (2023) 35 Journal of Environmental Law 295, 298.
[49] Paris Agreement (adopted 12 December 2015, entered into force 4 November 2016) [2016] UNTS 54113, Articles 4.2, 4.3, 4.8, 4.9.
[50] Ibid, Article 4.4.
[51] Ibid, Article 4.6.
[52] Ibid, Article 4.2
[53] Anna Huggins, 'Debate 4: Compliance ~B~ the Paris Agreement's Article 15 Mechanism: An Incomplete Compliance Strategy' in Benoit Mayer and Alexander Zahar (eds), *Debating Climate Law* (Cambridge University Press 2021) 106.
[54] Bodansky (n 18) 304.
[55] Zahar (n 48) 298.
[56] Röser and others (n 29) 416.
[57] UNEP (n 1) 31.

support for execution,[58] would result in a temperature rise of 2.5 °C.[59] Evidently, the NDCs are currently falling short of fulfilling their intended purpose to achieve the mitigation targets of the Paris Agreement, as well as the reiterated goals in recent COPs.

(3) Adaptation

Adaptation receives little attention in Article 4, which is most focused on the structure of NDCs.[60] Article 7, which primarily centers on adaptation, establishes a global goal to enhance adaptive capacity.[61] The language employed is generally weak, lacking substantial legally binding obligations. Many paragraphs merely express that Parties "acknowledge," "recognize," or "should" undertake certain actions, none of which impose specific requirements on Parties.[62] Even in formulating plans for the implementation of adaptation actions, the use of the term "shall" is accompanied by the qualifier "as appropriate," allowing states discretion in their implementation approaches.[63]

The strongest language emerges in the concluding paragraphs related to transparency, enhanced support, and the global stock take.[64] Overall, NDCs seem to offer limited prospects for the effective implementation of adaptation measures, apart from ensuring a gradual increase in ambition over time. However, the significance of this depends on the initial state of individual states' NDCs, rendering it potentially inconsequential. Once again, the impetus for prioritizing the implementation of adaptation lies with the willpower of states, as the Paris Agreement lacks substantive obligations in this regard.

In the COPs that have convened since the inception of the Paris Agreement, there has been a consistent emphasis on the necessity for adaptation, yet tangible and substantive actions have not been undertaken.[65] While US$40 billion of the targeted US$100 billion per year fund was supposedly designated for adaptation efforts, as agreed in Glasgow,[66] the overarching goal of reaching US$100 billion annually remains unfulfilled[67]. Even if it were to be fulfilled, recent research has revealed that US$387 billion per year is needed to implement the adaptation plans that exist in the current NDCs.[68] Consequently, it is evident that the available resources are inadequate to ensure the realization of the adaptation measures outlined in NDCs.

E. COMPLIANCE

(1) Overview

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[58] Pauw and others (n 40) 469.
[59] UNEP (n 1) 31.
[60] Paris Agreement (adopted 12 December 2015, entered into force 4 November 2016) [2016] UNTS 54113, Article 4.
[61] Ibid, Article 7.1.
[62] Ibid, Articles 7.2, 7.4, 7.5, 7.6, 7.7, 7.10.
[63] Ibid, Article 7.9.
[64] Ibid, Articles 7.11-7.14.
[65] OECD (n 45) 3.
[66] UNFCCC, "Decision 1/CMA.3: Glasgow Climate Pact" (8 March 2022) FCCC/PA/CMA/2021/10/Add.1, para 18.
[67] OECD (n 45) 9.
[68] UNEP, 'Adaptation Gap Report 2023: Underfinanced. Underprepared. Inadequate Investment and Planning on Climate Adaptation Leaves World Exposed' (2023) <https://www.unep.org/resources/adaptation-gap-report-2023> accessed December 2023, 30.

The compliance section of the Paris Agreement is set out in Article 15, but it is closely interlinked with the provisions on transparency (Article 13)[69] and the global stocktake (Article 14),[70] as it is through the information collected through these processes that the compliance mechanism can function properly.

The rules regarding transparency apply to all Parties with some differentiation.[71] All information is to be subjected to a technical expert review which considers the progress of the NDC, "taking into account the flexibility accorded to the Party."[72] Developing countries are to be supported in the implementation and development of their commitments under this article.[73]

The global stocktake, as set out in Article 14, is meant to keep track of the progress of the Parties in meeting the ultimate objectives of the Agreement.[74] The global stocktake is set to begin in 2023 and occur again every 5 years;[75] Parties are expected to enhance their NDCs throughout this process.[76]

Article 15 briefly establishes the compliance mechanism, along with its corresponding Committee, emphasizing that it is facilitative, non-adversarial, and non-punitive and that it shall consider the "capabilities and circumstances of Parties."[77]

The Katowice Climate Package includes the decisions that further specify the structure of the compliance mechanism. The modalities and procedures established in this decision provide the Committee with the ability to initiate proceedings regarding binding procedural obligations in non-compliance cases where a Party fails to "[communicate] or [maintain] a nationally determined contribution" on time, "[submit] a mandatory report or communication of information" with regards to their NDC or finance, or "[participate] in the facilitative, multilateral consideration of progress."[78] While this does provide an additional layer of accountability,[79] the Committee is still limited in that they cannot initiate proceedings related to *any* provision of the Agreement, unlike the Parties themselves.[80] Possible measures that can be set by the committee include dialogue, assistance, recommendations, or fact-finding, the latter being the most stringent output possible and only allowed in relation to the procedurally binding obligations mentioned previously.[81] The Committee may also consider systemic issues, but can only provide recommendations for the CMA to consider.[82] Overall, the compliance mechanism is extremely facilitative.

(2) Mitigation

[69] Paris Agreement (adopted 12 December 2015, entered into force 4 November 2016) [2016] UNTS 54113, Article 13.
[70] Ibid, Article 14.
[71] Ibid, Article 13.2
[72] Ibid, Article 13.12
[73] Ibid, Articles 13.14, 13.15
[74] Ibid, Article 14.1
[75] Ibid, Article 14.2
[76] Ibid, Article 14.3
[77] Ibid, Article 15.2
[78] UNFCCC, "Decision 20/CMA.1: Modalities and procedures for the effective operation of the committee to facilitate implementation and promote compliance referred to in Article 15, paragraph 2, of the Paris Agreement" (19 March 2019) FCCC/PA/CMA/2018/3/Add.2, para 22(a).
[79] Rajamani and Bodansky (n 37) 1038-1039.
[80] UNFCCC, "Decision 20/CMA.1: Modalities and procedures for the effective operation of the committee to facilitate implementation and promote compliance referred to in Article 15, paragraph 2, of the Paris Agreement" (19 March 2019) FCCC/PA/CMA/2018/3/Add.2, para 20.
[81] Ibid, para 28.
[82] Ibid, para 32-34.

Regarding mitigation, reports of emissions and removals are necessary as well as progress made in achieving NDCs.[83] This is formatted in mandatory language, meaning that failure to comply would trigger the compliance mechanism.[84] Again, in cases of non-compliance, the compliance mechanism can only act on the procedural obligations[85] of states in a facilitative matter.[86] Due to the voluntary nature of NDCs and the lack of enforcement power in the compliance mechanism, action cannot be taken on the substantive obligations of states. This makes the mechanism's effectiveness limited when it comes to assisting with the achievement of the overarching temperature limit objective of the Paris Agreement.

Aside from this issue, the Compliance Mechanism does appear to offer value in the preparation, communication, and transparency of the NDCs. The facilitative nature of the compliance mechanism may help when states lack the capacity necessary to comply with their procedural obligations. While it may not directly affect the potential attainment of the mitigation objective, it can still contribute by mandating the creation of mitigation plans and aiding states that encounter difficulties in compliance.[87]

(3) Adaptation

The provision on reporting on adaptation measures is less stringent, using hortatory language and additionally qualifying the statement that requests Parties to provide relevant information.[88] Ultimately, this provision suffers from the same weaknesses regarding substantive obligations as the provisions regarding compliance with mitigation; it is then additionally weakened because it cannot even rely on binding procedural obligations. This would only be successful in cases where states request assistance themselves, again limiting this provision's contributions to the overall achievement of the adaptation goal.

The absence of stringency regarding the transparency provisions for adaptation is concerning. This may have been done with the goal of differentiation in mind, but as Alexandraki explains, this "[undermines] the ability, or motivation, of developing countries to report reliable information related to their greenhouse gas emissions and mitigation action, as well as undermine their ability to gain additional finance needed to sustain their capacity-building efforts."[89] Inadequate transparency provisions have a direct adverse effect on compliance measures. This is because it results in a reduced amount of reliable information for the Committee to work with, leading to a diminished capacity to assist.

F. ANALYSIS

The Paris Agreement signifies a paradigm shift in addressing climate change by introducing legally binding obligations, most notably through NDCs, and fostering a collaborative international

[83] Paris Agreement (adopted 12 December 2015, entered into force 4 November 2016) [2016] UNTS 54113, Article 13.5, Article 13.7(a), Article 13.7(b).
[84] Ibid, Article 13.7.
[85] UNFCCC, "Decision 20/CMA.1: Modalities and procedures for the effective operation of the committee to facilitate implementation and promote compliance referred to in Article 15, paragraph 2, of the Paris Agreement" (19 March 2019) FCCC/PA/CMA/2018/3/Add.2, para 22(a).
[86] Paris Agreement (adopted 12 December 2015, entered into force 4 November 2016) [2016] UNTS 54113, Article 15.2.
[87] Alan Boyle and Catherine Redgwell, *Birnie, Boyle, and Redgwell's International Law and the Environment* (Oxford University Press 2018) 255-256.
[88] Ibid, Article 13.8.
[89] Alexandraki (n 36) 326.

forum. Despite these positive aspects, critical shortcomings hinder its ability to achieve its ambitious goals.

NDCs exhibit inherent weaknesses in their current structure. They, as individualized action plans, allow flexibility based on national circumstances.[90] While this approach garnered widespread ratification, it has limitations, primarily stemming from the absence of legally binding provisions compelling states to achieve their NDCs.[91] Mitigation under NDCs faces challenges due to the discretionary nature of states in determining the extent of their actions.[92] The lack of enforceable substantive obligations result in a prioritization of national interests, often undermining the collective goal of limiting temperature rise.[93] Adaptation measures within NDCs suffer from weak language and a lack of binding obligations.[94] The emphasis on voluntariness and the limited financial resources further diminishes the effectiveness of adaptation goals.[95] For NDCs to have a sufficient impact, states must begin increasing ambition and making long-term plans.[96]

The compliance mechanism is characterized as facilitative, non-adversarial, and non-punitive.[97] However, its effectiveness is limited by its focus on procedural obligations and the absence of enforcement power.[98] The compliance mechanism's role in ensuring mitigation objectives faces challenges due to the voluntary nature of NDCs.[99] The most robust aspect of the compliance mechanism lies in its capacity to prompt action when procedural obligations are unmet, thereby introducing an additional layer of accountability.[100] Its facilitative nature holds considerable significance, as it can effectively improve the transparency of actions taken by states that struggle to satisfy their procedural obligations.[101] On the other hand, reporting on adaptation measures relies on voluntary provisions, diminishing its efficacy.[102] The purely facilitative approach of the mechanism has been heavily criticized, with some scholars calling for the addition of coercive measures and claiming the mechanism is incomplete in its current state.[103] While the compliance mechanism may not be perfect, considering the worldwide scope of this treaty, it is commendable that it has reached its current state.[104] Other scholars have pointed out that the inclusion of stricter enforcement measures in the compliance mechanism would have deterred states from entering the Agreement and prevented the achievement of universal participation, which is a quality that is imperative for a treaty addressing the global problem of climate change.[105] It has been further argued that this is the strongest and most suitable mechanism possible given the lack of a top-down element in the Paris Agreement.[106] There is the potential for further enhancement of this

[90] Bodansky (n 18) 304
[91] Zahar (n 48) 298.
[92] Ibid.
[93] Bodansky (n 18) 289-290.
[94] Paris Agreement (adopted 12 December 2015, entered into force 4 November 2016) [2016] UNTS 54113, Article 7.
[95] Ibid.
[96] Röser and others (n 29) 416.
[97] Paris Agreement (adopted 12 December 2015, entered into force 4 November 2016) [2016] UNTS 54113, Article 15.2.
[98] Huggins (n 53) 102.
[99] Ibid, 106.
[100] Rajamani and Bodansky (n 37) 1038.
[101] Meinhard Doelle, 'Debate 4: Compliance ~A~ in Defence of the Paris Agreement's Compliance System: The Case for Facilitative Compliance' in Benoit Mayer and Alexander Zahar (eds), *Debating Climate Law* (Cambridge University Press 2021) 97.
[102] Bodansky (n 18) 308.
[103] Huggins (n 53) 104.
[104] Doelle (n 101) 87.
[105] Ibid.
[106] Ibid.

compliance mechanism, particularly if transparency provisions for all Parties are strengthened[107] and if Parties are eventually obliged to both achieve and establish sufficiently ambitious NDCs.[108]

G. CONCLUSION

In summary, the international climate regime faces significant hurdles in achieving its goals through the Paris Agreement, primarily as a result of the common challenges associated with global treaties. Therefore, in its current state, the international climate regime has failed and is not fit for purpose. NDCs, while designed for flexibility, lack binding provisions, hampering their efficacy in both mitigation and adaptation. The compliance mechanism is commendable due to its facilitative nature and its relatively strong emphasis on procedural obligations but is still limited in achieving the objectives of the Agreement so long as the NDCs remain insufficient. Despite these challenges, the potential for improvement exists, specifically through future enhancements that mandate states to achieve and establish more ambitious NDCs and for transparency provisions to be strengthened for all states. This offers a pathway for the international climate regime to evolve and address current shortcomings.

[107] Alexandraki (n 36) 333-334.
[108] Doelle (n 101) 98.

TO BREAK THE FOURTH WALL: A COMPARATIVE APPROACH TO *SCOTTISH MINISTERS, PETITIONERS*

Samuel C Etchells[*]

A. INTRODUCTION
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A. INTRODUCTION

In December 2023, the Outer House determined the fate of the Gender Recognition Reform (Scotland) Bill (GRR Bill) in finding that the use of an order made pursuant to s 35(1)(b) of the Scotland Act 1998 was 'reasonable' and as such the challenge brought by way of judicial review was to fail.[1]

The saga of the GRR Bill and the unprecedented use of a s 35 order has been a fraught politico-legal affair, and yet another which has been shrouded in distortion and misinformation. In effect, the order acts as a veto power exercisable by the Secretary of State[2] should certain requirements be met.[3] The use of the order was met with shock, being described by the relevant Cabinet Secretary as a 'sad day for democracy'[4] and by others as the beginning of a 'slippery slope from devolution to direct rule'.[5] From hyperbole, we also find blatant misunderstandings of what s 35 actually does such as this question asked in the Scottish Parliament:

'It seems that if Westminster is allowed to veto this legislation, it could veto *any* legislation. Can [the Cabinet Secretary] confirm that that is the case and that it could stop the budget or anything else?'[6]

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[1] *Scottish Ministers, Petitioners* [2023] CSOH 89 at paras 81-82 per Lady Haldane

[2] Not necessarily but most likely the Secretary of State for Scotland.

[3] See Pt B (1)

[4] Scottish Parliament Official Report (SP OR) 17 January 2023 col 70 (The Cabinet Secretary for Social Justice, Housing and Local Government (Shona Robison MSP))

[5] Hansard HC Deb 18 January 2023 [Engagements] col 358 (Stephen Flynn MP)

[6] SP OR 19 April 2023 col 35 (John Mason MSP) (my emphasis)

Only a cursory read of s 35 of the Scotland Act 1998 would confirm that the answer is an obvious 'no' however this has not stopped widespread confusion about what s 35 is especially compared to how other countries maintain territorial control within their respective polities. This article will draw on examples from the United States – to demonstrate that territorial control devices like s 35 are not unusual and a far cry from the 'attack on devolution' that many have likened it to.

While an executive veto power can be styled as an intolerable assault on the institution of the Scottish Parliament, Lady Haldane stated that s 35 is an instrument 'described and delineated within the four walls of the 1998 Act'.[7] For public lawyers it is therefore of interest to explore how (or if) other countries can break the fourth wall.

B. SECTION 35: ITS COUSINS AND ANCESTORS

(1) Scotland Act 1998

The order made by the Secretary of State for Scotland was pursuant to s 35(1)(b) of the Scotland Act 1998 which reads as follows:

35 Power to intervene in certain cases.

(1) If a Bill contains provisions –

> (b) which make modifications of the law as it applies to reserved matters and which the Secretary of State has reasonable grounds to believe would have an adverse effect on the operation of the law as it applies to reserved matters,

he may make an order prohibiting the Presiding Officer from submitting the Bill for Royal Assent.

There is therefore a bipartite test; (1) does the Bill contain provisions which *modify* the law as it applies to reserved matters?; and (2) are there *reasonable grounds* for the Secretary of State to believe that those modifications would have an *adverse effect* on the operation of law as it applies to reserved matters?[8] Logic would dictate that if part (1) of the test is answered in the negative, then part (2) falls with it. Lady Haldane also recognises a common law duty for the Secretary of State to acquaint himself with the relevant information before making the order.[9] As the adage goes; with great power, comes great (common law and statutory) responsibility.

(2) Government of Wales Act 2006

[7] *Scottish Ministers, Petr* at para 70

[8] David Torrance and Doug Pyper 'The Secretary of State's veto and the Gender Recognition Reform (Scotland) Bill' (House of Commons Library: Research Briefings 2023) 5

[9] *Scottish Ministers* at para 72. See also *Secretary of State for Education and Science v Tameside Metropolitan Borough Council [1977] AC 1014*

Neither history nor geography make provisions such as s 35 in any way unique. One needs not travel any further than Wales to find a more permissive variant of s 35 requiring only that the Secretary of State have 'reasonable grounds to believe' that the legislation 'would have an adverse effect on a reserved matter' or 'would have an adverse effect on the operation of law as it applies to England'.[10] There is no requirement that it must make modifications to the law but it would be difficult to conclude that a bill can confer an adverse effect without modifying the operation of law.[11]

(3) The British Empire

Torrance and Pyper make mention of colonial legislation particularly in Canada and Australia where colonial laws that were within the *vires* of the legislatures were disallowed as UK law applied by 'paramount force'.[12] Most striking is the situation in Northern Ireland where an attempt to change the voting system was withheld by the Governor of Northern Ireland generating a political crisis between Westminster and Stormont. In language that echoes the response of the Scottish Government in the present case, Winston Churchill noted that vetoing legislation that was within the competence of the Northern Irish Parliament 'would form a dangerous precedent'.[13]

Taking the UK's broader geographic and historical backdrop into consideration, it is clear that s 35 is not an alien power and exists as an inherent part of the devolution settlement. This is not something that is unique, not even controversial in the overwhelming majority of countries that employ some form of multilevel government.[14] Article 31 of Das Grundgesetz für die Bundesrepublik Deutschland simply says, 'Bundesrecht bricht Landesrecht'.[15] Rather than being an impermissible intrusion on the autonomy of the Länder, this is accepted as being a necessary ingredient for the existence of a multi-level state with individual territorial identities. Interestingly, in Germany the breaking up of territories was beneficial to the centre as it prevented regional challenges, most importantly in Prussia which does itself not exist as a federal unit in Germany.[16] This will be further demonstrated by reference to jurisprudence of the Supreme Court of the United States of America.

C. THE AMERICAN EXPERIENCE

(1) Territorial control with the federation

Territorial control within the polity is neither a historical anomaly nor a colonial relic considering that today's federal systems are engaged in similar exercises. The Supreme Court of the United

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[10] Government of Wales Act 2006 s 114(1)(a), (c). See also David Torrance and Doug Pyper 'The Secretary of State's veto and the Gender Recognition Reform (Scotland) Bill' (House of Commons Library: Research Briefings) (December 2023) 8

[11] See S. Wortley (@Scott_Wortley), "Modify in the Scotland Act …", (17th January 2023), (X, f.k.a. Twitter) https://twitter.com/scott_wortley/status/1615423125314801683?s=61&t=ff7Kn0w9VWCgcvHmhmbPVw..

[12] Torrance and Pyper, 'Secretary of State's Veto', 11. See also the Colonial Laws Validity Act 1865

[13] Ibid, 13. See also Brendan O'Leary, A Treatise on Northern Ireland Volume 2: Control (Oxford University Press, 2019) 35.

[14] Daniel Elazar goes as far as to contend that in the around 80% of the global population lived under some kind of federal arrangement in the mid-1990's. See D. Elazar, *Federal Systems of the World: A Handbook of Federal, Confederal and Autonomy Arrangements,* 2nd edn (Harlow: Longman, 1994) xv. The exact definition of what constitutes a 'federal' country is contested but as we know, the issues of multilevel government are not exclusive to federal systems and play out in devolved governments as in Scotland.

[15] 'Federal law takes priority over Land/state law.'

[16] C. Clark, *Iron Kingdom: The Rise and Downfall of Prussia, 1600-1947* (Cambridge MA: Harvard), 687. Cited in S Tierney, *The Federal Contract: A Constitutional Theory of Federalism*, (Oxford University Press 2022) 16

States in the case of *Rice v. Santa Fe Elevator Corp*[17] considered the how Congress could legislate 'in a field which the States have traditionally occupied'.[18] The intention of Congress is important as it could demonstrate either subsidiarity or collaboration between state and federal levels. Equally, the express purpose of Congress could be to adopt a federal policy even if it supersedes terrain traditionally occupied by the states. For federal systems like the USA, paramountcy at the federal level is the adhesive that allows the conglomerate of fifty states to exist as a union especially in the post-war era where the state only got bigger.

The implementation of the New Deal is important in this regard. At the beginning of the 20th century, the federal government only took responsibility for the 'nightwatchman' functions of the state such as international relations and defence.[19] By 1934, the Roosevelt Administration attempted to resuscitate the ailing American economy following the Great Depression with sweeping federal grants. This process of centralisation effectively nationalised the American polity leading to the conclusion that 'federalism is no longer an operative principle in the United States'.[20]

The same is true of the Civil Rights movement where the idea of racial *equality* becomes something of a misnomer if there are fifty different Civil Rights Acts rather than a unitary federal one.[21] Nowadays, it is such that the prospect of reproductive rights being decided at state level is met with widespread apprehension as fundamental reproductive rights are entrusted by many only at the federal level.

(2) The Fourteenth Amendment

Fourteenth Amendment jurisprudence is enlightening in this regard. Section 1 reads that 'No State shall make or enforce any law which shall abridge the privileges or immunities of citizens of the United States'. These are, of course, words written in the days before the abolition of slavery and the universal adult suffrage. As such, the Fourteenth Amendment has been subject to selective elastication and restriction by the United States Supreme Court.[22]

In the landmark 2015 ruling in *Obergefell v Hodges*,[23] the US Supreme Court held 5-4 that the Fourteenth Amendment required states to licence and recognise marriages between two persons of the same sex. The dissent feared that the majority result would encroach 'upon the legislative prerogatives of the states'.[24] We therefore see that the tension between the protection of nationwide fundamental rights and the autonomy of sub-state units.

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[17] 331 U.S. 218 (1947). Cited in S. Tierney 'The Gender Recognition Reform (Scotland) Bill: Time for the United Kingdom to Learn from Other Federal Systems?' IACL-AIDC Blog (23 March 2023)

[18] Ibid, page 331 U.S. 230

[19] J.J. Wallis and W.E. Oates, 'The Impact of the New Deal on American Federalism', in M.D. Bordo, C. Goldin, and E.N. White (eds), *The Defining Moment: The Great Depression and the American Economy in the Twentieth Century* (Chicago: University of Chicago Press, 1998), 163.

[20] Feeley and Rubin, *On Federalism: Federalism as Tragic Choice*, Preface ix and 152. Cited in S Tierney, *The Federal Contract: A Constitutional Theory of Federalism*, (Oxford University Press 2022) 8

[21] Notwithstanding the recalcitrance towards the Civil Rights Act in many southern States at the time of its promulgation.

[22] See generally, WE Nelson, *The Fourteenth Amendment: from political principle to judicial doctrine*, (Harvard University Press 1988), 1-12. Nelsons book covers important Fourteenth Amendment cases such as *Brown v. Board of Education* 347 U.S. 483 (declared racial segregation in public schools to be unconstitutional) and *Muller v. Oregon* 208 U.S. 412 (sustained an Oregon statute setting maximum working hours for women) but predates others such as *Lawrence v. Texas* 539 U.S. 558 (declared a Texas anti-sodomy law to be unconstitutional).

[23] 576 U.S. 644 (2015)

[24] F Palermo and K Kössler, *Comparative Federalism: Constitutional Arrangements and Case Law*, (Hart Publishing, 2017) 326

The inverse is true considering the politico-legal rupture that was caused by the overturning of *Roe v. Wade* which has resulted in a radical segmentation of reproductive rights across America.[25] This demonstrates the consequences of abrogating federal control in favour of state-level decision making.

The dissent in *Dobbs v Jackson Women's Health Organization* is perhaps indicative of the potential reverse direction that the United States may be embarking on. The dissent[26] says that SCOTUS 'does not act "neutrally" when it leaves everything up to the states. Rather, the Court acts neutrally when it protects the right against all comers'.[27] Where interracial[28] and same sex[29] marriage are protected (at least for now) through judicial pronouncement in the United States, the direction signalled by this disproportionately conservative Supreme Court may leave these federal protections at the chopping block.

While *Dobbs* is only a sample of one, Justice Clarence Thomas in his concurring judgment, described *Obergefell v. Hodges* as 'erroneous' and worth 'reconsidering'.[30] It is doubtful whether Justice Thomas is the only Supreme Court judge who is of the same view. Considering this, it might not be premature to describe *Dobbs* as an inflection point concerning protection of rights in the American Constitution.

(3) From Philadelphia to Edinburgh

This comparative backdrop shows the importance, indeed the necessity of ensuring federal conformity rendering it unsurprising why the Scotland Act 1998 would seek to employ similar mechanisms through s 35 to protect the Equality Act 2010. In this light, talk of it being an 'outrage' or an 'attack on devolution' fails to explain why the examples listed above are not an 'attack on state autonomy' in the same way. Surely any *Equality* Act worth its name would merit universal application across the four UK nations. The author reserves serious doubts as to whether those who describe the use of s 35 as an 'attack on devolution' would view *Obergefell* in the same light. What ought or ought not to be subject to nationwide protection is thus a values question. It falls to each individual polity as to which rights deserve nationwide protection and which don't.

How does the 'attack on devolution' argument deal with the idea that individual American states should have total discretion on same-sex marriage if *Obergefell* were overturned? It is thus difficult to resist the conclusion that the opposition to s 35 in this specific case is more about the strength of feeling about a particular piece of legislation rather than any principled understanding about territorial control.

[25] See *Dobbs v. Jackson Women's Health Organization,* No. 19-1392, 597 U.S. 215 (2022). Some states such as Texas implemented 'trigger laws' rendering abortion a felony punishable by up to life in prison, the trigger being the overturning of *Roe v. Wade*, 410 U.S. 113. See Texas Health and Safety Code Sec. 170A drafted in anticipation of *Roe v. Wade* being overturned. Thirteen other states such as Mississippi, Oklahoma and Louisiana have taken similar measures. A recent development has been the near total ban on abortion instituted in the state of Arizona in resurrecting a law from 1864. Twenty states including New York, Minnesota and Hawaii have strengthened their abortion access laws following *Dobbs*.

[26] The dissent consists of Breyer, Sotomayor, and Kagan JJ.

[27] 597 U.S. 20 (2022)

[28] *Loving v. Virginia* 388 U.S. 1 (1967)

[29] *Obergefell v. Hodges*, 576 U.S. 644 (2015)

[30] *Dobbs v. Jackson Women's Health Organization,* 597 U.S. 3 (2022)

D. APPROPRIATE STANDARD OF REVIEW

(1) The Scottish Ministers position

Dawn Oliver raises an interesting point about how judicial review could respond to increased constitutionalisation in saying that 'the constitutional implications or the impact of a decision on public policy and administration could be ventilated in court and taken into account when a decision is made'.[31] This chimes with the Scottish Ministers in their note of argument. The intention of the Scotland Act 1998 is the creation of 'a constitutional structure which is intended to be stable and coherent'[32] and it is within this context that they argue for a more exacting standard of review by the courts.[33]

The democratic pedigree of the Scottish Parliament has found judicial recognition in the past, most notably in *AXA General Insurance Ltd v Lord Advocate*.[34] Here, Lord Hope of Craighead said that '[t]he dominant characteristic of the Scottish Parliament is its firm rooting in the traditions of a universal democracy'.[35] It is this which distinguishes the Scottish Parliament from, say, a taxi licencing sub-committee in its decision-making authority since the Scottish Parliament is imbued with democratic recognition.

Lord Hope is making the point that the Scottish Parliament has joined the club of parliaments across the world. With that membership comes the perk of democratic recognition. In eerie resonance with the present case, Lord Hope issues a warning that the 'democratic process is liable to be subverted if, on a question of political or moral judgment, opponents of an Act achieve through the courts what that could not achieve through parliament'.[36]

(2) The UK Government's position

Lady Haldane notes that the Scottish Ministers and UK Government 'adopted entirely opposing positions on [the] question' of intensity of review.[37] The UK Government is dismissive of any extra-legislative or constitutional interpretative aids in relation to the Scotland Act in saying that '[n]o special approach applies to the interpretation of the SA'.[38]

The Scottish Minsters assert that the decision of the Secretary of State 'rests upon a policy disagreement'.[39] As such, the standard of review would need to be more searching since Order would more plainly offend against the devolution settlement. To this, the UK Government refers to the black-letter of s 35 itself. It could hardly be seen as a bare policy disagreement if the 'adverse effects' requirement is engaged.[40]

While there was no great need for any comparative exercise in the averments, counsel for the UK government nonetheless contend that there was nothing 'sinister' about s 35 with it being

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[31] D. Oliver *Constitutional Reform in the United Kingdom*, (Oxford University Press, 2003) 106

[32] Scottish Ministers, Gender recognition reform: Section 35 Order challenge – petition (9 August 2023) at para.19

[33] Ibid, para.35

[34] [2011] UKSC 46

[35] *AXA* at para 49

[36] Ibid

[37] *Scottish Ministers, Petr* at para 69

[38] Office of the Advocate General for Scotland and the Office of the Secretary of State for Scotland, Note of argument for Judicial Review of the Gender Recognition Reform (Scotland) Bill (6 September 2023). Available at *https://www.gov.uk/government/publications/answers-and-note-of-argument-for-judicial-review-of-the-gender-recognition-reform-scotland-bill/note-of-argument-for-judicial-review-of-the-gender-recognition-reform-scotland-bill* <accessed 15th April 2023>

[39] Scottish Ministers note of argument (n 32) at para.31

[40] See S Wortley (@Scott_Wortley), 'If simply about policy disagreement and "culture war" [the Scottish Ministers] would have lost…' (8th December 2023) (X f.k.a. Twitter) available at *https://x.com/scott_wortley/status/1733240629759500426?s=46&t=AWUTqm6kx-c_QOXku2hiiQ*

'part of the machinery of how parliaments work'.[41] This is perhaps an implicit assertion about the division of powers within multilevel states generally and the need to ensure the nationwide protection of fundamental rights such as those contained in the Equality Act 2010 but neither party goes any further than this.

(3) The prevailing view and reflecting thoughts

Lady Haldane ultimately determined the intensity of review according to 'good old-fashioned rationality' on the administrative law front.[42] On the constitutional law front, she determined that '[t]he nature of the power that has been invoked, whilst a constitutional one, is described and delineated within the four walls of the 1998 Act'.[43] Given that the 1998 Act contains mechanisms to allow the Secretary of State to police the (albeit now hazy) boundaries between devolved and reserved competences, it is an 'intrinsic part' of the devolution settlement rather than an 'impermissible intrusion' upon it.[44]

As Foran put it, 's.35 becomes the manifestation of democratic choices about how best to devolve and retain power between the various organs of state'.[45] As the American experience has demonstrated, it is a matter of deep controversy about how best decision making can be taken particularly given the fraught judicial history of the Fourteenth Amendment. Outside the Fourteenth Amendment, the nationalisation of rights be that the right to a fair trial, to free speech or (one might daresay) to bear arms is relatively settled.

Donald Dewar was not naïve to the possibility of tension during the development of the Scotland Act 1998 in saying that 'there are no exact demarcations or neat barriers that cannot be crossed—so legislation in a devolved area of responsibility will often have implications for reserved areas and reserved functions'.[46] Though the likelihood for tension becomes greater in attempting to navigate the 'complex mosaic with overlapping concurrent powers' that devolution has turned into since 1999 as additional powers have accrued to Scotland in two separate tranches.[47]

(4) The decision not to appeal

The Court of Session rules stipulate a 21-day time limit to reclaim (appeal to the Inner House) following the decision of the Outer House.[48] At time of writing[49] we are on day 131 so the chance for further judicial pronouncement on this issue is well behind us. The decision is a disappointing one since the constitutional issues – particularly relating to intensity of review – could have been more thoroughly interrogated all the way to the United Kingdom Supreme Court. All the Scottish Ministers' arguments on the administrative law front were rejected by Lady Haldane, leaving them with the chance to drill into the meaning of a 'stable, coherent and workable' system of devolution more robustly. Interestingly, Lord Reed who issued a

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[41] *Scottish Ministers, Petr* at para 38
[42] P Daly, 'The Section 35 Order was Lawful After All: Re The Scottish Ministers' Petition 2023 CSOH 89', (Administrative Law Matters Blog) 8th December 2023)
[43] *Scottish Ministers, Petr* at para 70
[44] Ibid
[45] M. Foran, 'Section 35 and the Separation of Powers: On the Role of Unwritten Constitutional Principles in the Interpretation of the Scotland Act', (U.K. Const. L. Blog) (13th December 2023)
[46] HC Deb 12 May 1998 Vol 312 c267 [Power to intervene in certain cases]
[47] S. Tierney, 'The Gender Recognition Reform (Scotland) Bill: Time for the United Kingdom to Learn from Other Federal Systems?' (n 17). See also Scotland Act 2012 and Scotland Act 2016.
[48] Court of Session Rules r38.2
[49] 17th April 2024

concurring judgment in *AXA*[50] happens to be the current President of the United Kingdom Supreme Court. As such the Scottish Government seems to have cost itself the chance to test the outer boundaries of the dicta in *AXA*.

An appeal would carry both reward and risk. There is reward of a narrow and constrained interpretation of s.35 which would allow the Scottish Government to draw a line in the sand. This, however, comes with the risk of a wide and permissive view of s.35 that could embolden the UK Government to use it again.[51] But alas, the strength of feeling on this issue has left this thistle too thorny even for the Scottish Government to grasp.

E. CONCLUSIONS

The well-worn word 'unprecedented' is used almost *ad nauseum* in our changing constitution. Though it is worth pointing out that after 25 years, Scottish devolution is - constitutionally speaking - in its relative infancy. It is germane, therefore, to look to other countries like the United States with not a 25-year linage, but an almost 250-year lineage to see how the issue of territorial control is managed. Unlike Scotland, the United States has a Bill of Rights but today, a disproportionately conservative Supreme Court has decided that the issue of reproductive rights no longer deserves federal protection.

In Scotland, the primacy of the Equality Act 2010 has formed the battleground for yet another dispute over devolved law-making competence. In helping to reset the boundaries, the UK Supreme Court could adopt similar language such as that used in the case of *Maryland v. Louisiana*[52] which declared that 'all conflicting state provisions be without effect'.[53] Alternatively, Parliament could step in to replicate something not dissimilar to the American Supremacy Clause.[54]

This would ensure that the Equality Act 2010 is well beyond the reach of cross border tinkering by the Scottish Government. For example, the American Supremacy Clause is allows for a situation where the 'federal interest is so dominant that the federal system will be assumed to preclude enforcement of state laws on the same subject'.[55] It is true that s 28(7) allows the UK Government to continue to legislate in devolved matters but as Tierney points out, beyond its 'oblique' wording, it does little to clearly establish the UK's constitutional pecking order with the same clarity as the United States.[56]

Clarity would be warmly welcomed given that one MSP said, following *Scottish Ministers, Petr* that the judgment 'makes a mockery of any vote or decision that we as parliamentarians take at Holyrood from now on in the result is knowing that Westminster will veto anything they don't

[50] *AXA* at para 148 per Lord Reed: 'Law-making by a democratically elected legislature is the paradigm of a political activity, and the reasonableness of the resultant decisions is inevitably a matter of political judgment. In my opinion it would not be constitutionally appropriate for the courts to review such decisions on the ground of irrationality. Such review would fail to recognise that courts and legislatures each have their own particular role to play in our constitution, and that each must be careful to respect the sphere of action of the other.'

[51] C. McCorkindale and A. McHarg, 'Rescuing the Gender Recognition Reform (Scotland) Bill? The Scottish Government's Challenge to the Section 35 Order', (U.K. Const. L. Blog, 25th April 2023)

[52] 451 U.S. 725

[53] *Maryland* at 746

[54] Article VI, Clause 2: 'This Constitution, and the Laws of the United States which shall be made in Pursuance thereof; and all the Treaties made, or which shall be made, under the Authority of the United States, shall be the supreme law of the Land; and the Judges in every State shall be bound thereby, any Thing in the Constitution or Laws of any State to the Contrary notwithstanding.'

[55] *Gade v. National Solid Wastes Management Association* 505 U.S. 88, 98 (1992)

[56] S. Tierney 'The Gender Recognition Reform (Scotland) Bill: Time for the United Kingdom to Learn from Other Federal Systems?' (n 17)

like'.[57] The reader can decide for themselves whether this is informed by individual strength of feeling, or weakness of legislative clarity.

[57] D Torrance and D Pyper, 'The Secretary of State's veto and the Gender Recognition Reform (Scotland) Bill, (House of Commons Library: Research Briefings, 2023) 49.

SEABED TRAWLING ON THE HIGH SEAS: LEGISLATING ENVIRONMENTALLY DAMAGING FISHING TECHNIQUES BEYOND NATIONAL JURISDICTION

Bryn Barraclough[*1]

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H. CONCLUSION

A. INTRODUCTION

Climate change has become an increasingly important issue in the domestic politics of nearly every country in the world, and accordingly, some states have passed legislation with the goal of protecting the environment and slowing climate change. The Arctic and the High Seas present two legally distinct areas outside the jurisdiction of states, and which both are environmentally exploited for that very reason. Lawlessness on the High Seas has become pervasive in the fishing industry. Many NGOs can only attempt to document the rates of Illegal, Unreported and Unregistered (IUU) fishing that takes place.[2] There have been numerous accounts of forced labour,[3] of targeted fishing of endangered species,[4] and of extremely environmentally degrading fishing practices,[5] specifically that of seabed trawling. This paper will focus on resource exploitation via seabed

[1] Graduate LLB student at the University of Edinburgh
[2] Corey Norton, Stephanie Bradley and Ben Freitas "Illegal Fishing" (World Wildlife Fund) <https://www.worldwildlife.org/threats/illegal-fishing>.
[3] Sallie Yea, Christina Stringer "Caught in a vicious cycle: Connecting forced labour and environmental exploitation through a case study of Asia–Pacific" (2021) 134 Marine Policy.
[4] Ibid.
[5] Ibid.

trawling in the High Seas, "the common heritage of mankind".[6]

This paper will present an analysis of the current organisations and legislation surrounding the fisheries on the high seas in addition to a comparative analysis of the moratorium on driftnet fishing and the fur seal treaty of 1911 in an attempt to answer a broader question: With increased awareness of climate change in comparison to 1982, how can the world legislate against high seas fishing techniques, such as seabed trawling, which contribute significantly to the climate crisis? First, seabed trawling will be explained and analysed as a key contributor to resource decline and climate change in international waters, and arguments will be presented for it to be either banned or seriously changed to become more environmentally friendly. Secondly, the key provisions of the United Nations Convention on the Law of the Sea (UNCLOS) which apply to fishing on the high seas and sustainable fishing practices will be analysed individually and in detail, especially in relation to how they could apply to the issue of seabed trawling. Thirdly, Regional Fisheries Management Organizations (RFMO), their authority, and their capacity to manage seabed trawling will be analysed. Fourthly, United Nations General Assembly (UNGA) though non-binding, will be analysed within the context of the driftnet moratorium and how a potential seabed trawling moratorium could be conducted. Fifthly, the success of the driftnet moratorium, though it is less environmentally damaging than seabed trawling will be analysed. This will be done in conjunction with the success of the North Pacific Fur Seal Treaty since both represent successful cessation and multilateral cooperation against environmentally damaging fishing techniques. Finally, the upcoming Beyond Borders of National Jurisdiction (BBNJ) treaty will be analysed as a future tool to aid in promoting environmentally friendly fishing practices.

B. SEABED TRAWLING

Seabed trawling is a very common, but practically unheard of, method of fishing. It involves a boat attaching a (up to 200m long) net at its rear, which then essentially "scoops" the ground of the ocean in an effort to catch bottom dwelling fish.[7] In temperate waters this can include fish such as cod, plaice, clams, cockles, scallops and cold-water shrimp; in tropical waters this can include warm-water shrimp and other bottom dwelling fish.[8] In contrast to regular trawling, in which the net flows in the water behind the boat, seabed trawling involves disturbing the entire seabed in search for target species.[9]

This causes a number of problems related to sustainability. Firstly, there is a large rate of by-catch with this method of fishing.[10] Since the nets indiscriminately drag across the bottom of the seabed many species which are not the target species end up being caught and die, and their carcasses end up not being used for any purpose.[11] This can include female species in the midst of breeding, or juvenile male species which would not normally be sanctioned for fishing.[12] By-catch is an issue which affects nearly all methods of fishing, and though it is a prominent problem in seabed trawling, it is not the primary reason I would set forth that there be a moratorium and international management of this method.

The second major problem associated with seabed trawling is the habitat devastation that it causes.[13] While it sifts through the upper layer of sand, it also rips away any coral, sponge, weeds, or other natural pre-existing seabed habitat.[14] This causes immeasurable damage for species

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[6] United Nations Convention on the Law of the Sea, 1994, Article 136.
[7] *Effects of Trawling and Dredging on Seafloor Habitat* (National Academies Press; 2002).
[8] Daniel Steadman. "Report Highlights Urgent Need to End Bottom Trawling" (Fauna and Flora International, December 2021) https://phys.org/news/2021-12-highlights-urgent-bottom-trawling.html.
[9] *Effects of Trawling and Dredging on Seafloor Habitat* (n 7).
[10] Steadman (n 8).
[11] Ibid.
[12] Ibid.
[13] *Effects of Trawling and Dredging on Seafloor Habitat* (n 7).
[14] Ibid.

regeneration and population stabilisation.[15] In Scottish waters, seabed trawling has been used to fish for scallops and the earliest estimates state that if seabed trawling stops, some areas would take six years to fully regrow.[16] This aspect of seabed trawling has been argued to be the sea's equivalent of deforestation.[17] Many studies say they have found "footprints" associated with seabed trawling which constitute an unnatural deviation from the norm.[18] Though there is little data reported on the problems associated with seabed trawling on the high seas, it likely occurs at high rates, given the rates of other Illegal, Unreported or Unregulated (IUU) fishing.[19] In the European Union's Exclusive Economic Zone (EEZ), nearly 50% of the seabed was found to have been trawled.[20]

The third and perhaps most consequential problem associated with seabed trawling is that dredging up the seabed results in a large amount of carbon being released into the atmosphere.[21] Some studies estimate seabed trawling accounts for 1% of all global carbon emissions, this presents a very serious problem, unique to the fishing methods.[22] The leading science states that there are ways to mitigate the effects of seabed trawling on carbon disruption since not all areas of the seabed contain the same amount of carbon, however, the study notes there is not enough legal control over the industry to effectively regulate the sustainable use of seabed trawls on the high seas.[23] The environmental impacts for seabed trawling are devastating and clear yet there is no decisive international effort to stop this ecologically devastating practice. This is in contrast to the driftnet moratorium passed in UNGA resolution 46/215, and enforced by the NPAFC to be discussed in chapter 6.

C. UNCLOS

Understanding which state has jurisdiction at which time is key to understanding how to legislate against emerging environmentally unsafe techniques. Primarily, UNCLOS outlines under which conditions on the sea a state has sovereign rights. In the territorial sea, the state has sovereignty, yet similarly in the EEZ, the state has sovereign rights but is not exclusively sovereign since other states enjoy certain freedoms within the EEZ.[24] Within both the territorial sea and the EEZ, the state to which the area is connected to is the one who decides matters of law for that area.[25] For this paper particularly that includes matters of conservation and fishing techniques.

Outside these areas is what is known as the "High Seas" which has been referred to as "the common heritage of mankind" under article 136 of UNCLOS.[26] On the High Seas, there is no one state which has jurisdiction over the laws and regulations surrounding conservation efforts. In this sense, the law is mainly found in UNCLOS, RFMOs, and treaties. However, upcoming legislation

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[15] Jan Geert Hiddink "Is sustainable seabed trawling possible? A look at the evidence" (The Conversation, 2022) https://theconversation.com/is-sustainable-seabed-trawling-possible-a-look-at-the-evidence-177671.
[16] Ibid.
[17] Ibid.
[18] Ole Eigaard, Francois Bastardi, Niels Hintzen, Lene Buhl-Mortenson et al. "The footprint of bottom trawling in European waters: distribution, intensity and seabed integrity" (2016) 74(3) ICES Journal of Marine Science https://academic.oup.com/icesjms/article/74/3/847/2631171.
[19] Yea and Stringer (n 3).
[20] Eigaard and others (n 18).
[21] Kirsty Black, Craig Smeaton, William Turrell, and William Austin, "Assessing the potential vulnerability of sedimentary carbon stores to bottom trawling disturbance within UK EEZ" (2022) 9 Frontiers in Marine Science, https://www.frontiersin.org/articles/10.3389/fmars.2022.892892/full.
[22] Michael Le Page, "Seabed Trawling is a Major Source of Global CO2 Emissions" (2024) New Scientist International Edition, https://go-gale-com.eux.idm.oclc.org/ps/i.do?p=ITOF&u=ed_itw&id=GALE|A780848210&v=2.1&it=r.
[23] Black and others (n 21).
[24] United Nations Convention on the Law of the Sea, 1994, Article 3; United Nations Convention on the Law of the Sea, 1994, Article 55.
[25] Ibid, Article 92.
[26] Ibid, Article 136.

(predicted to enter into force in 2025, once it has obtained enough signatures) will provide more structure on environmental impacts of resource exploitation on the High Seas.[27]

(1) Article 92

On the High Seas, all ships are bound by the laws of their flag state.[28] This is to say the state whose flag they fly. This means each state is bound by the national conservation laws and initiatives of the flag state, and often this can result in many ships flying the flag of countries with less stringent requirements, known colloquially as "flags of convenience".[29]

It is estimated that nearly 15% of the world's fishing fleet is flying "flags of convenience" to be met with less stringent regulations.[30] There are no strict universal requirements found in UNCLOS regarding fishing conservation on the high seas, aside from the need to maintain catch limits on harvestable stocks. The legislation which exists can be found in Articles 116-120 and will each be discussed individually.

(2) Article 116

Article 116 primarily sets out the right for all nations to fish on the high seas and the international parameters on living resource extraction in the area outside national jurisdiction. Article 116 states that all states have the right to fish on the high seas, subject to treaty obligations, the provision of Section 2 UNCLOS, and Articles 63(2), 64 and 67 of UNCLOS.[31] Notably there is no section of the treaty which deals with environmental damages associated with specific fishing techniques, and there are only provisions for catch quotas. Some states are parties to RFMOs, and will therefore be bound by the rules and requirements of RFMOs or other treaties governing high seas fishing including the Agreement on Port State Measures (PSMA). The requirements states have to follow for fishing on the high seas under section 2 UNCLOS will be further analysed in sections 3.3-3.6. Article 116 also states that states must be in compliance with Articles 63(2), 64, and 67; each article will be analysed in turn.

(a) *Article 63(2)*

Article 63(2) requires that "where the same stock or stocks of associated species occur both within the exclusive economic zone and in an area beyond and adjacent to the zone, the coastal State and the States fishing for such stocks in the adjacent area shall seek, either directly or through appropriate subregional or regional organizations, to agree upon the measures necessary for the conservation of these stocks in the adjacent area."[32] This provision provides further legitimacy to the RFMOs, and works in tandem with Article 118 UNCLOS which states that states must cooperate on matters of conservation.[33] Article 63(2) specifically provides that states have agency over conservation measures of stocks which are both in the EEZ and the High Seas, this could

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[27] "United Nations Convention on the Law of the Sea Agreement under the United Nations Convention on the Law of the Sea on the Conservation and Sustainable Use of Marine Biological Diversity of Areas Beyond National Jurisdiction" (Oceans and Law of the Sea, United Nations, 2024) https://static.un.org/Depts/los/bbnj.html.
[28] United Nations Convention on the Law of the Sea, 1994, Article 92.
[29] Emily Benson, Catherine Puga, "Flagging the Issues: Maritime Governance, Forced Labor and Illegal Fishing," (Center for Strategic and International Studies, August 2021) https://www.csis.org/analysis/flagging-issues-maritime-governance-forced-labor-and-illegal-fishing.
[30] Matt Gianni and Walt Simpson, "How flags of convenience provide cover for illegal, unreported and unregulated fishing." (World Wildlife Fund, Australian Government Department of Agriculture, Forestry and Fisheries and International Transport Workers Federation, October 2005) https://assets.wwf.org.uk/downloads/flagsofconvenience.pdf.
[31] United Nations Convention on the Law of the Sea, 1994, Article 116.
[32] United Nations Convention on the Law of the Sea, 1994, Article 63(2).
[33] United Nations Convention on the Law of the Sea, 1994, Article 118.

mean that states could create legislation against seabed trawling in specific areas of the High Seas for the purpose that it removes the habitats of designated harvestable species within the EEZ.[34] This provides a very narrow and limited basis for a state to propose such measures in the name of conservation and since it has yet to be invoked in the many years that seabed trawling has been used on the high seas, Article 63(2) will likely not be invoked on such measures in the future. This is especially unlikely since many states, especially coastal EU states and the UK, use seabed trawling within their EEZ's.[35]

(b) *Article 64*

Article 64 states that all states who fish for highly migratory species will cooperate with international institutions (typically RFMOs though this is not explicitly stated in the treaty), to "[ensure] conservation and [promote] the objective of optimum utilization of such species throughout the region, both within and beyond the [EEZ]."[36] Article 64 provides a legal basis for states to cooperate on conservation matters on the High Seas, similarly to Article 118.[37] However, Article 64 only requires this cooperation in regards to migratory species listed in Annex 1.[38] This is a short list and contains only seventeen species, eight of which are species of tuna, thereby limiting the basis for states to take action.[39] Article 64 further requires states to create international cooperation organisations for fisheries management of the listed migratory species if there is not one existing already.[40] This, again, similarly to Article 63(2) does not provide for an opportunity for fishing techniques or practices to be assessed according to their environmental impact but rather their impact only on the flow of migratory species which provide economic benefits to states. This article therefore does not aid in the overall protection of all species on the high seas.

(c) *Article 67*

Article 67 is dedicated to the protection of catadromous species.[41] Catadromous species are a species of fish which begin their life cycle in freshwater usually within national borders, and then migrate to saltwater as they mature. Article 67(1) states that the coastal state in which catadromous species spend the majority of their life cycle has responsibility for the management of the species.[42] Furthermore, article 67(2) states that catadromous species shall only be harvested "in waters landward of the outer limits of exclusive economic zones".[43] This is to say that catadromous species may only be harvested within the EEZs of the particular country where the freshwater that the catadromous species begins its life cycle is.[44] Under article 67(2) catadromous species should not be harvested from the High Seas.[45] Again, though this relates to fisheries management, it only relates so far as to conclude where potential catches may be harvested. This does not provide a space for review of pre-existing or new fishing methods in relation to their environmental impact on catadromous or other types of species.

(d) *Conclusions of Article 116*

Articles 64 and 63(2) discuss effective fisheries management in the form of catch quotas, in relation

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[34] United Nations Convention on the Law of the Sea, 1994, Article 63(2).
[35] Black and others (n 21).
[36] United Nations Convention on the Law of the Sea, 1994, Article 64.
[37] United Nations Convention on the Law of the Sea, 1994, Article 64; United Nations Convention on the Law of the Sea, 1994, Article 118.
[38] United Nations Convention on the Law of the Sea, 1994, Article 64.
[39] United Nations Convention on the Law of the Sea, 1994, Annex 1.
[40] United Nations Convention on the Law of the Sea, 1994, Article 64.
[41] United Nations Convention on the Law of the Sea, 1994, Article 67.
[42] United Nations Convention on the Law of the Sea, 1994, Article 67(1).
[43] Ibid.
[44] Ibid.
[45] United Nations Convention on the Law of the Sea, 1994, Article 67(2).

to specific species whereas article 67 discusses where catadromous species may be caught.[46] These provisions, though relevant to High Seas fisheries management, do not adequately provide the legislative ability for states to adapt to the climate crisis' new and ever-changing problems. Moreover, they do not provide a universal overview of sustainable fishing techniques in relation to migratory species and instead rely on RFMOs to create regulations surrounding sustainable fishing techniques.[47] This has resulted in diverse standards across the High Seas. Though some may argue that these diverse practices reflect the diversity of the states who are party to the RFMOs, and the regions which they serve, in actuality, they are oftentimes unable to properly present and enforce minimum standards of sustainability efforts which should be equally present (with some deviations depending on the ecological makeup of the region) across the High Seas. This can be directly attributed to the lack of a clear minimum standard set out by UNCLOS. A116 also states that states are bound by the other provisions in section 2: Articles 117 through to 120.[48]

(3) Article 117

Article 117 requires through multilateral cooperation and domestic law that states take measures to ensure conservation efforts from their nationals.[49] This provision is targeted to "living resources of the high seas", and the use of the word "resource" implies that efforts should be targeted towards fish who would act as living resources, fish who can be harvested.[50] If the intention was for this provision to provide recourse for all flag states to act in accordance with conservation efforts, drafters would have used the phrasing "marine environment" as was used in article 145.[51] Nevertheless, article 117 places on the flag state a responsibility, via multilateral cooperation and domestic law, to comply with conservation efforts, specifically against IUU fishing.[52] Therefore though states always have legitimacy to take action against seabed trawling occurring on flag ships in accordance with their sovereignty and lawmaking processes, they would only be mandated to under article 117 when a harvestable fish stock is threatened by that practice in particular.[53] Similarly RFMOs have the capacity under article 117 to ensure states party to the RFMO take action but only when a harvestable fish stock is threatened.[54]

(4) Article 118

Article 118 requires cooperation amongst states on areas of conservation and management of living resources on the High Seas, yet, its focus is also on conservation of marine resources that can be harvested.[55] Article 118 also gives authority to RFMOs on matters of conservancy and could theoretically result in a ban on seabed trawling, however, it would only occur if a harvestable fish stock was suffering.[56] This provision requires states cooperate but only under the situation when fishing stocks on the high seas are threatened, not for the overall protection of the marine environment which would, in turn, ensure the health of all fish stocks.[57] Therefore Article 118

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[46] United Nations Convention on the Law of the Sea, 1994, Article 63(2); United Nations Convention on the Law of the Sea, 1994, Article 64; United Nations Convention on the Law of the Sea, 1994, Article 67.
[47] United Nations Convention on the Law of the Sea, 1994, Article 116.
[48] Ibid.
[49] United Nations Convention on the Law of the Sea, 1994, Article 117.
[50] Ibid.
[51] United Nations Convention on the Law of the Sea, 1994, Article 145.
[52] United Nations Convention on the Law of the Sea, 1994, Article 117.
[53] Ibid.
[54] Ibid.
[55] United Nations Convention on the Law of the Sea, 1994, Article 118.
[56] Ibid.
[57] Stephen Palumbi, Paul Sandifer, David Allan, Michael Beck, et al. "Managing for ocean biodiversity to sustain marine ecosystem services" 2009 7(4) Frontiers in Ecology and the Environment.

provides limited grounds for RFMOs to create substantial regulations for the health of the overall ecosystem in relation to damaging fishing techniques.

(5) Article 119

Article 119(1) relates to sustainable catch limits of fish on the high seas and sets out the recording requirements of fisheries.[58] 119(1)(a) states that states are required to use science to keep fish at their "maximum sustainable yield", taking into account "relevant environmental and economic factors".[59] This is another instance of UNCLOS legislation targeting only the direct sustainability of harvestable fish. 119(1)(b) uses soft law to bring the first mention of ecological dependencies of the marine environment in this section.[60] 119(1)(b) states that states will "take into consideration" environmental risks associated with dependent or associated species of the target species in determining the allowable catch of the target fish.[61] Unfortunately, the language of this legislation suggests a soft law approach in that states must "take into consideration" associated or dependent species, rather than making their success in conjunction with the target species a mandated requirement.[62] With present science, it is clear that the health of an ecosystem overall requires all species within it, from plankton to whales, to be at healthy levels, and this must be prioritised rather than "[taken] into consideration".[63] 119(2) provides further legitimacy towards RFMOs and states that scientific data regarding catch allowances must be shared through the relevant RFMO.[64] Though this is an important step in ensuring sustainable harvest of target fish, it does not provide any mechanisms for addressing what may be causing a decline in the fish population aside from overfishing. If a fish population is struggling due to a lack of habitats caused by seabed trawling, or rising sea temperatures, contributed to by carbon emissions from seabed trawling, then there is no mechanism in this article to address the root of the issue aside from managing allowable catch and responding to unreported fishing. 119(3) finally states that there will be no discrimination against fishermen of any state based on measures to ensure allowable catch limits.[65]

(6) Article 120

The last provision in the series governing fishing on the high seas states that article 65 also applies to the conservation of marine mammals in the high seas.[66] Article 65 provides states and RFMOs the option to legislate more strictly than what UNCLOS set out as the minimum in EEZs.[67] Furthermore, article 120 requires states to cooperate through RFMOs to conserve, manage and study marine mammals.[68] This is the first direct mention of non-target species conservation in high-seas fishing governed under UNCLOS. Mammals were particularly affected by bycatch in driftnet fishing and therefore, though this article was not cited when the UNGA resolution was pursued, it provides additional legal basis and legitimacy to state action during that time period.

(7) Article 145

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58 United Nations Convention on the Law of the Sea, 1994, Article 119(1).
59 United Nations Convention on the Law of the Sea, 1994, Article 119(1)(a).
60 United Nations Convention on the Law of the Sea, 1994, Article 119(1)(b).
61 Ibid.
62 Ibid.
63 Palumbi and others (n 57).
64 United Nations Convention on the Law of the Sea, 1994, Article 119(2).
65 United Nations Convention on the Law of the Sea, 1994, Article 119(3).
66 United Nations Convention on the Law of the Sea, 1994, Article 120.
67 United Nations Convention on the Law of the Sea, 1994, Article 65.
68 United Nations Convention on the Law of the Sea, 1994, Article 120.

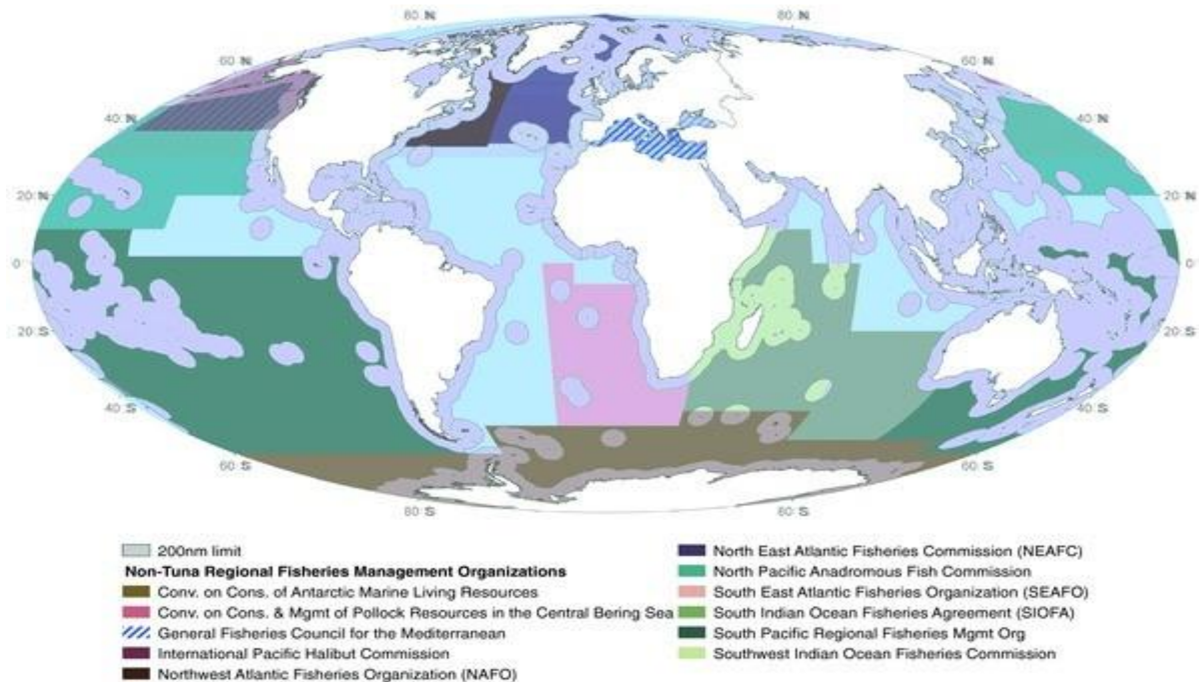
Article 145 does not directly address fishing on the high seas, but provides measures for protection of the marine environment generally on the high seas from "activities in the Area".[69] Article 145(a) gives the International Seabed Authority (ISA) the authority to adopt measures for "the prevention, reduction and control of pollution and other hazards to the marine environment… [and] interference with the ecological balance of the marine environment".[70] Perhaps a flaw in the drafting of this article is that it next specifies areas requiring "particular attention" including "protection from harmful effects of such activities as drilling, dredging, excavation, disposal of waste, construction and operation or maintenance of installations, pipelines and other devices related to such activities".[71] This way this legislation is worded indicates there are areas which require more attention on matters of conservation relating to those surrounding deep-sea mining. Since 1994 when UNCLOS entered into force, the ISA has consistently produced legislation, creating regional management plans, protected areas where no mining can occur, and has required environmental impact assessments on nearly all proposed mining sites.[72] Even on its own website the ISA discusses article 145 as the article which gives it the mandate to legislate on seabed mining, when, in actuality it provides the ISA the ability to legislate on nearly all matters of conservation, with only a focus on issues of deep-sea mining.[73] However, since the ISA has only taken its mandate to be related to deep-sea mining, it is unlikely they will pursue a wider scope of legislative power. The ISA could require Environmental Impact Assessments (EIA) on a number of different fishing techniques, as they do with mining, but their focus has been solely applied to mining and until or unless that changes they will not be able to effectively manage the pollution caused by seabed trawling.[74] Furthermore, 145(b) specifically notes that the ISA will have authority to adopt appropriate rules to assist in the "prevention of damage to the flora and fauna of the marine environment".[75] Damage to flora and fauna is a key feature and problem of seabed trawling which would therefore put itself within the ISA's mandate. However, as mentioned above, the ISA is unlikely to legislate on such issues since such a focus is placed on issues related to deep-sea mining and no direct fishing measures have been taken to date.

(8) UNCLOS Conclusions

Based on the above articles, UNCLOS has taken a lax approach to protection of the overall marine ecology and places the majority of the legislative focus on issues surrounding harvestable fish rather than protection of the overall environment. The most important legal mechanism, article 145, in relation to climate governance on the high seas, has been interpreted to have less authority than that which the treaty prescribed it with.[76] This presents a problematic situation as there is currently no mechanism within the treaty which can appropriately respond to the complex effects of climate change that have significantly evolved since the treaty was signed in 1994. Moreover, since so many conservation initiatives and catch allowances have been devolved to RFMOs, there is no ability, within the treaty, unless an amendment was made, to stop new environmentally degrading fishing techniques such as seabed trawling.

[69] United Nations Convention on the Law of the Sea, 1994, Article 145.
[70] United Nations Convention on the Law of the Sea, 1994, Article 145(a).
[71] Ibid.
[72] "Our Work" (International Seabed Authority, 2024) https://www.isa.org.jm/.
[73] United Nations Convention on the Law of the Sea, 1994, Article 145; "Our Work" (International Seabed Authority, 2024) https://www.isa.org.jm/.
[74] "Our Work" (n 72).
[75] United Nations Convention on the Law of the Sea, 1994, Article 145(b).
[76] United Nations Convention on the Law of the Sea, 1994, Article 145.

D. RFMOs



RFMOs are an extremely important mechanism in fisheries law on the high seas. UNCLOS has delegated a measure of authority to RFMOs as vehicles of collaboration and sharing between states, particularly in relation to harvestable fish.[78] There are currently twenty-two RFMOs acting across the high seas.[79] Some have specific mandate to a particular type of fish such as the NPAFC (North Pacific Anadromous Fishing Commission) and others work towards the management of the fishing region as a whole such as NAFO (the Northwest Atlantic Fisheries Organization).[80] States can choose to be party to RFMOs, which would give them a stake in the decision making of the organisation.[81] This is particularly relevant for coastal states and states which often fish in the region. For example, Canada, Russia, Japan and the USA are all signatories of NPAFC due to the importance of salmon fishing in their economies.[82] However, if a state does not sign or ratify the agreement, they are not legally bound to cooperate with the RFMO and the organisation and member states can take diplomatic or economic action to encourage compliance.[83] These actions can include a ban on fish imported to RFMO member states from non-compliant sources, international arbitration, or negotiations among other things.[84]

There are a number of regions which are not currently covered by RFMOs. Despite the UNCLOS requirement that states work together to create and maintain RFMOs for conservation, there are a number of regions where no RFMOs are present and fishermen are bound by the

[77] Natalie Ban, Nicholas Bax, Kristina Gjerde, Patrick Halpin, "Systematic Conservation Planning: A Better Recipe for Managing the High Seas for Biodiversity Conservation and Sustainable Use" (2013) 7(1) Conservation Letters.
[78] United Nations Convention on the Law of the Sea, 1994, Article 117; United Nations Convention on the Law of the Sea, 1994, Article 118.
[79] Terje Lobach, Matilda Petersson, Eliana Haberkon and Piero Manini, "Regional fisheries management organizations and advisory bodies Activities and developments, 2000–2017." (2020) 651 FAO Fisheries and Aquaculture Technical Paper.
[80] Ibid.
[81] Eric Molenaar "Participation, Allocation, and Unregulated Fishing: The Practice of Regional Fisheries Management Organizations," (2003) 18(4) International Journal of Marine and Coastal Law.
[82] Rosemary Rayfuse, *Non-Flag State Enforcement in High Seas Fisheries,* (Leiden 2004).
[83] Ibid.
[84] Ibid.

diverse laws of the flag state and the laws of UNCLOS only.[85] Though these are usually areas where fishing is not as present, it still occurs, and therefore leaves a space open for environmentally degrading measures to occur since there is no universal instrument to oversee fishing practices. This also likely opens up the regions to higher rates of IUU since there is no organised body to manage catch ratios and legal techniques.[86]

The current system of RFMOs presents a glaring hole in marine protection globally. There are regions in which no protection from RFMOs occurs, within RFMO regions some states refuse to abide by conservation measures and there is no effective international body tackling the large amount of IUU fishing on the high seas, harmful fishing by non-compliant states. The ISA has not fully fulfilled its mandate in protecting the high seas from environmentally damaging activities and therefore there is no efficient mechanism to enforce state cooperation unless states pressure other states to comply, or a case is brought through the ICJ or ITLOS. However, if a case is brought before the ICJ or ITLOS it does not necessarily indicate states will stop the illegal actions since states are the sovereign actors in international law.

(2) RFMO Action on Seabed Trawling

A few RFMOs have taken action already in response to environmental and economic concerns (loss of harvestable fish habitats) caused by seabed trawling. The Northwest Atlantic Fisheries Organization (NAFO) is responsible for the areas past the EEZ of Eastern Canada and Greenland and is represented by the black shading in Figure 4.1.[87] NAFO, in response to seabed trawling, has created zones in which no seabed trawling can occur in order to protect the ecosystems existing there.[88] Similarly, the Northeast Atlantic Fisheries Commision (NEAFC) (dark blue on Figure 4.1) and the Commission for the Conservation of Antarctic Marine Living Resources (CCAMLR) (brown on Figure 4.1) have also passed regulations creating protected areas where seabed trawling is prohibited.[89] The South Pacific Regional Fisheries Management Organization (SPRFMO) (dark green on Figure 4.1) and the Southeast Atlantic Fisheries Organization (SEAFO) (pink on the map) have also created protected areas within their jurisdictions but have taken the prerogative further to also include the requirement that states participating in bottom trawling use specific types of gear to minimise damage to the seabed.[90]

Though these are important steps forward, the diversity in legislation presents a problem since, as article 136 states, the high seas are the heritage of mankind, and yet that heritage is receiving different levels of protection across the world, with no minimum requirement.[91] Even within those regions where seabed trawling has been taken seriously, some RFMOs have created protected areas where others have mandated a change in the equipment used to minimise environmental damage.[92] If the effort is to preserve the common heritage of mankind and protect economic resources for future generations it seems most logical that all states should use the gear which preserves the overall marine environment and therefore the economic interests of the world economy. Furthermore, even where there are protected areas, states which are not party to the

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[85] United Nations Convention on the Law of the Sea, 1994, Article 118.
[86] Yea and Stringer (n 3).
[87] Ban and others (n 77).
[88] Vulnerable Marine Ecosystems" (NAFO, 2024) https://www.nafo.int/Fisheries/VME.
[89] Map of NEAFC Regulatory Area Showing Existing Fishing Areas and All Closures" (NEAFC, 2011) https://www.neafc.org/page/closures; "CCAMLR Conservation Measures," (CCAMLR, 2017) https://cm.ccamlr.org/en/measure-22-06-2019.
[90] "Bottom Fishing Science," (SPRFMO, 2024) https://sprfmo.int/science/bottom-fishing/; "VME Protection" (SEAFO, 2024) http://www.seafo.org/Management/VME-Protection
[91] United Nations Convention on the Law of the Sea, 1994, Article 136.
[92] "Map of NEAFC Regulatory Area Showing Existing Fishing Areas and All Closures" (NEAFC, 2011) https://www.neafc.org/page/closures; "Bottom Fishing Science," (SPRFMO, 2024) https://sprfmo.int/science/bottom-fishing/.

RFMOs can still seabed trawl. The only consequence appears to be diplomatic.[93] Practically, states are much more concerned with matters of economic security than that of climate change, even though the two are inextricably linked, and therefore states are not very likely to take significant diplomatic action to prevent non-compliant states from fishing in protected areas.

Perhaps the most stringent deterrent is the ban of fish not fished legally to be imported into RFMO member states.[94] Problematically though, there are not many states party to RFMOs, on average there are 16.6 states per RFMO and many states are party to multiple RFMOs.[95] This means that of the 193 states which are UN members, only 8% are, on average, represented in RFMOs, though all have the right to fish on the high seas.[96] This means 92% of states, on average, are not bound to RFMO regulations. The importance of RFMOs cannot be understated, they are working in areas where there would be no significant fishing legislation otherwise, however, in order to preserve the high seas for all future generations, and to preserve fisheries and the fishing economy, significant changes must be made in the law of the sea. Especially since IUU fishing is so rampant on the high seas.[97]

(3) IUU Fishing, PSMA and UNFSA

IUU fishing is largely governed by UNCLOS, and the Agreement on Port State Measures (PSMA) under the Food and Agriculture Organization (FAO) of the UN. Though seabed trawling is legal on the high seas, it may be considered IUU if the catch is above the limit and/or endangered species were caught. There are currently 78 parties to the PSMA, which are required to implement measures to prevent and deter IUU fishing, such as vessel inspections and information exchange.[98] The PSMA does not directly enforce the driftnet moratorium, however it does help to deter illegal fishing methods which driftnet fishing has now been designated as.[99] If seabed trawling were to receive the same treatment perhaps the PSMA could aid in its enforcement on a universal scale. Under UNCLOS and RFMOs, regulated fishing consists of being registered with a flag state, and adhering to their requirements on gear and catch limits, participating in conservation efforts under A118 UNCLOS, and cooperating with monitoring and surveillance efforts.[100] Problematically, there is currently no requirement to assess the environmental impacts of different types of fishing before doing so. So long as a vessel is in compliance with its flag state and the relevant RFMO (if you are a party to it), the state may choose to use whatever fishing method it prefers (except driftnet fishing or other illegal techniques).

The United Nations Fish Stocks Agreement (UNFSA) is another agreement which further promotes the need for RFMOs where they do not already exist.[101] It further pushes for sustainable fishing methods with limited ecological damage to be used, however this agreement entered into force in 2001, and nearly 25 years later there are still areas of the High Seas ungoverned by RFMOs.[102]

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[93] Rayfuse (n 82).
[94] CCAMLR Conservation Measures," (CCAMLR, 2017) https://cm.ccamlr.org/en/measure-22-06-2019; "Vulnerable Marine Ecosystems" (NAFO, 2024) https://www.nafo.int/Fisheries/VME.
[95] These statistics were compiled by adding all the member states listed as parties on each website of the RFMOs. Once all the member states were added, the total was then divided to obtain the average.
[96] United Nations Convention on the Law of the Sea, 1994, Article 116.
[97] Yea and Stringer (n 3).
[98] Agreement on Port State Measures" (Food and Agriculture Organization of the United Nations, 2024) https://www.fao.org/port-state-measures/background/history/en/.
[99] Ibid.
[100] United Nations Convention on the Law of the Sea, 1994, Article 118; "VME Protection" (SEAFO, 2024) http://www.seafo.org/Management/VME-Protection.
[101] United Nations Fish Stocks Agreement, 1995, Part 1 Article 7(b).
[102] Ban and others (n 77).

(4) RFMO Conclusions

RFMOs, though an important actor in regulating the high seas, do not provide adequate coverage to ensure equal protection for marine life. There are some areas where RFMOs do not exist, and some areas where measures against seabed trawling include protected areas and equipment requirements to minimise damage.[103] Most importantly, RFMOs place an overly heavy focus on harvestable stocks rather than the marine environment as a whole when the protection of the latter would result in the sustainability of the former.[104] Moreover, the authority of RFMOs is case dependent and requires diplomatic pressure to enforce sustainability efforts which would disincentive countries to subject themselves to the limits of RFMOs if they are able to catch more and increase their economic power outside the RFMO jurisdiction. Therefore, significant adaptation to UNCLOS and the legal mechanisms providing RFMOs with more authority should be made to provide adequate environmental protections across the high seas while maintaining sustainable catch rates.

E. UNGA RESOLUTIONS

Another mechanism which could be triggered to change the law across the whole of the High Seas instead of amending UNCLOS could be passing a resolution through the United Nations General Assembly (UNGA). This would require a state or group of states to draft the resolution including an outline of the issue and recommendations to address the issue.[105] The proposed resolution must then be submitted to the President General of the Assembly, and then referred to the appropriate committee.[106] The driftnet fishing moratorium, (to be discussed in further detail in chapter 6), but which would be materially similar to a moratorium on seabed trawling, was sent to be heard by both the second committee which handles economic matters, and the sixth committee which handles legal issues.[107] If the committee is satisfied with the proposal it will be forwarded to the general assembly for further consideration, and then, a vote.[108] Typically, for a resolution to pass, it must obtain a majority of the member states present votes, this is what occurred in the driftnet moratorium and is likely what would happen if a resolution on seabed trawling was presented.[109] If the resolution achieves a majority vote, it will be passed.[110] However, as with all UNGA resolutions, they will never be legally binding and states have no legal obligation to follow the terms of the resolution.[111]

UNGA resolutions, though not legally binding, can carry significant political weight.[112] In the case of the driftnet moratorium, the UNGA resolution was pushed by two United Nations Security Council members, the United States and Russia, in conjunction with two other politically powerful countries in the region; Canada and Japan.[113] The proposal was also backed by a number of countries in the South Pacific sea including New Zealand and Australia.[114] During this time period driftnet fishing and its rates of bycatch were presumed to be the cause for a number of harvestable fish species dwindling in numbers which is what prompted many Pacific coastal states

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[103] Ibid.
[104] Palumbi and others (n 57).
[105] United Nations Charter, 1945, Article 10.
[106] United Nations Charter, 1945, Article 22.
[107] Grant Hewison, "The Legally Binding Nature of the Moratorium on Driftnet Fishing," 1994 25(4) Journal of Maritime Law and Commerce.
[108] United Nations Charter, 1945, Article 18(3).
[109] Ibid.
[110] Ibid.
[111] D Johnson, "The Effects of Resolutions on the General Assembly of the United Nations," (1995) 32 Brit YB Int'l L 97.
[112] Rayfuse (n 82).
[113] Ibid.
[114] Andrew Richards, "Problems of Drift-net Fisheries in the South Pacific." 1994, 29(1) Marine Pollution Bulletin.

to act.[115] The combined political pressure and urgency of all these nations in protecting their harvestable stocks is what resulted in the success of the driftnet moratorium across both the High Seas and EEZs.[116] To create a universal ban on seabed trawling on the high seas, states must push for an amendment to UNCLOS, a new treaty to govern environmentally damaging techniques on the high seas, or they must treat seabed trawling with the severity it deserves and work towards a moratorium as was done with driftnet fishing when harvestable stocks were threatened.

F. THE DRIFTNET MORATORIUM

(1) Introduction

The NPAFC is a RFMO designed to ensure the protection of anadromous fish across the Pacific, specifically salmon.[117] It was this RFMO which spearheaded the implementation of the Driftnet Moratorium across the high seas. In the 1990s, many nations began to notice a significant depletion in fish stocks, specifically those of salmon and migratory fish.[118] Salmon fisheries are an important part of the economies of pacific coastal communities in Japan, Russia, Canada and the United States, so as their supplies began to dwindle, states became motivated to act.[119] Driftnets were presumed to be the cause of this diminished supply.[120] Driftnets are a type of fishing which involves buoys to hold nets which are set vertically just underneath the surface of the water.[121] This fishing is designed to have fish get caught via their fins or gills in the material of the net.[122] Driftnet fishing does not cause the same carbon or habitat destruction as seabed trawling, however it was presumed to have a high bycatch rate.[123] Driftnet fishing was primarily used on the high seas by Japanese fishermen which saw a boom in the early 1990s, they were used to hunt for squid, however this would often result in the capture of other species and seabirds, but particularly salmon.[124] In 1989 political pressure began to ramp up for an international moratorium of driftnet fishing, with the North Pacific Driftnet Conference between Pacific coastal Canadian provinces and American states on the grounds that it was harming the environment and damaging the salmon stocks.[125] This idea was, however, flawed.[126] Many scientists have subsequently stated that the high seas bycatch rates of squid fisheries were the lowest despite the equipment used, and that this was a case where politics and public fear trumped science.[127] The international pressure and fear of the decline of salmon stocks became so strong that Japan even subjected itself to the Japanese Soviet Fishing Convention (JFSC) which essentially stated that Japan was subject to soviet jurisdiction for the amount of salmon it was allowed to catch on the high seas.[128]

The United States (and Russia) too, faced internal pressure, so much so that it used its strong political position as a member of the security council to push for a driftnet moratorium.[129] Canada, and Japan also pushed for this, along with many South Pacific nations who were dealing

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[115] Ibid.

[116] William Burke, Mark Freeberg, Edward Miles. "United Nations Resolutions on Driftnet Fishing: An Unsustainable Precedent for High Seas and Coastal Fisheries Management." 1994 25(2) Ocean Development and International Law.

[117] Yvonne Dereynier "Evolving Principles of International Fisheries Law and the North Pacific Anadromous Fishing Commission" 1998 29(2) Ocean Development and International Law.

[118] Burke, Freeberg and Miles (n 116).

[119] Ibid.

[120] Ibid.

[121] Ibid.

[122] Ibid.

[123] Ibid.

[124] Ibid.

[125] Ibid.

[126] Ibid.

[127] Ibid.

[128] Dereynier (n 117).

[129] Ibid.

with similar issues in their seas.[130] This was eventually supported and passed in the UNGA resolution 46/215 which created a driftnet moratorium.[131] The moratorium made large-scale driftnet fishing illegal in both international waters and countries' EEZs.[132] UNGA resolutions are non-binding on the member states of the UN, and there is no positive obligation on any member state to abide by the resolutions, however, after the resolution was passed, the United States, Canada, Japan and Russia created the NPAFC, whose goal was to conserve migratory fisheries between the four countries, particularly that of salmon in the North Pacific.[133] In doing so, they created Operation DRIFTNET which is still active to this day.[134] This resolution was taken so seriously that NPAFC ships would engage military technology to find ships participating in illegal driftnet fishing on the high seas and take disciplinary measures.[135] This could result in a seizure of the catch, fines or penalties (on ship owners, operators or flag state vessels), denial of entry into NPAFC ports, or diplomatic pressures on the flag state.[136] IUU fishing still remains rampant on the high seas, and driftnet fishing is still used, although is much less common due to Operation DRIFTNET.[137] Yet after this moratorium and the clear internal political pressure, a UNGA resolution was passed and treated as law.[138] The driftnet moratorium and military action by Canada and the United States is still active to this day and represents a success in collective environmental protection on the High Seas, even if it was not completely in accordance with science.[139]

(2) Driftnet Fishing and Seabed Trawling Comparison

As mentioned in chapter two, there are three main environmental problems associated with seabed trawling: bycatch rates, underwater habitat destruction, and significant carbon emissions.[140] Driftnet fishing is much less environmentally destructive than seabed trawling, with there being only one main environmental problem associated with it: bycatch rates.[141] In fact, many scientists have since stated that there is no need for there to have been a moratorium since the bycatch rates for driftnet fishing were some of the lowest reported out of all fishing types, and in fact the fishing technique could have remained and been even more sustainable had a few measures been taken.[142] For example, only using seabed trawling in areas with less carbon stores, creating areas protected from seabed trawling where carbon emissions are high.[143] As Burke, Freeberg and Miles puts it, this is a situation where politics trumped science.[144] Since the political pressure from Northern Pacific coastal communities and economies became so adamant on a ban on driftnet fishing, due to salmon bycatch, states were domestically motivated to act.[145]

(3) The North Pacific Fur Seal Treaty

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[130] Richards (n 114).
[131] Resolution 46/215, 1991.
[132] Ibid.
[133] Dereynier (n 117).
[134] "Operation DRIFTNET." (The Government of Canada, April 2018) https://www.canada.ca/en/department-national-defence/services/operations/military-operations/current-operations/operation-driftnet.html.
[135] Ibid.
[136] Rayfuse (n 82).
[137] "Operation DRIFTNET." (n 134).
[138] Rayfuse (n 82).
[139] Burke, Freeberg and Miles (n 116).
[140] Geert Hiddink (n 15); Steadman (n 8); *Effects of Trawling and Dredging on Seafloor Habitat* (n 7).
[141] Burke, Freeberg and Miles (n 116).
[142] Ibid.
[143] Black and others (n 21).
[144] Burke, Freeberg and Miles (n 116).
[145] Dereynier (n 117).

Another important case in international law relating to non-sovereign areas and resource protection and management dates back to 1911 with the signing of the North Pacific Fur Seal Convention of 1911.[146] This case did not concern a specific type of fishing technique like the driftnets, or seabed trawling, however it does present an example of multilateral cooperation in an effort to conserve and protect natural resources.[147] Similarly to salmon, the fur seals were important pillars of pacific communities economies, especially as they boomed in fashion and they became ever more rare.[148] The seals were hunted to near extinction by a number of different groups, until it became clear that the only viable course of action to preserve the resource would be to restrict the hunting of seals to a level that would be sustainable.[149] This included targeting only "extra" males, and not hunting females.[150] This treaty had a resounding success and resulted in the number of fur seals returning to pre-overhunting levels.[151]

(4) Concluding Remarks on the Case Study

It can be noted that in both these cases of successful living resource management, the target species; salmon and fur seals, were both migratory beyond the economic and natural borders prescribed to states and thereby had a transnational effect on all pacific coastal economies. This presented an urgency for action to protect all who had a stake in the success of the industry, and thereby invited cooperation from all states to ensure economic stability, and in the case of the NPAFC, calming of the political landscape.[152] With both the fur seal industry and the use of driftnet fishing, the methods of fishing were detrimental to specific species, but certainly are not as impactful on a global scale as seabed trawling. It becomes clear that the states in this case have responded to, and created international law when their direct short-term economic needs were affected.

Seabed trawling persists on the high seas since it does not affect harvestable migratory species who support many economies, and instead affects sedentary species. The underwater "deforestation" and carbon release does not present a short-term economic need and therefore there is no significant international pressure nor legislation on the high seas to prevent and protect marine life from fishing methods which are completely unsustainable as they are currently being conducted.

G. THE BBNJ

(1) BBNJ Introduction

As mentioned, there is currently no blanket ban nor mitigation efforts on fishing techniques which are scientifically proven to be environmentally degrading. The ISA currently has the authority, however the relevant UNCLOS provision has been interpreted to allow legislation only on underwater mining related issues.[153] The ISA has been working to create the new BBNJ treaty which is predicted to provide increased protections to marine animals on the high seas, and is

146 Scott Barrett, *Environment and Statecraft: the Strategy of Environmental Treaty Making* (Oxford Scholarship Online 2005).
147 Ibid.
148 Ibid.
149 Ibid.
150 Ibid.
151 Ibid.
152 Burke, Freeberg and Miles (n 116).
153 "Our Work" (n 72).

predicted to come into force in 2025.[154] In 2023 the BBNJ treaty was created.[155] While its primary goal was to decide resource distribution across the high seas, from those more affected by climate change to those causing it, it also contributed a number of important clauses to environmentally damaging practices taking place across the high seas. Though this treaty was drafted by the ISA, whose focus is on environmental protection from deep sea mining, the new legislation states that EIAs must occur for all activities on the high seas which may affect the environment negatively.[156] The process of the EIA under the new system is outlined in article 31(1) and most importantly, it states in 31(1)(d)(i) that if there are adverse environmental effects the party is not mandated to not go forward with the action.[157] The party is required to analyse and mitigate measures, however there is no obligation to stop the unsustainable act.[158] Most important, is that article 31(1)(e) mandates that states must share the EIA with the public along with all states and stakeholders in the EIA process.[159] This is a huge development and, as was demonstrated in the driftnet moratorium and fur seal treaty, public pressure is very important in state cooperation on legislating the high seas. Climate change is becoming a much more prominent issue in domestic politics around the globe and by increasing public knowledge of environmentally damaging processes, it will likely spark further calls to action. Moreover, it will create transparency between states, and could result in diplomatic pressure.

(2) The BBNJ and RFMOs

The BBNJ also addresses the legal status of RFMOs and attempts to address the issue of state non-compliance.[160] In article 22(2) it states that all states party to the BBNJ "shall respect the competences of, and not undermine," relevant bodies such as RFMOs, in respect to the provisions under article 22.[161] Article 22(1) requires states, in conjunction with article 22, respect all marine protected areas, presumably from all RFMOs, and decisions adopted by RFMOs.[162] Though there will still be states who are outliers to the agreement, this would make all states party to the BBNJ respect the competencies of relevant RFMOs across the high seas.[163]

The BBNJ advocates for area-based management, however the universal EIAs are very important in providing a minimum standard across the high seas. Though a negative result will not stop the activity from occurring, as mentioned above, it can provide more awareness of the activity in the first place.[164] Article 28(1) mandates that an EIA must occur before the activity is authorised to occur, thereby creating a new minimum requirement, unseen thus far in international law, of awareness of environmentally degrading practices.[165] Seabed trawling as it is commonly done,

[154] "United Nations Convention on the Law of the Sea Agreement under the United Nations Convention on the Law of the Sea on the Conservation and Sustainable Use of Marine Biological Diversity of Areas Beyond National Jurisdiction" (Oceans and Law of the Sea, United Nations, 2024) https://static.un.org/Depts/los/bbnj.html.
[155] Ibid.
[156] 2023 Agreement Under the United Nations Convention on the Law of the Sea on the Conservation and Sustainable Use of Marine Biological Diversity of Areas Beyond National Jurisdiction, 2023, Article 31.
[157] 2023 Agreement Under the United Nations Convention on the Law of the Sea on the Conservation and Sustainable Use of Marine Biological Diversity of Areas Beyond National Jurisdiction, 2023, Article 31(1)(d)(i).
[158] 2023 Agreement Under the United Nations Convention on the Law of the Sea on the Conservation and Sustainable Use of Marine Biological Diversity of Areas Beyond National Jurisdiction, 2023, Article 31(1)(d).
[159] 2023 Agreement Under the United Nations Convention on the Law of the Sea on the Conservation and Sustainable Use of Marine Biological Diversity of Areas Beyond National Jurisdiction, 2023, Article 31(1)(e).
[160] 2023 Agreement Under the United Nations Convention on the Law of the Sea on the Conservation and Sustainable Use of Marine Biological Diversity of Areas Beyond National Jurisdiction, 2023, Article 22(2).
[161] Ibid.
[162] 2023 Agreement Under the United Nations Convention on the Law of the Sea on the Conservation and Sustainable Use of Marine Biological Diversity of Areas Beyond National Jurisdiction, 2023, Article 22(1).
[163] Ibid.
[164] 2023 Agreement Under the United Nations Convention on the Law of the Sea on the Conservation and Sustainable Use of Marine Biological Diversity of Areas Beyond National Jurisdiction, 2023, Article 31(1)(d)(i).
[165] 2023 Agreement Under the United Nations Convention on the Law of the Sea on the Conservation and Sustainable Use of Marine Biological Diversity of Areas Beyond National Jurisdiction, 2023, Article 28(1).

would most certainly present as causing major harm to the environment and this would require states to consider mitigation efforts, when perhaps mitigation efforts had not been considered before.[166] If the seabed trawling goes ahead, the public would learn about it and it could cause outrage and domestic pressure. Seabed trawling can become more sustainable, as was done in the SEAFO and SPRFMO with the mandated equipment change, or by only trawling in areas where the carbon percentage under the seabed is low, it's just a matter of encouraging states to do so.[167] Contemporarily, seabed trawling is a little known issue on the climate crisis in comparison to the discourse surrounding plastic waste in the ocean and therefore the EIAs will provide the public with knowledge and access to how different practices affect the biodiversity and health of the High Seas, and therefore a motivation to pressure local governments to act in a way consistent with the science.[168]

Similarly, with the driftnet moratorium, there was scientifically not a need to outright ban the practice, since the bycatch rates were relatively low.[169] Likely if the controversy over driftnets had occurred while the BBNJ was signed, states would have implemented mitigating measures, as is the first step of an EIA, rather than completely ban the practice if its effects are not comparatively harmful to warrant a ban under A34(2) BBNJ.[170]

The BBNJ, while a very revolutionary treaty, is yet to enter into force. It is awaiting 60 states to become parties to the agreement at which point it will enter into force.[171] Its effects are difficult to fully determine until relevant case law is heard, EIAs are conducted, and the effects of the BBNJ on RFMOs authority can be fully determined.

H. CONCLUSION

This paper set out to understand how the High Seas could be legislated to prevent environmentally damaging fishing techniques such as seabed trawling. It reviewed relevant UNCLOS articles, the legal authority of RMFOs, the implementation of a UNGA resolution similar to Resolution 46/215 except with respect to seabed trawling. It provided analysis and comparison of the successes of the North Pacific Fur Seal Treaty of 1911 and more in depth, the driftnet moratorium, to gain understanding of which factors aided in the success of the law in those instances. Finally, this paper set out to understand how the upcoming BBNJ treaty will affect governance of environmentally damaging fishing techniques on the High Seas.

At this stage of High Seas conservation governance, there is only one way for a blanket ban or conservation efforts to occur for Seabed Trawling, and that is to follow the same path as the Driftnet Moratorium; to receive a ban from the UNGA, and to have that ban upheld through RFMOs, pressured domestically. Of course, states may, have banned seabed trawling in their own EEZ's and from their own flag ships on the high seas, but so long as there is not a complete universal ban, states wishing to continue the practice may, and fisherman wishing to continue the practice may take up flags of convenience. The other way states can be proactive is to add a clause into UNCLOS under A313, specifically targeting seabed trawling, or, targeting more stringent

[166] 2023 Agreement Under the United Nations Convention on the Law of the Sea on the Conservation and Sustainable Use of Marine Biological Diversity of Areas Beyond National Jurisdiction, 2023, Article 29(4)(b)(ii).
[167] Black and others (n 21).
[168] 2023 Agreement Under the United Nations Convention on the Law of the Sea on the Conservation and Sustainable Use of Marine Biological Diversity of Areas Beyond National Jurisdiction, 2023, Article 31(1)(e).
[169] Burke, Freeberg and Miles (n 116).
[170] 2023 Agreement Under the United Nations Convention on the Law of the Sea on the Conservation and Sustainable Use of Marine Biological Diversity of Areas Beyond National Jurisdiction, 2023, Article 34(2).
[171] "United Nations Convention on the Law of the Sea Agreement under the United Nations Convention on the Law of the Sea on the Conservation and Sustainable Use of Marine Biological Diversity of Areas Beyond National Jurisdiction" (Oceans and Law of the Sea, United Nations, 2024) https://static.un.org/Depts/los/bbnj.html.

environmental protections for the high sea.[172] Though states may be more unwilling to do so, since the BBNJ has been signed.

Seabed trawling continues to be one of the most damaging fishing techniques on the High Seas due to its release of carbon and significant disruption and destruction of underwater ecosystems, and is therefore a significant contributor to climate change as a whole and unsustainable fishing techniques. Given the science on the issue, action should be taken, and if/until the BBNJ comes into force, the onus falls on individual people to create a discourse and pressure government action to be taken against seabed trawling both domestically and on the high seas.

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[172] United Nations Convention on the Law of the Sea, 1994, Article 313.

HAS THE INTERNATIONAL CLIMATE REGIME FAILED AND MISSED ITS PURPOSE? LOSS AND DAMAGE AND HUMAN RIGHTS PERSPECTIVE

*Yingqi Wang**
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A. INTRODUCTION
B. LOSS AND DAMAGE PERSPECTIVE
C. HUMAN RIGHTS PERSPECTIVE
D. CONCLUSION

A. INTRODUCTION[1]

The development of the international climate change regime perhaps could be divided into seven stages: the first stage was before 1985, when initial scientific knowledge of global warming began to emerge; the second stage was from 1985 to 1988, when global warming was transformed from a scientific issue into a policy-making issue; and the third stage was from 1988 to 1990, when the international climate change regime began to enter into a informal negotiation phase; the fourth stage was the formal intergovernmental negotiations and the conclusion of the United Nations Framework Convention on Climate Change (the UNFCCC) in 1992; the fifth stage was the negotiations on how to implement the UNFCCC and the adoption of the Kyoto Protocol in 1997;[2] the sixth stage was the negotiations on emissions reductions and the adoption of the Paris Agreement in 2015; the seventh stage is the negotiations since the signing of the Paris Agreement until now, which have been centred on how to advance the implementation of the Paris Agreement.[3] With the increasingly awful impacts of climate change, the international climate change regime has faced accusations from the international community, particularly from those climate-vulnerable states. It is said that the international climate change regime has failed and is not in line with its original purpose. This essay argues that the international climate change regime has been relatively successful in terms of its legislative framework, but its operationalisation function has been poor, thus making it a near failure and inconsistent with its original objectives. The essay will analyse this argument from two perspectives: damage and loss and human rights protection.

B. LOSS AND DAMAGE PERSPECTIVE

As the new emerging issue of the international climate change regime, loss and damage become a more and more significant issue these days. Loss and damage has not been clearly defined in either the UNFCCC or the Paris Agreement, also being debated in the international community, as it is a politically, economically and socially multifaceted issue.[4] It was referred to by the Warsaw International Mechanism in 2013 *as the adverse impacts brought about by climate change, including extreme weather and slow onset events*.[5] Loss and damage is currently recognised in academia as well as in practice as an unmitigated and non-adaptable adverse effect of climate change.[6] Such adverse impacts are usually divided into two categories: one is economic losses, which can be addressed with monetary compensation; the other one is non-economic losses, which are often difficult to

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[1] Legal norms used up to 30 November 2023
[2] Urs Luterbacher and Detlef F Sprinz, International Relations and Global Climate Change (MIT Press 2001) 24
[3] Bodansky, D, Brunnée J and Rajamani L, International Climate Change Law (Oxford University Press 2017).
[4] Kreienkamp J and Vanhala L, 'Climate Change Loss and Damage' (Policy Brief, March 2017)
[5] WIM, decision 2/CP.19, Article 1
[6] van der Geest K and Warner K, 'Editorial: Loss and Damage from Climate Change: Emerging Perspectives' (2015) 8(2) Int J Global Warming 133

compensate for, including social, cultural and livelihood losses.[7] There is also a certain overlap between the two.

The issue of loss and damage was first raised in the early twentieth century in the context of the international climate negotiating agenda by representatives of the Alliance of Small Island States (AOSIS). The reason for raising this topic was that human adaptation and mitigation efforts had not been as effective as they should have been.[8] As a result, the adverse impacts of climate change could or would result in significant loss and damage to particular states, especially climate-vulnerable countries and small island countries. Loss and damage from climate change can often be devastating to a state's economy or society or culture. In Micronesia, where communities in Kosrae are losing burial grounds due to coastal erosion caused by sea level rise;[9] in Inuit communities whose cultural identity and hunting practices are being threatened by the loss of Arctic sea ice.[10] While the issue of loss and damage was raised, it did not receive much attention in that international negotiations round. That's the reason why it was avoided by the UNFCCC in 1992, and subsequent negotiations continue to focus on adaptation and mitigation. Until 2007, loss and damage caused by climate change in some developed countries became progressively more serious than before, then this issue was reintroduced into the agenda of international negotiations.[11] In 2013, the Warsaw International Mechanism (WIM) set up a global mechanism and institutional framework for dealing with the issue of loss and damage; in 2015, there was a heated discussion on this issue at the Paris Climate Conference, which finally led to the conclusion of the Article 8 of the Paris Agreement. At COP26, a coalition of vulnerable states advocated for the establishment of a financial institution or fund for loss and damage. Although their suggestion was unsuccessful, COP26 established a two-year Glasgow Dialogue Mechanism to discuss arrangements for loss and damage funding.[12] At COP27, loss and damage took center stage for the first time, and a fund for compensation for loss and damage caused by climate change was successfully established.[13] Currently, loss and damage, together with mitigation and adaptation, constitute the three pillars of the international climate change regime, with the focus of attention mainly on the compensation and indemnification regime.

Based on the lineage of development of loss and damage regulations and policies, it can be said that it is in a favourable state of development. Firstly, the issue of loss and damage has gained the attention of the international community after several years of efforts by small island states. When the issue was mentioned by the AOSIS at the beginning of the twentieth century, most countries did not think much of it. After several years, however, it has developed to the core topic at COP 27, which means most of the states in the world recognize the importance of loss and damage issue. Secondly, the establishment of the WIM in 2013 has given loss and damage its own institutional arrangements for implementation. The WIM established the Executive Committee, whose main tasks include addressing loss and damage caused by the adverse effects

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[7] 'Climate loss and damage: practical action' (The Scottish Government - gov.scot) <www.gov.scot/publications/practical-action-addressing-loss-damage/pages/5/> accessed 16 December 2023.

[8] Reinhard Mechler, Loss and Damage from Climate Change: Concepts, Methods and Policy Options (Springer Nature 2019)

[9] 'What Is 'Loss and Damage' from Climate Change? 8 Key Questions, Answered' (World Resources Institute) <www.wri.org/insights/loss-damage-climate-change> accessed 16 December 2023.

[10] Chris Baraniuk, 'The Inuit knowledge vanishing with the ice' (BBC - Homepage, 12 October 2021) <www.bbc.com/future/article/20211011-the-inuit-knowledge-vanishing-with-the-ice> accessed 16 December 2023.

[11] W Neil Adger and others, 'Are there social limits to adaptation to climate change?' (2008) 93(3-4) Climatic Change 335.

[12] see COP 26 The Glasgow Climate Pact

[13] 'COP27 Reaches Breakthrough Agreement on New 'Loss and Damage' Fund for Vulnerable Countries | UNFCCC' <https://unfccc.int/news/cop27-reaches-breakthrough-agreement-on-new-loss-and-damage-fund-for-vulnerable-countries> accessed 16 December 2023.

of climate change; coordinating dialogue among parties; promoting cooperation and providing financial, technological, and capacity-building assistance.[14] It can be said that the Warsaw International Mechanism has set up an initial framework for addressing loss and damage issue, which has laid a good foundation for the subsequent negotiations on the Paris Agreement. In addition, under the UNFCCC, a number of support projects have been carried out on regulations to prevent or compensate for the occurrence of loss and damage. A typical example is the Caribbean Catastrophe Risk Insurance Facility (CCRIF), developed with the technical assistance of the World Bank and the financial support of the Government of Japan. It is mainly financed by the World Bank, the European Union, Canada and other developed countries.[15] The purpose is to respond rapidly to the adverse effects of extreme weather and emergencies such as tropical cyclones and excessive rainfall that occur in the Caribbean.[16] Over the past 16 years, this institution has significantly reduced the economic pressure on Caribbean countries facing natural disasters and extreme weather and is a relatively successful case of compensation for loss and damage.

Even though the legal framework for loss and damage is constantly being improved with a number of projects being developed to try to address the problem. It still has to be said that it has indeed failed and appears to have strayed from its original purpose. One possible reason for this is the loss and damage regulations may run counter to the principles of the international climate change regime. On the one hand, the industrialised countries of the northern hemisphere have, for historical reasons, emitted large quantities of pollutants during the past industrial revolution.[17] These industrialised countries should be held accountable for the pollution they caused in their history because, according to the 'polluter pays principle'[18] and the implication of historical development, these industrialised countries polluted the atmosphere and are one of the main contributors to the current global warming for the reason that they should be made to pay for their actions or else it may be a violation of the polluter pays principle. On the other hand, the industrialised countries of the North plundered a lot of the resources of the non-industrialised countries of the South during their industrialisation in the past so that they can reach the present level of development.[19] Even today, the pollution emissions of the non-industrialised countries in the South are still far lower than those of the industrialised countries in the North. Under these circumstances, it may run counter to the principles of equity and common but differentiated responsibilities principle[20] to hold countries of the North and South equally responsible for climate change. On the contrary, most of the industrialised countries of the North are unwilling to compensate and take responsibility for the pollution they caused in history.[21] There is no way that the existing loss and damage framework can compel developed countries of the North to pay for past pollutant emissions, and both Article 8 of the Paris Agreement and WIM deal only with a framework for addressing loss and damage in the future, not even with compensation to address the Loss and Damage that the globe is facing at present. Current solutions to the problem of pollution compensation generally involve judicial recourse after the damage has been caused.[22]

An important reason is that the international climate regime's response capacity in this

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[14] WIM, decision 2/CP.19, Article 5

[15] 'Home | CCRIF SPC' (Home | CCRIF SPC) <www.ccrif.org/> accessed 16 December 2023.

[16] 'The Caribbean Catastrophe Risk Insurance Facility (CCRIF) | UNFCCC' (UNFCCC) <https://unfccc.int/topics/adaptation-and-resilience/resources/S-N/CCRIF> accessed 16 December 2023.

[17] Benoit Mayer and Alexander Zahar, 'Debating Climate Law: Conclusion' [2021] SSRN Electronic Journal.

[18] Rio Declaration, Principle 16

[19] Benoit Mayer and Alexander Zahar, 'Debating Climate Law: Conclusion' [2021] SSRN Electronic Journal.

[20] UNFCCC, Article 3(1)

[21] MJ Mace and Roda Verheyen, 'Loss, Damage and Responsibility after COP21: All Options Open for the Paris Agreement' (2016) 25(2) Review of European, Comparative & International Environmental Law 197

[22] Richard SJ Tol and Roda Verheyen, 'State responsibility and compensation for climate change damages—a legal and economic assessment' (2004) 32(9) Energy Policy 1109.

regard is weak and slow. In terms of recognition, the mainstream view of the international community still focuses on adaptation and mitigation, which is considered sufficient to solve the environmental problems currently faced. The states that hold such a view are mainly developed countries,[23] which hold the main discourse power in the international community. Even though the importance of the issue of loss and damage is recognised, most states still view it in relation to mitigation and adaptation.[24] Within the framework of the WIM, countries led by the United States and the European Union continue to limit the scope of the Executive Committee's work to enhance adaptation and risk management.[25] It is precisely because the international community is not yet sufficiently aware of the issue of loss and damage, and the states with sufficient awareness lack sufficient voice at the international level. This led to the construction of the implementation system for loss and damage being slow and the consensus that can be reached is limited. In terms of implementation mechanisms, the WIM and Article 8 of the Paris Agreement are both very broad provisions. The activities that WIM can implement have to appear in your work programme that it has agreed upon, and the current work programme is not ambitious enough. [26]In addition, there are internal problems with the WIM Executive Committee, which is required to have half developed country representatives and half developing country representatives in order to make decisions by consensus.[27] The problem in the selection and composition of the members has prevented the Committee from functioning.

The most important, and fundamental, reason of the failure of the loss and damage mechanism is the lack of financial resources. According to the current categorisation of loss and damage in practice, non-economic losses are generally difficult to repair thus are not considered here. The solution to economic losses requires a large amount of funds to support, which are generally used to rebuild homes damaged by the adverse impacts of climate change or to resettle residents whose living environment and standards have been affected by climate change.[28] Although WIM has mentioned the issue of funds, up to now WIM does not have a stable and sufficient source of funds, and even initially relies on the funds of some developed countries to support its operation in the first two years.[29] Moreover, the financial content of the five-year work plan has been always in a blank state.[30] In the Paris Agreement, developed countries committed to jointly provide $100 billion per year in climate finance to developing countries.[31] Due to the linkage between WIM and the Paris Agreement, WIM has called for a portion of this funding to be used to address loss and damage. In 2020, developed countries provided $83.3 billion, only 8 per cent of this has gone to low-income countries and about a quarter to Africa. Most of it has been used to address adaptation and mitigation, with a very small portion used to address loss and damage. This lack of funding does not allow the loss and damage regulations to function well, since the most fundamental way to address loss and damage is to provide financial compensation, and the

[23] Boyd E, James RA, Jones RG, Young HR and Otto FEL, 'A Typology of Loss and Damage Perspectives' (2017) 7(10) Nature Climate Change 723.
[24] Boyd E, James RA, Jones RG, Young HR and Otto FEL, 'A Typology of Loss and Damage Perspectives' (2017) 7(10) Nature Climate Change 723.
[25] MJ Mace and Roda Verheyen, 'Loss, Damage and Responsibility after COP21: All Options Open for the Paris Agreement' (2016) 25(2) Review of European, Comparative & International Environmental Law 197
[26] MJ Mace and Roda Verheyen, 'Loss, Damage and Responsibility after COP21: All Options Open for the Paris Agreement' (2016) 25(2) Review of European, Comparative & International Environmental Law 197
[27] see WIM, decision 2/CP.19
[28] 'CCRIF Makes Four Payouts Totalling US$15.2 Million During October for 2022 Hurricane Season Events | CCRIF SPC' (Home | CCRIF SPC) <www.ccrif.org/news/ccrif-makes-four-payouts-totalling-us152-million-during-october-2022-hurricane-season-events> accessed 16 December 2023.
[29] Kreienkamp J and Vanhala L, 'Climate Change Loss and Damage' (Policy Brief, March 2017)
[30] Report of the Executive Committee of the Warsaw International Mechanism for Loss and Damage associated with Climate Change Impacts. Addendum, FCCC/SB/2017/1/Add.1
[31] United Nations, 'Climate Finance' https://www.un.org/en/climatechange/raising-ambition/climate-finance accessed 16 December 2023.

lack of funding is the biggest obstacle to the good functioning of such a mechanism. In summary, the international climate change regime may not be in a position to fulfil its original purpose, given that the current loss and damage rules may violate the basic principles of the international climate change regime, and that the capacity to respond and implement in practice is weak.

C. HUMAN RIGHTS PERSPECTIVE

Human rights issues are fundamental to international law and should be given equal attention in the international climate change regime. In the context of growing environmental problems, the issue of human rights in the field of the environment was not mentioned at all until the 1980s. The first time human rights were mentioned in an international conference was at the Stockholm Conference on the Human Environment in 1972, where the declaration stated that human beings have a fundamental responsibility towards the environment and at the same time have a valuable right to live.[32] During 1990s, the possible impacts of environmental degradation on the right to life and the right to health began to be discussed in the negotiations of the UN Commission on Human Rights.[33] On 28 March 2008, the United Nations Human Rights Council adopted resolution 7/23 on human rights and climate change, which, for the first time in a United Nations resolution, explicitly acknowledged that climate change 'has implications for the full enjoyment of human rights'.[34] In 2015, the Paris Agreement called on all parties to respect, promote, and take into account the human rights obligations of all States.[35] Now there is an international consensus that climate change will lead to human rights violations. Dozens of political, economic, social and cultural human rights are enshrined in the International Declaration of Human Rights, and in the area of the environment, climate change threatens several widely enjoyed human rights, including, but not limited to, the right to life, the right to health, the right to water, the right to food, the right to development and the right to self-determination.[36]

From the perspective of human rights protection, the international climate change regime has had its more successful aspects. One important aspect is that it provides a relatively well-developed framework for the protection of human rights in the climate context. On the one hand, this framework provides safeguards for the core conditions of human life in the context of the climate crisis. The Human Rights Council report contains detailed descriptions of the rights to life, health, food, access to clean water and habitat, calling on Governments to focus on the living environment, food and drinking water stocks and sanitation.[37] These are the basic conditions for human survival, and the inclusion of human rights in the international climate change framework has largely supplemented the inadequacies of the previous climate change governance system in the context of the current growing climate crisis. As an example, the core content of the long-term development of the original international climate regime is to reduce greenhouse gas emissions through the trading mechanism of carbon emission, which mainly relies on the market mechanism.[38] However, the market mechanism is not completely fair and just, which will lead to the neglect of human needs in the governance of the international climate regime. In this context, the international climate regime's concern for human rights has ensured the most basic conditions of human survival, especially those of environmentally fragile states and small island states. On the

[32] Report of the Conference A/CONF.48/14/Rev.1, para.1
[33] Daniel Bodansky, 'Introduction: Climate Change and Human Rights: Unpacking the Issues' (2010) 38 Ga J Int'l & Comp L 511
[34] Human Rights Council Res 7/23, UN Doc A/HRC/7/78 (28 March 2008)
[35] see Paris Agreement Preamble
[36] UNHRC, 'Report of the Special Rapporteur on the Issue of Human Rights Obligations Relating to the Enjoyment of a Safe, Clean, Healthy and Sustainable Environment' (1 February 2016) UN Doc A/HRC/31/52
[37] UNHRC, 'Report of the Special Rapporteur on the Issue of Human Rights Obligations Relating to the Enjoyment of a Safe, Clean, Healthy and Sustainable Environment' (1 February 2016) UN Doc A/HRC/31/52
[38] Atieno M, 'Human Rights and the Global Climate Change Regime' (2018) 58(1) Natural Resources Journal 51

other hand, human rights provide a basis for prosecution in international climate change litigation. In contexts where there is no reference to human rights, a person cannot claim his rights if he loses food because of climate change. The existence of human rights has fuelled climate change litigation by providing a way for victims to claim their rights. Since the signing of the Paris Agreement, such lawsuits have sprung up.[39] In the case of Urgenda Foundation v. Government of the Netherlands, the Urgenda Foundation filed a lawsuit in the District Court of the Netherlands on the grounds that the Government of the Netherlands was not doing enough to reduce emissions, which may be insufficient to fulfil the Paris Agreement's requirement of 'limiting warming to 2 degrees Celsius', and thus endangering the right to life of its citizens.[40] The case was brought before the District Court of the Netherlands on the basis of the European Human Rights Act. From this perspective, the international climate change regime has played a role in safeguarding human rights.

The international climate change regime has done far too little to give only a framework of protection and a basis for litigation in the area of human rights protection, which is why it has been accused of having failed and of not being able to fulfil its original purpose. Its failure is reflected in the inadequate protection of the rights of groups. The first group that is not adequately protected is the citizens, whose rights to participate in the international climate regime's decision-making are not well protected. The International Covenant on Civil and Political Rights mentions that the right of the public to take part in the conduct of public affairs is protected.[41] Under the current international climate change regime, both the UNFCCC[42] and the Paris Agreement[43] require States Parties to enhance citizens' access to information and participation in decision-making. In practice, however, this 'global democracy' has not been achieved. The public may have access to a great deal of information about the international climate change regime through the media or social media platforms, but it is very difficult for them to express their own or a group's ideas on an international platform. Currently, citizen participation is more likely to take the form of citizens signing petitions via the Internet, or webpage creators posing a question to which citizens respond with a short yes or no answer.[44] The second group that is not adequately protected is the vulnerable groups of women, children and persons with disabilities, their rights to life, health, development and self-determination are not well protected. In the context of climate change, women and children in economically disadvantaged areas, who were often responsible for collecting water and some food resources,[45] may be suffering unprecedented abuse due to the lack of basic survival resources. Those persons who with disabilities belonged to a group of people who had been neglected in the process of climate change for the reason that they were likely to encounter various problems in adapting to climate change.[46] And they are not such valuable to society. Existing international environmental regimes have left a virtual void in this area of protection, with only initiatives that need to pay extra attention to this category of people in the context of the climate change process.[47] For this vulnerable group, such initiatives have little

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[39] Quirico O, 'Climate Change and State Responsibility for Human Rights Violations: Causation and Imputation' (2018) 65(2) Netherlands International Law Review 185

[40] *see* The State of the Netherlands (Ministry of Infrastructure and the Environment) v Urgenda Foundation, Case No 200.178.245/01, The Hague Court of Appeal, 9 October 2018

[41] ICCPR, Article 25

[42] UNFCCC, Article 6

[43] Paris Agreement, Article 12

[44] Hayley Stevenson and John S Dryzek, 'The discursive democratisation of global climate governance' (2012) 21(2) Environmental Politics 18

[45] Bethuel Sibongiseni Ngcamu, 'Climate change effects on vulnerable populations in the Global South: a systematic review' [2023] Natural Hazards

[46] Bethuel Sibongiseni Ngcamu, 'Climate change effects on vulnerable populations in the Global South: a systematic review' [2023] Natural Hazards

[47] UNHRC, 'Report of the Special Rapporteur on the Issue of Human Rights Obligations Relating to the Enjoyment of a Safe, Clean, Healthy and Sustainable Environment' (1 February 2016) UN Doc A/HRC/31/52, para.81-84

practical implementation effect at the legal level. As a vulnerable group, they are still not able to have equal rights under the protection of operational laws, and are still subject to violence and physical and mental health problems, not to mention these initiatives and reports that have no operational capacity.

The third group that is not sufficiently protected, which is the one that will be most affected throughout the climate change process, is the group that will migrate as a result of climate change. The first point is to know how to define this group. Since the decision of individuals to move is multifaceted, the definition has always been controversial. Climate refugees are mainly people displaced by the effects of climate change, with storms, heavy rains and floods being the main causes of this displacement.[48] The International Organisation for Migration defines environmental migrants as groups of people who are forced to leave their habitual place of residence or to migrate temporarily or permanently within their own country or abroad for compelling external reasons resulting from sudden or destabilising changes in the environment that adversely affect their living or subsistence conditions.[49] Clearly, the definition of environmental migrants encompasses the definition of climate refugees. The human rights of climate migrants cannot be guaranteed due to the current lack of a specific international legal regime applicable to climate migrants. International climate change law focuses primarily on mitigation and adaptation, but it fails to clarify the legal status of people who cannot adapt to climate change in their own countries and have to flee to other countries. The Cancun Agreements recognised climate migrants for the first time, encouraging states to implement measures at the national, regional and international levels on climate change-induced displacement, migration and planned resettlement, thereby enhancing understanding, coordination and cooperation.[50] Considering that existing international refugee law and protection of stateless persons do not adequately address and resolve the issue of climate-induced migration. Under the United Nations Convention relating to the Status of Refugees of 1951 and the Refugee Protocol as amended in 1967, climate change-induced migrants are often unable to demonstrate a well-founded fear of persecution and are therefore not eligible for protection as refugees.[51] If the protection of stateless persons is invoked, it is subject to a certain degree of uncertainty. In such cases, the disappearance of nationality presupposes the disappearance of the State, and the disappearance of the State presupposes the loss of territory. Maldives, for example, it would take some time before it was submerged totally, but it was clear that the country would no longer be habitable before it was completely submerged. What law should apply to those migrants during that period becomes a question. In this situation, where every legal rule is not applicable, even though the Cancun agreement recognises climate migrants and asks the parties to try to solve this problem, the international climate change regime has not given relevant operational details to this nascent issue in the climate field. In the absence of specific implementation rules, the human rights of climate migrants are not guaranteed at all, and even their survival is in question.

D. CONCLUSION

In summary, the international climate change regime has had some success, but it has certainly been a near failure. From the perspective of loss and damage, the climate change regime has set

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[48] Walter Kälin, 'Conceptualising Climate-Induced Displacement' in Jane McAdam (ed), Climate Change and Displacement: Multidisciplinary Perspectives (Hart Publishing 2010)
[49] International Organization for Migration, 'Discussion Note: Migration and the Environment' (1 November 2007) MC/INF/288
[50] UNFCCC Conference of the Parties, 'Report of the Conference of the Parties on its sixteenth session, held in Cancun from 29 November to 10 December 2010: Addendum Part Two: Action taken by the Conference of the Parties at its sixteenth session' (15 March 2011) UN Doc FCCC/CP/2010/7/Add.1,para. 13
[51] The 1951 Refugee Convention, Article 1

up a framework for addressing loss and damage and has made all the parties recognise the importance of this issue; but it has been nearly inoperative, with the developed countries unwilling to assume their historical responsibility to make up for the loss and damage they have caused in the past; nor are they willing to deal with loss and damage as an important issue on its own, and still not treating it as a separate issue from mitigation and adaptation; furthermore, without adequate financial support, it is not possible to move into the practical stage. From a human rights protection perspective, the international climate change regime has likewise established a simple framework for it and has also provided a basis for climate litigation. However, due to the lack of specific operational provisions of the international climate change regime, the framework is mostly in the form of initiatives, which is not legally binding and is unable to solve the problems of public participation, protection of the rights and interests of vulnerable groups and climate migration. All in all, the international climate change regime is in a state of empty framework, weak legal-binding and practical operation, from this perspective, the international climate change regime has nearly failed and no longer meets its original purpose.

A CRITICAL ANALYSIS ON THE REGULATION AND SANCTIONING OF WRONGFUL AND FRAUDULENT TRADING: WHETHER THE SYSTEM IS SUFFICIENT TO DETER DIRECTORIAL MISCONDUCT IN TRADING

*Xuan Mao**

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- **(3) Director's Duty to Creditors (Section 172(3))**
- **(4) The Doctrine of Limited Liability**

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- **(4) The Civil Offence vs The Criminal Offence**
- **(5) Liability for Fraudulent Trading; Contribution to the Company's Assets**
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E. DIRECTOR DISQUALIFICATION; SUFFICIENT TO DETER?
- **(1) Introduction**
- **(2) Effect of Disqualification**
- **(3) Protection of the public**
- **(4) Conclusion**

F. CONCLUDING CHAPTER

A. INTRODUCTORY CHAPTER

While shareholders own the company, it is directors who deal with the company's day-to-day affairs and management.[1] A company and their director(s) have a fiduciary relationship of trust for the directors to act on their behalf.[2] Where there is a large corporation with numerous directors, the management powers are given to the board as a whole, not just one individual. As directors have such authority in the management of the company, there are various fiduciary duties imposed

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[1] Eugenio Vaccari and Emilie Ghio, *English Corporate Insolvency Law: A Primer* (1st edn, EE) 211.

[2] Derek French, *Mayson, French & Ryan on Company* Law (37th edn, OUP 2021) 456.

on them to ensure they do not act *ultra vires*.[3] The Companies Act 2006 provides seven fiduciary duties originating from common law. Although these duties are owed to the company as a whole, it is debatable whether they offer much protection to creditors.

Section 172(3) of the Companies Act 2006 provides for a duty to creditors, however, it was not until the recent landmark case of *BTI 2014 LLC V Sequana SA and others* [2022] that confirmed directors should indeed consider the interests of creditors.[4] Following this judgement, directors must aim to minimise losses to creditors when the company is insolvent or bordering insolvency.[5] Here, section 172(3) of the Companies Act 2006 is engaged and directors should cease trading as this may cause further loss to creditors. Thus, if the director continues to trade when they are no longer permitted to, they may not only be found liable for wrongful or fraudulent trading but also be in breach of section 172(3).

However, the protection offered by limited liability creates an incentive for directors to commit misconduct and take on risky ventures. As companies have their own separate legal personality, the debts of the company are not the debts of its shareholders.[6] This safeguards shareholders as they will not be found personally liable for the company's debts, however, places creditors at a greater risk for loss. Furthermore, limited liability has led to issues concerning the corporate veil.[7] As the veil protects the company's members and directors, it is difficult to hold them accountable for misconduct. This prompts directors to take risky ventures which they otherwise would not. Therefore, limited liability and the corporate veil provides an incentive for directors to continue trading even when there is a risk that this will cause greater loss for creditors.

When directors continue trading even though the company is insolvent or facing imminent insolvency, they may be liable for wrongful trading. This civil offence was first introduced as the burden of proof in fraudulent trading was too high and is nowadays much more common than fraudulent trading. However, questions remain on whether this is sufficient to deter director misconduct in relation to trading. The punishments, or lack thereof, for directors liable of wrongful trading have been criticised for being ineffective deterrence.[8]

A court may order directors to contribute to the company's assets to make up for the loss caused to the company as a result their wrongful trading.[9] However, this is only ordered when the wrongful trading results in a loss and the amount is limited to the loss caused.[10] Thus, this is more compensatory rather than punitive for the directors.[11] Furthermore, directors may also face disqualification. While disqualified, they will not be permitted to be a director for any company in the UK or with connections to the UK. However, similarly, this does not aim to punish the director themselves but rather to protect the public. This does not make the contribution order or disqualification insufficient deterrence as they do effectively raise standards of director practise.[12] Whilst the current schemes for the regulation and sanctioning of wrongful trading are not

[3] ibid at 457.
[4] [2022] UKSC 25.
[5] ibid.
[6] Geoffrey Morse and Thomas Braithwaite, *Partnership and LLP Law* (9th edn, OUP 2020) 318.
[7] David Milton, 'Piercing the Corporate Veil, Financial Responsibility, and the Limits of Limited Liability' (2007) 56 ELJ 1305.
[8] Richard Williams 'What Can We Expect to Gain from Reforming the Insolvent Trading Remedy?' (2015) MLR 78 (1) 55-84.
[9] s 214 Insolvency Act 1986.
[10] *Re Produce Marketing Consortium Ltd (No 2)* [1989] BCLC 520.
[11] *Re Lo-Line Electric Motors Ltd* [1988] Ch 477.
[12] ibid (n1) 269.

necessarily inadequate, there is a notably low number of claims which suggest some reform may be beneficial.[13]

The continuation of trading in an insolvent (or impending insolvency) company with the intent to defraud is fraudulent trading.[14] Unlike wrongful trading, this is a civil offence under section 213 of the Insolvency Act 1986 as well as a criminal offence under section 993 of the Companies Act 2006. For both the civil and criminal offence, it must be proved that the director in question had the intention to defraud creditors of the company or trade for any fraudulent purposes.[15] However, the phrasing of "intent to defraud" has led to many complications and uncertainties.[16] Whilst some interpretations have been given by English courts, no conclusive definition is provided by statute. Furthermore, the high burden of proof has made claims difficult to succeed in, thus, discouraging claims from being made. Similar to wrongful trading, directors may be ordered to contribute to the company's assets or face disqualification if found liable. Moreover, section 993(3) provides for criminal sanctioning of up to ten years imprisonment. The criminal penalty is an effective deterrence, however, similar with wrongful trading, the effectiveness of the civil offence is questionable. Furthermore, the lack of certainty caused by the phrase "intent to defraud" and the high burden of proof suggest that reform may be beneficial to ensure the current systems are adequate in the prevention of fraudulent trading.

Thus, this essay will analyse the aforementioned statues and their applications and interpretations in the English courts to determine whether they are adequate to deter director misconduct in relation to wrongful and fraudulent trading.

This chapter introduces topics of director misconduct in relation to wrongful and fraudulent trading which is the focus of this dissertation. Chapter two will discuss director duties and the effects of the doctrine of limited liability. Following this, chapter three will focus on the regulation and sanctioning of wrongful trading. Then, chapter four addresses the issue of fraudulent trading and whether the current schemes of regulation and sanctioning are sufficient. The penultimate chapter five will consider director disqualification and whether this sanctioning is sufficient to deter directors from committing such offences. Finally, chapter six is the concluding chapter.

B. THE DUTY TO PROMOTE THE SUCCESS OF THE COMPANY AND THE EFFECTS OF LIMITED LIABILITY

(1) Introduction

A director's relationship with their company is a fiduciary one and so they are subject to a number of fiduciary obligations.[17] This refers to a relationship of trust and confidence and is based on the notion of loyalty;[18] a fiduciary is trusted to act on behalf of another.[19] Thus, the director as a fiduciary, acts on behalf of the company taking into consideration their best interests. Unlike the traditional duties, such as contractual, these obligations are not stated in the contracts but are found in statute. Originating in common law, the enactment of the Companies Act 2006 later

[13] A Herzberg 'Why Are There So Few Insolvent Trading Cases?' (1998) 6 ILJ 77.
[14] s 213 Insolvency Act 1986, s 993 Company Act 2006.
[15] ibid.
[16] Andrew Keay 'Fraudulent Trading: The Intent to Defraud Element' (2006) CLWR 35 (2).
[17] [1967] 2 AC 134, 159.
[18] Millett LJ in *Bristol and West Building Society v Mothew* [1998] Ch 1, 18.
[19] Derek French, *Mayson, French & Ryan on Company Law* (38th edn, OUP 2023) 457.

consolidated these duties giving them statutory footing; sections 171 to 177 now sets out seven general directors' duties.[20]

However, when a company becomes insolvent or is on the brink of insolvency, the directors' duties shift to also consider the interest of creditors as per section 172(3).[21] The recent case of *BTI 2014 LLC V Sequana SA and others* [2022] clarified this.[22] This chapter shows that though directors have various fiduciary duties which regulate their conduct, the effectiveness of such duties are diminished because limited liability protects the company and thus creates an incentive for misconduct especially in relation to trading when the company is insolvent.

(2) Section 172; Duty to Promote the Success of the Company

The Companies Act 2006 consolidated the pre-existing law on the regulation of director duties.[23] Here, the focus is on section 172 specifically because, as Woods argues, this is one of the duties most commonly "disputed in post insolvency cases", concerning what the directors should have done prior to the company is declared insolvent.[24]

Under section 172, directors must act in a way, which they consider in good faith, would be most likely to promote the success of the company. They must "have regard to" to a non-exhaustive list of factors provided by section 172(1). These factors range from likely long-term consequences of decisions[25] to the need to act fairly between members of the company[26]. However, section 172(1) has faced criticism for its ambiguity in relation to the phrase "have regard to". Though some guidance has been provided by Secretary of State, Margaret Hodge who stated that "have regard to" means to "think about" and to "give proper consideration to",[27] ambiguity remains. Keay argues that many components of section 172(1) "remain somewhat of a mystery".[28] He criticised that this phrase has caused uncertainty surrounding what directors "actually need to do to fulfil their obligations under the section".[29]

This has undoubtably been the most controversial director duty under the Companies Act 2006. Keay provides that section 172 is more educational rather than practical and thus does little in practice. [30] Moreover, he criticises section 172 for being "vague" and providing "little direction or guidance".[31] Nonetheless, this duty remains relevant in insolvency. When a company is placed into insolvency (or when the director ought to know this), directors must cease trading as this may place the company into more debt.[32] Directors must consider the interest of creditors and minimise

[20] Eugenio Vaccari and Emilie Ghio, *English Corporate Insolvency Law: A Primer* (1st edn, EE) 216.
[21] Companies Act 2006.
[22] [2022] UKSC 25.
[23] Sarah Worthington and Sinead Agnew, *Sealy & Worthington's Text, Cases, and Materials in Company Law* (12th edn, OUP 2022)
[24] John Wood 'Directors' duties post insolvency' (2021) IC&CLR 32 (7) 371-386, 5.
[25] s 172(a) CA 2006.
[26] s 172(f) CA 2006.
[27] Web archive, 'Duties of company directors' (*The National Archives*, 28 June 2007)<https://webarchive.nationalarchives.gov.uk/ukgwa/20070628230000/http:/www.dti.gov.uk/files/file40139.pdf>accessed 14 January 2023.
[28] Andrew Keay, 'Having regard for stakeholders in practising enlightened shareholder value' (2019) OUCLJ 19 (1) 118, 120.
[29] Ibid at 137.
[30] Andrew Keay, 'The Duty to Promote the Success of the Company: Is it Fit for Purpose?' (2010) University of Leeds School of Law, Centre for Business Law and Practice Working Paper.
[31] ibid at [36].
[32] French (n 19) 697.

their losses.[33] Thus, when a company is insolvent or on the brink of insolvency, the section 172 duty to promote the success of the company is superseded by the creditor's duty (section 172(3) will be discussed later in chapter 2.3).

(3) Director's Duty to Creditors (Section 172(3))

Directors owe their fiduciary duties to the company itself.[34] However, there has been some ambiguity as to whether such duties are also owed to creditors.[35] The list of non-exhaustive factors under section 172(1) provides for stakeholder interests, however the interest of creditors is not generally mentioned here.[36] Section 172(3) does briefly mention creditors which provides that "the duty imposed by this section has effect subject to any enactment or rule of law requiring directors, in certain circumstances, to consider or act in the interests of creditors of the company".[37] However, it was not until the recent decision of the Supreme Court in *BTI 2014 LLC V Sequana SA and others* [2022] that the true extent of a duty to consider creditor's interests was clarified.[38] The following section will explore directors' duties towards creditors prior to and following this landmark case.

West Mercia Safetywear Ltd (in liquidation) v Dodd [1988] confirmed that directors have a duty to consider creditors' interest when they know or ought to know that the company is insolvent or on the brink of insolvency.[39] Nonetheless, there was uncertainty of whether the interests of creditors are to be prioritised at this point, or if this is merely to be considered alongside the interests of shareholders. The later enactment of section 172(3) preserved the duty and gave this statutory recognition.[40] However, *Yukong Line Ltd of Korea v Rendsburg Investment Corpn of Liberia (No 2)* [1998] later ruled against the idea of directors owing a duty to creditors.[41] Here, a director of an insolvent company, breached his duty to the company and transferred assets. Toulson J held that directors had no fiduciary duty towards creditors.[42] Nonetheless, the landmark decision in *BTI 2014 LLC V Sequana SA and others* [2022] clarified that directors do indeed have a duty towards creditors when the company is on the brink of or already insolvent.[43]

This was the first time the Court discussed the circumstances and extent to which directors must consider the interest of creditors with regard to their duties.[44] Here, the directors of *AWA* paid dividends of €135 million to *Sequana SA* which was compliant with the statutory requirements under the Companies Act 2006. However, *AWA* had long-term liabilities concerning pollution (needed to clean up a polluted river) which held the risk *AWA* may become insolvent in the future. This materialised a few months later and *AWA* became insolvent. *BTI* brought a claim on the basis that the director's decision to distribute dividends breached their duty to consider the interest of creditors, as there was a real risk of the company becoming insolvent in the future.

The Court here held that directors must consider the interest of creditors under section 172 and applied section 172(3). This concluded that there is no standalone creditors duty *per se*;

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[33] *BTI 2014 LLC V Sequana SA and others* [2022] UKSC 25.
[34] Vaccari and Ghio (n 20) 233.
[35] ibid.
[36] CA 2006.
[37] ibid.
[38] [2022] UKSC 25.
[39] [1988] BCLC 250.
[40] CA 2006.
[41] [1998] 2 BCLC 485.
[42] ibid.
[43] Uksc, 'New Judgment: BTI 2014 LLC v Sequana SA and others [2022] UKSC 25' (UKSC Blog, 5 October 2022)<http://ukscblog.com/new-judgment-bti-2014-llc-v-sequana-sa-and-others-2022-uksc-25/> accessed 11 April 2023.
[44] [2022] UKSC 25.

such a creditors duty exists but as an extension of section 172.[45] Lord Reed rejected the existence of a "creditor duty" distinct from the general duty to promote the success of the company. However, he acknowledges that "there are circumstances in which the interests of the company … should be understood as including the interests of its creditors as a whole".[46] The interest of creditors is only to be considered alongside the interest of members. In addressing *West Mercia Safetywear Ltd (in liquidation) v Dodd* [1988], Lord Reed states that the "duty remains the director's duty to act in good faith in the interests of the company … effect of the rule is to require the directors to consider the interests of creditors along with those of members".[47] Lord Reed's view is supported by Lord Hodge who provides that the risk of insolvency "gives rise to the fiduciary duty to the company to give separate and proper consideration to the interests of a company's creditors".[48]

However, though a duty to consider creditors' interest was found to exist, the Court held that the mere real risk of insolvency was not sufficient to trigger this duty. There must be an "sense of imminence" such as when the company is insolvent or borderline insolvent or when insolvent liquidation or administration is to be expected.[49] As per Lord Briggs, "real risk of insolvency is not a sufficient trigger for the engagement of the creditor duty".[50] He states that the "real risk" argument is based on an "unsound principle" which assumes that "creditors of a limited company are always among its stakeholders".[51] This argument is supported by Lord Hodge.[52] Thus, when the dividend was paid, directors were not under duty to consider the creditor's interest as *AWA* was neither actually nor imminently insolvent at this time.

Therefore, following this decision, directors do have a duty to consider the interest of creditors. This duty arises when they know or ought to know that the company is insolvent, bordering insolvency, or when the possibility of insolvency is probable. This deters directors from continuing to trade when the company is insolvent or on the brink of insolvency and thus preventing wrongful and fraudulent trading.

(4) The Doctrine of Limited Liability

Though there are duties imposed on directors to ensure they do not act unlawfully, the doctrine of limited liability offers some protection to both directors themselves and shareholders. The cornerstone case which established the principle of limited liability is *Salomon v Salomon*.[53] Lord Macnaghten provides; "the company is at law a different person altogether from the subscribers to the memorandum … the company is not in law the agent of the subscribers or trustee for them".[54] Thus, the company has a separate legal personality.[55] All business conducted and contracted signed are done so in the name of the company, not the individual(s) representing it.[56] Hence, liability of a company's member is limited to the amount they invested in the company.

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45 Pedro Schilling de Carvalho and Bobby Reddy, 'Credit Where Credit's Due: The Supreme Court Take On Director's Duties And Creditors' Interests' (2023) CLJ 82(1), 18.
46 [2022] UKSC 25 at [11].
47 ibid.
48 ibid at [246].
49 ibid at [88].
50 ibid at [199].
51 ibid at [191].
52 ibid at [247].
53 [1897] AC 22.
54 ibid at 51.
55 Geoffrey Morse and Thomas Braithwaite, *Partnership and LLP Law* (9th edn, OUP 2020) 319.
56 Alan Dignam and John Lowry, *Company Law* (12th edn, OUP 2022) 15.

Furthermore, money owed to the company is not owed to its shareholders and debts of the company are not debts of the shareholders.[57]

This creates an incentive for directors to take risky ventures which may lead to wrongful or fraudulent trading as their personal assets are protected if the company faces financial difficulties. As identified by Hirt, the issue of limited liability becomes particularly "apparent when the company is insolvent because it has insufficient assets to meet the claims of all creditors". [58] The abuse of limited liability places creditors at a greater risk during insolvency. If the company is insolvent and has no assets, creditors will struggle to obtain their owed capital. There are only certain circumstances, where wrongful or fraudulent trading is present, that a director who caused the loss may be held responsible to pay back some of the company's debts.[59] Therefore, the creditors bear a greater burden.

Thus, whilst directors do have duties imposed on them to prevent misconduct, the doctrine of limited liability offers protection which can be abused causing directors to take risky ventures. This may lead to wrongful or fraudulent trading as limited liability creates an incentive to continue trading even when the company is insolvent or bordering insolvency as personal assets are not at risk, only the company's is.

(5) Conclusion

Directors owe various fiduciary duties to both the company and also its creditors once the company becomes insolvent. The landmark case of *BTI 2014 LLC V Sequana SA and others* [2022] clarified that directors do indeed have a duty to consider the interest of creditors once the company is insolvent or on the brink of insolvency.[60] At this stage, section 172(3) can be engaged, and directors must aim to minimise loss caused to creditors. However, the principle of limited liability has caused greater risk for creditors. As companies have their own legal personality and are known as a separate entity, stakeholders will not be held personally liable if the company goes into insolvency. This offers greater protection to directors and shareholders; however, creditors are at greater risk of not receiving their owed capital.

C. THE REGULATION AND SANCTIONING OF WRONGFUL TRADING

(1) Introduction

This chapter will explore the civil offence of wrongful trading covered by section 214 of the Insolvency Act 1986. When there is no reasonable prospects of the company avoiding insolvency or is already insolvent, directors should cease trading.[61] At this stage, the financial welfare of their creditors must be prioritised; thus, should directors continue to trade, they may be found liable for wrongful trading. This was introduced following the recommendations from the Cork Report as the burden of proof required to establish fraudulent trading was too difficult.[62]

[57] Paul Davies, *Introduction to Company Law* (3rd edn, OUP 2020) 7.
[58] Hans Hirt, 'The Wrongful Trading Remedy in UK Law: Classification, Application and Practical Significance" (2004) 1 ECFR 71, 74.
[59] s 213 Insolvency Act 1986, s 214 Insolvency Act 1986.
[60] [2022] UKSC 25.
[61] Eugenio Vaccari and Emilie Ghio, *English Corporate Insolvency Law: A Primer* (1st edn, EE) 242.
[62] Insolvency Law and Practice: Report of the Review Committee (Chairman, Sir Kenneth Cork) Cmnd 8558 (1982) (Cork Report).

If found liable, the director will be held personally liable for the company's debts resulting from the wrongful trading starting from the point where they knew the company was insolvent.[63] In some cases, they may be disqualified from being a director for up to fifteen years.[64] However, section 214(3) of the Insolvency Act 1986 provides a defence arising when the director has done everything within their power to minimise loss caused to the company's creditors.

Though first introduced as an extension of fraudulent trading, nowadays wrongful trading is much more common. Nonetheless, the regulation and sanctioning of wrongful trading has faced criticism due to its lack of effectiveness.[65] This chapter will critically analyse the civil offence under section 214 and whether this is sufficient to deter director misconduct.

(2) Insolvency

Once a company becomes insolvent, it may be wound up or liquidated and when this is finalised the company ceases to exist.[66] This may be ordered by the court in compulsory liquidation, or by shareholders through special resolutions in voluntary liquidation. The money raised from this will be used to pay back the company's debts because in a limited liability company, the members are not liable for such debts, only the company's assets can be claimed by liquidators and distributed to its creditors. Thus, directors even when the company is nearing insolvency, may in an attempt to save the business, continue trading which could cause further debts and loss to creditors if unsuccessful. To prevent the abuse of limited liability, the conduct of the company's directors during insolvency will be investigated for any wrongdoing which may have occurred leading up to insolvency.[67]

Continuing to trade post insolvency is not in itself an offence. [68] However, where a loss has occurred as a result of this, the directors responsible may be held liable for wrongful trading.[69] Thus, where wrongful or fraudulent trading has occurred, directors may be ordered to contribute to the company's assets.[70]

(3) Establishing Wrongful Trading

For a claim of wrongful trading to succeed, the director must have known or ought to know that the company was impending insolvency and there were no reasonable prospects of avoiding this.[71] This is judged by the objective and subjective test provided by section 214(4) of the Insolvency Act 1986. Firstly, the court will consider the standard expectation of a reasonably diligent director with the knowledge, skill and diligence that can be reasonably expected of a person carrying out the same functions as the director.[72] Secondly, the subjective element will examine the specific director themselves and what "general knowledge, skill and experience that the director has".[73] Thus, where a director has specialist knowledge, skill or experiences, he will be judged against those higher standards. This is a strict test and failure to satisfy either of these elements will lead

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[63] Brenda Hannigan, *Company Law* (6th edn, OUP 2021) 311.
[64] s 10 Company Directors Disqualification Act 1986.
[65] Andrew Keay 'Wrongful trading: problems and proposals' (2014) 65 (1). 63 - 79 (17).
[66] Vaccari and Ghio (n 77).
[67] Richard Williams 'What Can We Expect to Gain from Reforming the Insolvent Trading Remedy?' (2015) MLR 78 (1) 55-84, 58.
[68] *Secretary of State for Trade and Industry v Taylor* [1997] 1 WLR 407, 414.
[69] s 213 Insolvency Act 1986, 214 Insolvency Act 1986, s 993 Companies Act 2006.
[70] Hannigan (n 79).
[71] Vaccari and Ghio (n 77) 242.
[72] s 214(4)(a).
[73] s 214(4)(b).

to an unsuccessful wrongful trading claim as seen in *Jackson v Casey* [2019].[74] Here, the petition failed because the applicant could not prove the objective test.

When applying section 214, courts must identify the relevant time which the directors knew or ought to have known that the company was insolvent or impending insolvency. As this is also a subjective test, courts are cautious with taking a strict approach. Hannigan argues that this is because they do not wish to encourage directors to put their companies into administration or liquidation too soon out of fear they may be found liable for wrongful trading.[75] *Re Hawkes Hill Publishing Ltd* [2007] held that while directors ought to have known that the company was insolvent, this did not necessarily mean that the company could not avoid insolvent liquidation.[76] However, often directors do not act until it is too late and creditors have to bear the consequences of this.[77] This is evidenced in *Roberts v Frohlich* [2011].[78] The court found that the company's accounts showed the company was balance sheet and cash flow insolvent, however, the directors continued trading for another year despite this. Mr Justice Norris here provides "hope that "something might turn up" was on any objective view groundless and forlorn".[79] This was because "insolvent liquidation was all but inevitable".[80]

These cases shows that while courts are rightly cautious to embrace a strict approach, directors do not act until it is too late. Thus, overall, a stricter approach may be more beneficial to deter wrongful trading and protect the interest of creditors.

However, such stricter approach has not materialised yet in all areas (though a strict approach is taken in relation to the defence under section 214(3) discussed in chapter 3.4). During the Covid-19 pandemic, the UK government introduced a temporary relief measure for wrongful trading. The Corporate Insolvency and Governance Act 2020 provides that courts should assume the director's conduct was not the cause for the worsening of the company's or its creditors' financial circumstances.[81] Scholars have argued that introduction of this provision as a result of the Covid-19 pandemic was not necessary.[82] One argument made by Vaccari and Ghio is that due to the current economic and financial climate during the pandemic, it was difficult for applicants to establish whether the company had reasonable prospects of avoiding insolvency. As per "directors may not have been able to assess if their companies had a reasonable chance of avoiding insolvent liquidation or administration because of the constantly changing governmental restrictions".[83] Nevertheless, this shows how the government is cautious when taking a strict approach as this may cause directors to put the company into insolvency proceedings when there may be a chance of saving it. They are mindful of the economic state especially during the pandemic when large numbers of businesses were shutting down as a result of global lockdowns.[84]

(4) Section 214(3) Defence

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[74] [2019] EWHC 1657 (Ch).
[75] Hannigan (n 79) 307.
[76] [2007] BCC 937.
[77] Hannigan (n 79) 307.
[78] [2011] 2 BCLC 625.
[79] ibid at [112].
[80] ibid.
[81] Corporate Insolvency and Governance Act 2020 (Coronavirus) (Suspension of Liability for Wrongful Trading and Extension of the Relevant Period) Regulations 2020.
[82] Vaccari and Ghio (n 77) 246.
[83] ibid.
[84] 'The economic impact of Covid-19 lockdowns' Debate Pack 25 November 2022 Number CDP 2022-0215 By Philip Brien, Daniel Harari, Matthew Keep, Matthew Ward.

A defence to wrongful trading is offered by section 214(3) of the Insolvency Act 1986. Even when a director has been found guilty of wrongful trading, they may avoid liability to contribute to the company's assets if the court is satisfied that the director "took every step with a view to minimising the potential loss to the company's creditors" even if they knew or ought to know that the company was insolvent.[85]

The burden of proof lies on the director to demonstrate that they took every step to minimise loss to creditors. This was emphasised by *Brooks v Armstrong* [2015] which held that this is judged against what a reasonably diligent person with the knowledge of the director would do.[86] Here, the court provided some factors to consider which range from "keeping creditors informed and reaching agreements to deal with debt and supply where possible" to "obtaining professional advice (legal and financial)".[87] Thus, whilst section 214(3) does offer a defence, the burden of proof lies on the directors themselves.

Re Ralls Builders Ltd [2016] considered the scope of this defence.[88] While the directors tried to rely on section 214(3), their argument was not successful. Snowden J held that "if a director can show that he took 'every step ... as he ought to have taken' after the relevant time 'with a view' to minimising the potential loss to creditors, he avoids liability under s.214(1), even if he does not actually succeed in his objective".[89] However, he goes on to apply a strict approach; "s.214(3) is intended to be a high hurdle for directors to surmount … it is right to construe s.214(3) strictly and to require a director who wishes to take advantage of the defence offered by that subsection to demonstrate not only that continued trading was intended to reduce the net deficiency of the company, but also that it was designed appropriately so as to minimise the risk of loss to individual creditors".[90] Thus, the interests and positions of creditors as a whole rather than individuals must be examined. This strict approach ensures that directors do not take advantage and protects the interests of all creditors. Therefore, though a defence can be raised, this is strictly applied.

(5) Liability for Wrongful Trading; Contribution to the Company's Assets

For a successful claim of wrongful trading, the applicant must also show that the wrongful trading caused an increase to the company's debts. Knox J in *Re Produce Marketing Consortium Ltd (No 2)* [1989] provides that the appropriate amount for the director to contribute is the loss caused by the director as a result of their wrongful trading.[91] Thus, the amount as per Hannigan, is "primarily compensatory rather than penal to ensure that any depletion of the assets attributable to the period of wrongful trading is made good".[92] Furthermore, Vinelott J in *Re Purpoint Ltd* [1991] rejected a claim for a director, liable for wrongful trading, to pay all the company's creditors for debts incurred after he should have known that the company was impending insolvent liquidation.[93] French provides that "in effect, the jurisdiction under s 214 is primarily compensatory rather than penal".[94] As the amount for contribution is limited and less is at stake for directors; this may be inadequate in the prevention of wrongful trading.

Where there are multiple directors, they will be jointly liable to contribute to the company's assets unless one of them can rely on the section 214(3) defence.[95] This money goes to the

[85] s 214(3).
[86] [2015] EWHC 2289 (Ch).
[87] ibid at [259].
[88] [2016] BCC 293.
[89] ibid at [244].
[90] ibid at [245].
[91] [1989] BCLC 520.
[92] Hannigan (n 79) 311.
[93] [1991] BCLC 491.
[94] Derek French, *Mayson, French & Ryan on Company* Law (37th edn, OUP 2021), 724.
[95] Vaccari and Ghio (n 77) 245.

company's general assets to be distributed amongst the company's creditors as per section 214(1) of the Insolvency Act 1986. Courts have discretion as to the order they can make so long as it goes to the company's assets.[96] However, orders cannot be made to specific creditors.[97] Vaccari and Ghio argue that since the contribution to the company's assets is not available for distribution to secured creditors except for the unsecured part of their claim, administrators and liquidators may be reluctant to commence expensive litigation procedures.[98] Thus, this may be a potential cause for the low number of claims.

(6) Conclusion

In conclusion, the regulation of wrongful trading under section 214 of the Insolvency Act 1986 could benefit from some reform. Whilst the government makes efforts to keep this provision up to date, as evidenced by the Covid-19 pandemic provisions which were somewhat unnecessary, the low number of proceedings suggests this is far from a perfect law. One criticism of section 214 is the lack of punishment for director misconduct. Unlike the criminal offence of fraudulent trading, wrongful trading is a purely civil offence and thus has no criminal sanctioning. Whilst directors may be ordered to contribute to the company's assets, this is limited to cases where a loss has resulted. Therefore, this is more compensatory rather than punitive. A better deterrence can be found in director disqualification which will be discussed in chapter five.

Nonetheless, section 214 has some merits which must not go unnoticed. The introduction of wrongful trading has been effective in the deterrence of improper trading as the standards of proof in fraudulent trading was perceived to be too high. Thus, where there is no fraud element, but the director has caused loss due to their continued trading when they knew the company was insolvent or impending insolvency, a claim can be brought under section 214. This allows creditors to receive some compensation for the amount of loss caused as a result of this trading. Furthermore, whilst there is a defence under section 214(3), this is strictly applied and places the burden of proof on the director to show they have taken every step possible to minimise loss.

D. THE REGULATION AND SANCTIONING OF FRAUDULENT TRADING; THE CIVIL AND CRIMINAL OFFENCE

(1) Introduction

This chapter will discuss the two aspects of fraudulent trading: the civil and criminal offence. Section 213 of the Insolvency Act 1986 provides for the civil offence of wrongful trading. However, unlike wrongful trading, fraudulent trading, is also a criminal offence under section 993 of the Companies Act 2006. Liability under section 993 may result in up to ten years imprisonment and fines.

The main difference between wrongful and fraudulent trading is intent. In fraudulent trading, the appellant must prove that the directors carried out business with the intention of purposefully defrauding the company's creditors. Section 213 and section 993 both provide that fraudulent trading refers to "any business of the company has been carried on with intent to defraud creditors of the company or creditors of any other person, or for any fraudulent purpose". Likewise with wrongful trading, directors liable for fraudulent trading may be ordered to contribute to the company's assets and face disqualification. This chapter will consider whether the regulation

[96] ibid.
[97] ibid.
[98] ibid.

and sanctioning of fraudulent trading under both section 213 and section 993 is effective to prevent directors (and others) from committing such offences.

(2) Dishonesty

Dishonesty is a key element in the offence of fraudulent trading.[99] Justice Laddie in *Bernasconi v Nicholas Bennett and Co* [2000] provides that "references to "intent to defraud", "for any fraudulent purpose" and "knowingly" all emphasise that the provision is only effective against those who have acted dishonestly".[100] Here, he referred to Maughham J's definition in *Re Patrick and Lyon Limited* [1933]; "the words "defraud " and "fraudulent purpose," where they appear in the section in question, are words which connote actual dishonesty".[101] Though dishonesty is not explicitly stated in the provisions, intention to defraud and common law implies that this is a key element which must be proved for a claim of fraudulent trading to suffice. Thus, raising the burden of proof on the applicant.

Furthermore, in *Pantiles Investments Ltd v Winckler* [2019], the court accepted that knowledge requires dishonesty.[102] Judge Mullen here refers to the test from *Ivey v Genting Casinos (UK) Ltd* [2017].[103] For the criminal offence of fraudulent trading, both the subjective and objective standard must be proven. Firstly, the defendant's state of mind will be considered with regards to their knowledge and belief. This does not concern whether it was reasonable but if it was honestly held. Secondly, the court must consider whether the defendant's conduct was honest by the objective standard of an ordinary person. However, as per *Welham v DPP* [1961], this test has proven problematic as actual dishonesty must be provided.[104] The high burden of proof in establishing dishonesty and intent to defraud has led to a lack of claims which will be discussed in chapter 4.3.

(3) Intent to Defraud

Trading with an insolvent company is not in itself sufficient for a claim of fraudulent trading, there must be an "intent to defraud". Fraudulent trading occurs when the business continues with an intention of defrauding the company's creditors or for some other fraudulent purpose. This is the main difference between the fraudulent and wrongful trading. However, "intent to defraud" has proven controversial by case law and academics due to its interpretation. Keay criticised that what is necessary to prove the directors had intention is problematic.[105] He directs this at how "intent to defraud" has never been statutorily defined which has led to inconsistency in the application and interpretation of the test.[106]

The interpretation of "intent to defraud" was firstly considered by Maugham J in *Re William C. Leitch Brothers Ltd* [1932], at the time, in relation to s 275 of the Companies Act 1929.[107] Nonetheless, its interpretation is still relevant for fraudulent trading in relation to its legislative successors. Maugham J here highlighted the difficulty of interpreting "intent to defraud" and sets out a test based on whether the director incurred debts when they knew there was no reasonable chance for the company to pay back its creditors. However, this was later narrowed in *Re Patrick*

[99] Lucy Jones, *Introduction to Business Law* (5th edn, OUP 2019) 526.
[100] [2000] BCC 921 [13].
[101] [1933] Ch 786, 790.
[102] [2019] EWHC 1298 (Ch).
[103] [2017] UKSC 67.
[104] [1961] AC 103.
[105] Andrew Keay 'Fraudulent Trading: The Intent to Defraud Element' (2006) CLWR 35 (2), 122.
[106] ibid at 122.
[107] [1932] 2 Ch 71.

and Lyon Ltd [1933], again by Maugham J stating that intent to defraud is concerned with actual dishonesty involving real moral blame.[108] Nonetheless, both definitions of "intent to defraud" are vague and has caused further uncertainty. As per Williams, Maugham J's attempt to define "intent to defraud" has caused more difficulty in its interpretation.[109] Similarly, Keay also provides that these two definitions have "been suggested on occasions, inconsistent". [110]

Whether the intent to defraud is present is dependent on the specific case itself.[111] This is for the court to decide based on the person's actions and conduct.[112] In *Re Augustus Barnett and Son Ltd* [1986], a subsidiary supported by its parent company continued trading even whilst making a loss.[113] The parent company continuously issued statements that it would support the subsidiary, some in letters known as 'comfort letters' published in the subsidiary's annual accounts. This continued for three consecutive years before the parent stopped its support and the subsidiary went into liquidation. Here, no fraudulent trading was found. Lord Hoffman J held that based on the facts of the case, the parent company had not intended to defraud the subsidiary's creditors. At the time the statements were made, the parent had an honest intention to support the subsidiary. Even though the parent company eventually stopped its support, this does not mean that its original statements were fraudulent. This case demonstrates the difficulties in establishing fraud which may potentially deter claims from being made.

The Company Law Committee report of 1962 considered the effects of the fraudulent trading provisions.[114] The Jenkins Committee criticised its inadequacy in dealing with the offence of fraudulent trading along with other directorial incompetence.[115] However, the report directed this criticism at the Board of Trade for its failure in bringing the cases to court, not the courts or legal draughtsman. Beekman and Ross suggest that the uncertainty of the standard of proof may have potentially contributed to this.[116] Even though the law has settled the issue of standard of proof, inconsistencies in its application has led to some uncertainty.[117] Both the Jenkin Committee and the Cork Committee have recognised the difficulties in its interpretation, however neither did much to resolve this issue. Thus, reform may be necessary to ensure certainty, as this will encourage claims to hold directors (and others) liable for fraudulent trading.

(4) The Civil Offence vs The Criminal Offence

Lord Steyn in *R v Hinks* [2001] provides that the purposes of civil law and the criminal law are in ways different.[118] Whilst the civil and criminal offence of fraudulent trading share many of the same characteristics, there are some distinct differences between the two. Fraudulent trading carries more serious sanctioning than wrongful trading due to criminal liability. As per section 993 "every person who is knowingly a party to the carrying on of the business in that manner commits an offence".[119] If found guilty, directors may face up to ten years imprisonment, thus, section 993 is a more effective deterrence than section 213. Furthermore, the criminal prosecution can be initiated even if the company is not yet insolvent.[120] This allows pre-emptive action to be brought

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[108] [1933] Ch 786, 790.
[109] R.C Williams, 'Fraudulent Trading' (1986) 4 C&SLJ 14, 26.
[110] ibid (n Keay) 125.
[111] Lee Roach, *Card & James' Business Law* (4th edn, OUP 2016), 642.
[112] Derek French, *Mayson, French & Ryan on Company* Law (37th edn, OUP 2021), 718.
[113] [1986] BCLC 170.
[114] Board of Trade, Report of the Company Law Committee (Cmnd 6659, 1962).
[115] ibid, 193.
[116] M. Beekman and S. Ross, 'Fraudulent or Wrongful Trading' (1991) 141 NLJ 1744.
[117] ibid.
[118] [2001] 2 AC 241.
[119] Companies Act 2006.
[120] Eugenio Vaccari and Emilie Ghio, *English Corporate Insolvency Law: A Primer* (1st edn, EE), 239.

against the director before the company is at an unsavable state preventing the company from entering insolvency.

Nonetheless, section 993 and section 213 share many of the same characteristics and conditions. The element of intention to defraud is present in both the civil and criminal offence, and similarly dishonesty. However, section 993 carries a higher standard of proof "beyond reasonable doubt". As a criminal law regulation, the claimant must prove beyond reasonable doubt that the defendant had the intention to defraud or act fraudulently. Nevertheless, there are not many differences between section 213 and section 993. This is highlighted by Keay who provides that there are not many apparent differences other than the procedural and burden of proof requirements.[121]

As per Hannigan, the civil offence of fraudulent trading is "less important now in the light of the provisions on wrongful trading in IA 1986, ss 214 and 246ZB".[122] He based this on how the burden of proof in fraudulent trading is much higher than the civil offence of wrongful trading and provides that liquidators or administrators are more likely to consider the civil offences as there is no need to establish intent to defraud.[123]

Nevertheless, fraudulent trading is still relevant as this can be used against a wider category of respondents whereas wrongful trading is only applicable to directors. A policy argument was made in *Bank of India v Christopher Morris & 6 Ors* [2005] that as the purpose of section 213 is to compensate those who have suffered loss because of fraudulent trading, it would defeat the purpose of this if liability was limited only to directors.[124] As per, it "would in practice defeat the effectiveness of the section if liability were limited to those cases in which the board of directors was actually a direct privy to the fraud of the company with whom the transactions were entered into".[125]

(5) Liability for Fraudulent Trading; Contribution to the Company's Assets

Likewise with wrongful trading, the same principles apply that directors could be made to make up for the loss that incurred while fraudulently trading. A liquidator or administrator can apply to the court for an order for the directors to contribute to the company's assets if liability has been found for either the civil or the criminal offence. As per section 213(2) of the Insolvency Act 1986 "the court … may declare that any persons who were knowingly parties to the carrying on of the business in the manner above-mentioned are to be liable to make such contributions (if any) to the company's assets as the court thinks proper". This is not only applicable to directors but also to any persons involved in the fraudulent activity. The funds from these orders will be shared amongst the company's creditors to compensate for the loss caused by the fraudulent trading.

However, similarly with wrongful trading, the aim of this is to compensate creditors for loss suffered due to the fraudulent trading rather than punish the guilty parties who conducted the offence. Courts do not have discretion to induce a punitive element to the orders.[126] As the aim is to compensate, this order can only be made where the fraudulent trading has caused a loss to the company or a 3rd party (likely creditor). *Instant Access Properties Ltd (in liq) v Rosser* [2018] held that even though the defendant fabricated false documents, they were not necessarily liable to contribute to the company unless a petitioner could prove that this fraudulent trading caused a

[121] Andrew Keay, *Company Directors' Responsibilities to Creditors* (1st edn, Routledge 2007), 39.
[122] Brenda Hannigan, *Company Law* (6th edn, OUP 2021) 303.
[123] ibid.
[124] [2005] EWCA Civ 693.
[125] ibid [112].
[126] Vaccari and Ghio (n 136) 241.

loss for the company or another party.[127] Here, Morgan J entirely dismissed the claim for fraudulent trading (along with the breach of fiduciary duty claim) despite the defendant's misconduct as no dishonesty was found.

Whether the court order to contribute to the company's assets is sufficient to deter directors and others from committing fraudulent trading is questionable. Under this provision, there is potential for the guilty party to avoid liability and punishment. Where section 993 applies, the guilty party may face criminal liability and imprisonment as a consequence of their actions. Furthermore, directors liable under section 213 may face disqualification.[128] However, where the guilty party liable under section 213 is not a director, the consequences they face are limited. They remain unaffected by director disqualification (though nonetheless may be disqualified from their role within the company) and where no loss has occurred, the court cannot make an order for the contribution of company assets. Though an argument could be made that there is no victim where no loss has occurred, this should not excuse the misconduct of the guilty party. By allowing these individuals to avoid repercussions sets a potentially dangerous precedent; of validating their misconduct and insubordination. Therefore, due to its limits, this may be insufficient to deter fraudulent trading.

(6) Conclusion

Overall, findings of liability for fraudulent trading have reduced since the introduction of wrongful trading. As the burden of proof in claims for fraudulent trading is high, this deters claims from being made and makes it more difficult to have a successful claim. The issue of fraudulent trading concerns its interpretation. Whilst not explicitly stated under section 213 nor section 993, dishonesty must be present and proven using the Ivey test.[129] There are also various issues concerning the phrase "intent to defraud" which has been subject to much interpretation by both courts and academics. Nonetheless, it remains that there is no official definition of this.

Unlike wrongful trading, liability for fraudulent trading holds the risk of criminal sanctioning. Those found guilty of fraudulent trading may face up to ten years imprisonment along with potentially additional fines, thus more is at stake for directors if found liable. Another consequence is the court may order the guilty director to contribute to the company's assets where their fraudulent trading has caused a loss. This also aims to compensate losses for the company and its creditors rather than punish the guilty director themselves like wrongful trading. however, where their trading is fraudulent, but they have not caused any losses to the company or any other third party, this order cannot be made and is thus limited. Therefore, whether this order is effective in the prevention of fraudulent trading is questionable. Though a director found guilty of fraudulent trading under section 993 may face criminal sanctioning, the civil offence under section 213 does not offer much to punish the director for their misconduct.

E. DIRECTOR DISQUALIFICATION; SUFFICIENT TO DETER?

(1) Introduction

Directors found guilty of wrongful or fraudulent trading may face disqualification for up to 15 years under the Company Directors Disqualification Act 1986 (CDDA 1986). Director disqualification proceedings are usually brought when the company is placed into insolvency

[127] [2018] EWHC 756 (Ch).
[128] s 10 Company Directors Disqualification Act 1986.
[129] *Ivey v Genting Casinos (UK)* Ltd [2017] UKSC 67.

proceedings.[130] When a company becomes insolvent or where there has been a complaint against a director, the company or the directors themselves will be investigated by the Insolvency Service. If the Service deems that a director has not followed their legal responsibility, they may face disqualification.[131] The Service will first inform the director in writing of their misconduct which deems them unfit and the intention to start the disqualification process.[132] In response, the director may wait for the Service to take them to court for a disqualification order or give a disqualification undertaking (though this is not available in wrongful and fraudulent trading).[133] Once disqualified, one will no longer be permitted to act as a director of a company registered in the UK or overseas companies with connections to the UK.[134]

Disqualification for participating in wrongful trading or the civil offence of fraudulent trading is covered by section 10 of the CDDA 1986. This provides that where a person liable under section 214 or section 213 of the Insolvency Act 1986 has been ordered to make a contribution to the company's assets, the court may if it deems fit, also make a disqualification order against them. Furthermore, disqualification for fraudulent trading under section 993 of the Companies Act 2006 is regulated by section 4 of the CDDA 1986. However, disqualification may also be ordered for a variety of other reasons, most commonly unfitness.[135] Therefore, even where the director is not liable for wrongful or fraudulent trading, they may still face disqualification if their conduct deems them unfit.[136] This aims to protect the public interest from limited liability abuse and unfit directors.[137] Whilst the primary purpose of disqualification is not to punish directors for misconduct, this does raise the standards of directors' practice and thus is an effective method in the deterrence of wrongful and fraudulent trading.[138]

(2) Effect of Disqualification

As per section 1(1)(a) of the CDDA 1986, one "shall not be a director of a company, act as receiver of a company's property or in any way, whether directly or indirectly, be concerned or take part in the promotion, formation or management of a company unless (in each case) he has the leave of the court". Section 1(1)(b) also provides that disqualified directors will not be permitted to act as insolvency practitioners. Furthermore, there are additional restrictions placed on disqualified directors.[139] If the disqualified director operated in a particular profession, for instance as an accountant or a solicitor, then their respective professional body may prevent them from operating during the disqualification period.[140] This limits the roles and job opportunities which a person can have within the company and thus deters directors from acting *ultra vires.*

Once the disqualification order is in effect, the disqualified director's details will be published on the Companies House database of disqualified directors[141] and the Insolvency

[130] Gareth Allen, 'Investigating company director misconduct' (*Insolvency Service Blog*, 2 October 2019) <https://insolvencyservice.blog.gov.uk/2019/10/02/investigating-company-director-misconduct/> accessed 9 March 2023.
[131] ibid.
[132] Gov.uk, 'Company director disqualification' (*GOV.UK*) <https://www.gov.uk/company-director-disqualification> accessed 9 March 2023.
[133] ibid.
[134] s 1(1)(a) CDDA 1986.
[135] Eugenio Vaccari and Emilie Ghio, *English Corporate Insolvency Law: A Primer* (1st edn, EE), 270.
[136] ibid.
[137] ibid at 269.
[138] ibid.
[139] Gov.uk (n 148).
[140] ibid.
[141] https://www.gov.uk/search-the-register-of-disqualified-company-directors.

Service's register of disqualified directors.[142] All of this information is public allowing anyone to search through these databases. This can be embarrassing and damaging to one's reputation and thus, deter directors from misconduct.

Section 10 of the CDDA 1986 provides for director disqualification for liability under section 213 or 214 of the Insolvency Act 1986. This is considered in *Secretary of State for Trade and Industry v Gill* [2004], which concerned two furniture companies that continued trading in an attempt to save the business even though it was in severe financial difficulties.[143] *Uno* accepted deposits from customers for orders which could later not be fulfilled. Though advised to, directors did not safeguard deposits by placing it into a trust account for the customers, and instead used this money to keep the business running. When the company eventually went into liquidation, an application was made for a directors' disqualification order. However, this was dismissed because the behaviour was realistic and reasonable as an attempt to save the business. Thus, whilst directors may face disqualification for wrongful or fraudulent trading, this can be avoided so long as the director's conduct was a reasonable attempt to save the business.

(3) Protection of the Public

The CDDA 1986 was introduced with the aim to protect the public interest from directors who may otherwise take advantage of the benefits of limited liability.[144] This ensures that directors give regard to all factors and do not prejudice stakeholders as well as the public. Most commonly, directors are not disqualified for criminal activity but for unfit conduct.[145] Director disqualification aims to protect the public rather than punish the guilty director.[146] Thus, questions arise of whether director qualification is sufficient to deter directors from committing such offence of wrongful or fraudulent trading. Scholars such as Williams critiques director disqualification as an ineffective form of regulation.[147] However, whilst its main aim is for the protection of the public, this does not diminish its effectiveness in deterring director misconduct in relation to wrongful and fraudulent trading.

In *Re Lo-Line Electric Motors Ltd* [1988], the director continued trading when he knew the companies were insolvent using unpaid Crown debts.[148] For this, the period of disqualification ordered was only three years because the respondent was not consciously dishonest. When considering what misconduct amount to disqualification, Sir Nicolas Browne-Wilkinson VC provides that "ordinary commercial misjudgment is in itself not sufficient to justify disqualification … the conduct complained of must display a lack of commercial probity".[149] Here, the court held that the primary purpose of disqualification was to protect the public from directors whose past records present them to be dangers to creditors. Hicks criticised that rather than considering the past, courts should examine evidence and likelihood of the director becoming a future danger to the public.[150] However, this will place a greater burden on courts and new issues will arise regarding the test for this. Nevertheless, as explained by Sir Nicolas Browne-Wilkinson VC, the "the power is not fundamentally penal".[151] The same principle is applied by Lord Woolf MR in *Re Westmid*

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142 https://www.insolvencydirect.bis.gov.uk/IESdatabase/viewdirectorsummary-new.asp.
143 [2004] EWHC 933 (Ch).
144 *Re Lo-Line Electric Motors Ltd* [1988] Ch 477.
145 Vaccari and Ghio (n 151) 270.
146 *Re Lo-Line Electric Motors Ltd* [1988] Ch 477.
147 Richard Williams, 'Disqualifying Directors: A Remedy Worse than the Disease?' (2007) JCLS 213.
148 [1988] Ch 477.
149 ibid at 486.
150 Andrew Hicks, 'Director Disqualification: Can it Deliver?' (2001) JBL 433, 447.
151 ibid at 486.

Packing Services Ltd (No 3), Secretary of State v Griffiths [1998].[152] However, whilst its primary purpose is to protect the public from unfit directors, this does not reduce its effectiveness as a deterrence for director misconduct in relation to wrongful and fraudulent trading as this promotes better director practice.

(4) Conclusion

Thus, director disqualification is an adequate deterrence for director misconduct in relation to wrongful and fraudulent trading. Though its main aim is to protect the public rather than punish the directors themselves, disqualification does effectively raise the standards of director practice. Whilst disqualification is ordered more commonly for unfit conduct rather than malpractice in relation to trading, this ensures operating directors are competent. Moreover, the lengthy period of disqualification of up to fifteen years is sufficient to deter as this is limiting on one's career options and growths. Furthermore, disqualified directors are published online for anyone to see, the negative publication can have detrimental effects on one's reputation. Therefore, by encouraging high standards of practice and placing restrictions on disqualified directors, this ensures they do not act ultra vires and commit offence such as wrongful and fraudulent trading.

F. CONCLUDING CHAPTER

Although directors do have fiduciary duties imposed on them to prevent misconduct, the doctrine of limited liability has caused issues.[153] The company operating as a separate legal entity entitles them to their own legal personality, property, and debts.[154] Therefore, when the company faces insolvency, the assets of its members and directors are protected. This however is more burdensome on the company's creditors who may suffer loss as a result. Thus, regulation on wrongful and fraudulent trading ensures that directors who continue trading when they knew or ought to have known that the company was in financial difficulties are held accountable preventing the abuse of limited liability.

Under the provisions on wrongful trading, liable directors may be ordered to contribute to the company's assets for the loss caused as a result of such trading. This more compensatory rather than penal approach may fail to dissuade directors from engaging in these activities. The liable directors may also face disqualification which is a much more effective deterrence as this is more consequential for the directors themselves. However, other than this, there is little punitive measures. Furthermore, courts are cautious when taking a strict approach as they do not wish for directors to place companies into insolvency procedures too soon where there is a possibility the business could be saved.[155] Thus, wrongful trading is rather underused, and the low number of claims suggests some reform may be beneficial to encourage more proceedings.

Fraudulent trading has a higher standard of proof than wrongful trading. This is potentially the reason for the low number of proceedings under this section.[156] However, unlike the civil offence of wrongful trading, fraudulent trading is also a criminal offence under section 993 of the Company Act 2006. As guilty directors may face up to ten years imprisonment, more is at stake, and this is therefore a better deterrence than the civil offences. Moreover, liability for fraudulent trading may also result in a court order for the contribution of the company's assets. However,

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[152] [1998] BCC 836, 843.
[153] Hans Hirt, 'The Wrongful Trading Remedy in UK Law: Classification, Application and Practical Significance" (2004) 1 ECFR 71.
[154] Geoffrey Morse and Thomas Braithwaite, *Partnership and LLP Law* (9th edn, OUP 2020), 318.
[155] Brenda Hannigan, *Company Law* (6th edn, OUP 2021), 307.
[156] A Herzberg 'Why Are There So Few Insolvent Trading Cases?' (1998) 6 ILJ 77.

unlike wrongful trading, this is not limited to directors but applies to all parties involved in the loss caused by the fraudulent trading.

Furthermore, directors found liable for wrongful or fraudulent trading may face disqualification for up to 15 years. Disqualification is arguably an equally or even more compelling remedy than personal liability, as directors would lose career and job opportunities. Thus, this paper found that disqualification is an adequate deterrence for director misconduct in relation to wrongful and fraudulent trading.

Overall, this dissertation proves that while the regulation and sanctioning of wrongful and fraudulent trading has its merits, the low number of claims suggest that some reform may be beneficial to make better use of the provisions. The high burden of proof (in fraudulent trading) and strict application of the tests to establish wrongful and fraudulent trading may be a cause of this. Furthermore, there are some flaws in the system such as ambiguity of "intent to defraud" in fraudulent trading where further clarification by the courts may be necessary. Finally, the lack of punitive measures for director misconduct is potentially why some liquidators and administrators are reluctant to bring claims. Therefore, due to the aforementioned reasons in this paper, the current systems are underused and may benefit from reform.

IS 'SAY-ON-PAY' THE MOST REASONED APPROACH TO EXECUTIVE REMUNERATION ACCOUNTABILITY?: AN ASSESSMENT OF THE MEANINGFULNESS OF UK AND US 'SAY-ON-PAY' FRAMEWORKS

*Zainab Sarhan**

A. INTRODUCTION
B. CONTEXTUALIZING THE LEGAL LANDSCAPE OF SAY-ON-PAY
C. A REVIEW OF THE WISDOMS OF SAY-ON-PAY
D. THE SHORTCOMINGS AND POTENTIAL IRRELEVANCE OF SAY-ON-PAY
E. ARE THE CURRENT SAY-ON-PAY FRAMEWORKS THE END ALL BE ALL SOLUTION FOR EXCESSIVE REMUNERATION?

A. INTRODUCTION

The issue of excessive executive remuneration is no stranger to scrutiny in numerous countries over the recent times.[1] The prominence of this debate, now more than ever, is largely attributable to the rise in shareholder activism, financial populism and the renewal of the public interest, particularly due to the most recent financial crisis, for 'exacerbat[ing]' income inequality.[2] Even though there is no standard definition for what exactly falls within the scope of 'excessive' compensation,[3] the contentiousness of this issue as the most 'egregious corporate governance failure' is well-founded, primarily considering that the ratio of CEO pay to average worker pay has increased from 20 or 30 to 1 in the 1960-70s to 200 or 300 to 1 in the past few years.[4] As a response, 'say-on-pay' legislation was introduced with the purpose of granting shareholders an advisory vote on the executive remuneration put forward by the board of directors. The pioneering legislator of this mandate is the UK in 2002, purportedly with the intention of promoting corporate governance efficiency within the corporation and increase the degree of accountability of the board to their shareholders.[5] Say-on-pay has grown increasingly common, with other states following the UK's steps, however the periodicity and the nature of the voting inevitably differ due to the varying degrees of 'concentration of ownership,…institutional ownership,…social tolerance toward income inequality, and certain political influences'.[6] The nature of say-on-pay later evolved into a dual-vote – an advisory vote on the annual remuneration report and a binding vote on the remuneration policy.[7] Having considered that, whether the growing political support for advisory say-on-pay on the remuneration report is rightly placed is a question that has been subjected to

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[1] Thomas A Hemphill and Wadeeha Lillevik, 'US "Say-on-Pay" Legislation: Is it Corporate Governance Overreach?' [2009] 51(2) International Journal of Law and Management 105-117, 107.

[2] Dean Baker, Josh Bivens, et al, 'Reining in CEO compensation and curbing the rise of inequality' (Economic Policy Institute, 4th June) <https://www.epi.org/publication/reining-in-ceo-compensation-and-curbing-the-rise-of-inequality/> accessed 19 December 2023; Thomas Picketty, *Capital in the Twenty-First Century* (1st edn, Harvard University Press 2014), 290.

[3] Stephani A Mason, et al, 'Say-on-Pay: Is Anybody Listening?' [2017] 20(4) Multinational Finance Journal 273–322, 281.

[4] Baker, Bivens et al (n 2); Picketty (n 2), 290.

[5] MJ Conyon and G Sadler, 'Shareholder Voting and Directors' Remuneration Report Legislation: Say on Pay in the UK' [2010] 18(4) Corporate Governance: An International Review 296-312, 297.

[6] Konstantinos Stathopolous and Georgios Voulgaris, 'The Importance of Shareholder Activism: The Case of Say-on-Pay' [2016] 24(3) Corporate Governance: An International Review 359-370, 362.

[7] Companies Act 2006, s. 439A(7)(a).

considerable academic debate.[8] Given how the US is known for its traditionally unwavering emphasis on 'business-friendly corporate laws', their introduction of say-on-pay is fairly monumental,[9] and it is certainly worthwhile to consider the legal developments and implications taking place there in comparison to the UK.

Therefore, this essay aims to contribute to the ongoing debate on the meaningfulness of 'say-on-pay' on the remuneration report as a corporate governance mechanism that aims to limit excessive executive remuneration and the harmfulness manifested by it in the UK and US. This will be achieved by contending that while this development in corporate governance has the potential to reduce the level of overly-exaggerated compensation packages, a greater emphasis needs to be placed on striking a balance between income fairness and aligning the interests of managers with shareholders to reduce overall agency costs. This argument will be made on the grounds that the current say-on-pay frameworks in the UK and the US are not only ineffectively designed, but also ineffectively utilized, given the observed low levels of voting dissent on remuneration policy.[10]

This essay will first examine the legal landscape of say-on-pay in the UK and US in section II, and then consider the benefits and shortcomings of say-on-pay in sections III and IV in relation to both jurisdictions. Lastly it will assess whether say-on-pay can be considered as the most reasoned approached to executive remuneration accountability by drawing on other mechanisms that could conceivably decrease excessive executive remuneration in section V.

B. CONTEXTUALIZING THE LEGAL LANDSCAPE OF SAY-ON-PAY

The controversy of the suggested 70% increase in the remuneration package of the CEO of British Gas Plc in 1994 triggered the enactment of the Directors' Remuneration Report Regulations in 2002 by virtue of s.257 of the Companies Act 1985.[11] It mandated the disclosure of executive compensation in an annual report submitted at the Annual General Meeting at an unprecedented degree of detail and granted shareholders an advisory vote to provide their assent or dissent of the remuneration report.[12] The effectiveness of this was bounded by shareholder apathy more often than not, as less than 10% abstain or voted against remuneration reports resolution.[13] It was speculated that the reason for this was either 'efficient monitoring, entrenchment issues or other firm related determinants'.[14] Meanwhile, the CEO pay in the UK grew a multiple of 47 times the average worker to 120 times between 1998 and 2010. The continuous concern regarding the disparity between the two and the aim of the legislation is justified when considering their repercussions on the productivity and incentives of employees and the broader impact on society at large through issues of fairness and distributive justice.[15]

Nevertheless, it is fair to deduce that the non-binding nature of the remuneration report vote is the reason for the lack of desired change and growth of executive pay as concluded by Ferri

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[8] Stephen M Bainbridge, 'Is 'Say on Pay' Justified?' (2009) UCLA School of Law, Law-Econ Research Paper No. 09-19/2009 < https://papers.ssrn.com/sol3/papers.cfm?abstract_id=1452761> accessed 19 December, 2023.

[9] Martin Petrin, 'Executive Compensation in the UK: Past, Present, and Future' [2015] 36(7) The Company Lawyer 196-204, 196.

[10] Ibid, 199.

[11] The Directors' Remuneration Report Regulations 2002; Lee Roach, 'The Directors' Remuneration Report Regulations 2002 and the Disclosure of Executive Remuneration' [2004] 25(141) The Company Lawyer 1-13, 1.

[12] Ibid, Sch.7A; ibid, 5.

[13] Conyon and Sadler (n 5), 297.

[14] Stathopolous and Voulgaris (n 6), 366.

[15] Petrin (n 9), 197.

and Maber's comparative study which considered firms between 2000 to 2002 and 2003 and 2005.[16] However, this overlooks that directors will have to face 'shareholder outrage' in case they proceeded with a compensation proposal that was largely voted against, of which can cause reputational harm and additional costs.[17] The circularity of this is amplified when considering that the majority of shareholders in the UK tend to be institutional investors who possess short-term goals and are not known for being engaged as stewards partaking in shareholder-activism.[18] The early and fragmented success of say-on-pay as an advisory vote is evident with the link established between the performance of a firm with executive remuneration, which in turn reduced executive rewards for failure.[19] It cannot be implied from this link that the legislation had any significant impact on the alignment of pay with performance.[20] The introduction of the say-on-pay framework in the UK was partly praised on the basis of the assumption that there is 'no doubt' that companies and their shareholders agree that it 'improved communication between boards and shareholders'.[21] Regardless, the 2002 say-on-pay was not without fault, as this success remains 'questionable'.[22] This is because relying on an integrated system of mandatory disclosure, an advisory vote, along with remuneration committees has not effectively lowered rising remuneration levels. [23] Furthermore, a wider scope of disclosure had an adverse impact in some instances, which could make the impact of say-on-pay redundant.[24]

The 2008 recession made shareholders, the public and the Government more 'acutely aware' of the excessive levels of executive remuneration.[25] As a result, shareholders' voices were strengthened with the introduction of additional disclosure regulations that were accompanied by the enactment of reforms in the Enterprise Regulatory Reform Act 2013.[26] This reform granted shareholders with a three-yearly binding vote on their company's remuneration policy every three years.[27] It also provided an advisory vote on the annual report on remuneration, which lays out the payments and benefits given to directors every financial year.[28] This change was perceived as 'over-engineered' and 'unlikely' to curb rising executive pay levels. This perception was validated, to some degree, by initial findings that reported that average CEO pay of FTSE 100 increased by 5%

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[16] Fabrizio Ferri and David A Maber, 'Say on Pay Vote and CEO Compensation: Evidence from the UK' [2011] 17(2) European Finance Review 527-563, 554.
[17] Lucian Ayre Bebchuk and Jesse M Fried, 'Executive Compensation as an Agency Problem' [2003] 17(3) Journal of Economic Perspectives 71-92, 75.
[18] Brian R Cheffins, 'The Stewardship Code's Achilles' Heel' [2010] 73(6) The Modern Law Review 1004-1025, 1004.
[19] Ferri and Maber (n 16), 554.
[20] Petrin (n 9), 199.
[21] Andrew Clark, 'US research backs Britain's 'say on pay'' (*The Guardian*, 5 March 2008) <https://www.theguardian.com/business/2008/mar/05/executivesalaries.useconomy> accessed 21 December 2023.
[22] Petrin (n 9), 199.
[23] Ibid, 199.
[24] Alan Dingam, 'Remuneration and Riots: Rethinking Corporate Governance Reform in the Age of Entitlement' [2013] 66(1) Current Legal Problems 401–441, 410.
[25] The Department for Business, Innovation and Skills, 'Executive Remuneration: Discussion Paper' (gov.uk, September 2011), 4 <https://assets.publishing.service.gov.uk/media/5a78cab040f0b6324769a335/11-1287-executive-remuneration-discussion-paper.pdf> accessed 21 December 2023.
[26] Large and Medium-sized Companies and Groups (Accounts and Reports) (Amendment) Regulations 2013; Charlotte Villiers, 'Executive Pay: A Socially-Oriented Distributive Justice Framework ' [2016] 37(5) Company Lawyer 139-154, 139.
[27] Enterprise Regulatory Reform Act 2013, s.79.
[28] Carsten Gerner-Beuerle and Tom Kirchmaier, 'Say on Pay: Do Shareholders Care?' (2018) The European Corporate Governance Institute Finance Working Paper 579/2018, 2 <https://www.ecgi.global/sites/default/files/working_papers/documents/finalgerner-beuerlekirchmaier.pdf> accessed 21 December 2023.

between the years 2012 and 2013.[29] While some caveats apply to the empirical data such as change in CEOs, the figures still provide valuable insight on the initial impact, or lack thereof, of complementing the advisory remuneration report vote with a binding say-on-pay vote.[30]

An advisory say-on-pay framework was set in the US through the Dodd-Frank Wall Street Reform and Environmental Protection Act 2010 to counterbalance the 'substantially greater powers' that UK shareholders held prior to its introduction.[31] The troublesome nature of executive compensation was also being recognized at a wider scale in the US, with 61% of corporate directors believing that the current compensation models are problematic in 2007.[32] The premise of this non-binding vote on both remuneration reports and policies was to handle the way in which remuneration arrangements 'often fail' to give executives the appropriate incentives to fulfill their fiduciary duty to maximize shareholder wealth and align both of their interests.[33] As this reform was modeled after the then-existing UK's say-on-pay, it provided shareholders with a three-yearly non-binding vote, a say on the frequency of the vote and the right to vote on executive severance packages.[34] However, it was met with stronger criticism than it did in the UK. It was argued that it would increase agency costs and would cause a 'federalization' of corporate governance legislation, which would in turn have harmful consequences on the way the capital market operates in the US.[35] Beyond such issues, it was also expected to cause a 'major overreach' to the available provisions that gave the board the authority to manage the pay-setting process.[36] Though, upon its application, boards were found to be reactive to negative say-on-pay votes by lowering excessive remuneration.[37] On the other hand, it was also reported that, like the UK, the number of dissatisfied shareholders with executive packages is generally low as negative says never exceeded 3% and has even dropped to 1.7% in 2016.[38] Additionally, say-on-pay did not 'significantly reduce' CEO remuneration as intended.[39] The reasoning for this will be further examined in sections III and IV.

C. A REVIEW OF THE WISDOMS OF SAY-ON-PAY

The underpinning of say-on-pay is to 'correct social harms' caused by excessive executive pay. Such harms are manifested by denying shareholders, employees and other contributing stakeholders of the portion of the benefits that executives tend to reap for themselves.[40] As a result of this denial, the political economy generating society's wealth may be endangered by 'diffused

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[29] High Pay Centre, 'High Pay Centre Briefing: The Effect of Executive Pay Reforms' (*High Pay Centre*, 2 June 2014) <https://highpaycentre.org/high-pay-centre-briefing-the-effect-of-executive-pay-reforms/> accessed 21 December 2023.
[30] Ibid.
[31] Stathopolous and Voulgaris (n 6), 363; The Dodd-Frank Wall Street Reform and Environmental Protection Act 2010; The Securities Exchange Act 1934, s.14A.
[32] Sandeep Gopalan, 'Say on Pay, and the SEC Disclosure Rules: Expressive Law and CEO Compensation' [2007] 35(2) Pepperdine Law Review 101-163, 102.
[33] Bainbridge (n 8), 43.
[34] Jill E Fisch, Dairius Palia, et al. 'Is Say on Pay All About Pay? The Impact of Firm Performance' [2018] 8 Harvard Business Law Review 101-129, 105.
[35] Bainbridge (n 8), 45.
[36] Hemphill and Lillevik (n 1), 114.
[37] Paul Hodgson, 'Surprise surprise: Say on Pay appears to be working' (Fortune, 8 July 2015)<https://fortune.com/2015/07/08/say-on-pay-ceos/> accessed 21 December 2023.
[38] Semler Brossy, '2016 Say on Pay Results: End of Year Report ' (*Semler Brossy*, 1 February 2017) <http://www.semlerbrossy.com/sayonpay> accessed 21 December 2023, 3-2.
[39] Fisch and Palia et al (n 34), 106.
[40] Mason (n 3), 309.

mistrust, resentment and anger'.[41] On the other hand, Walker suggests, the cost of excessive remuneration may be recognized as one that is 'borne solely' by the shareholders,[42] as they are the residual claimants of the remaining profits of the corporation.[43] Within this risk that they bear, shareholders expect managers to maximize the company's value, thereby maximizing their dividends.[44] This, however, tends not to be the case when managers prioritize the maximization of their own remunerations.[45] Therefore, the assumed advantage of using a shareholder-centric approach, that being say-on-pay, to curb very high executive pay, is that as the residual claimants, shareholders possess the incentive to effectively monitor the proportionality of the executives' pay with their performance.[46] This line of argument, however, is limited by the reality of shareholders being 'typically' unable to effectively conduct this monitoring function.[47] This is traceable to the collective action problem, as discussed by Berle and Means, both of whom contended that the diffusion of ownership amongst varying classes of shareholders reduces their incentive to participate in governance, based on the assumption that their vote would not influence the outcome.[48] Irrespective of that, say-on-pay is continuously rationalized with the agency-based theoretical model, built on the understanding that the separation between ownership and control manifests agency problems between the agent (directors) and the principal (shareholders). This rationale is reiterated by considering it against the lens of the 'managerial power perspective', which purports that weak governance structures enable the saturation of power with the CEO over the board and may enable them to act in their self-interest and control their own pay, thusly participating in rent extraction.[49] Nevertheless, the effective use of say-on-pay rests on the presumption that the board's decision will not be swayed by the costs and constraints of 'outrage' from relevant stakeholders.[50] In light of that, directors will be 'reluctant' in the first place to propose excessive compensation packages because of embarrassment or to avoid reputable harm, as evidenced in the past.[51] While this may lead to the inference that the board's reaction in fear of outrage could achieve the aims of say-on-pay by curbing the level of executive remuneration, the board could still resort to adopting 'camouflage' tactics to legitimize high executive pay.[52] In such cases, tighter transparency measures and enforcing a binding say-on-pay on the remuneration report may provide the oversight and control necessary. In that light, say-on-pay was still reasoned by some of the public to be 'a balanced, non-disruptive mechanism' for lessening agency costs, which are the 'most troubling and corrosive obstacles to the efficient operation of the market'.[53]

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[41] Ibid.
[42] David I Walker, 'Who Bears the Cost of Excessive Executive Compensation (and Other Corporate Agency Costs)' [2012] 57(3) Villanova Law Review 653-674, 671.
[43] Armen A Alchian and Harold Demsetz, ' Production, Information Costs, and Economic Organization' [1972] 62(1) American Economic Review 777-795, 782–783.
[44] Faith Bugra Erdem, 'The Steps Taken by Say-on-Pay towards Shareholder Primacy: An Anglo-Saxon Perspective' [2022] 5(1) Strathclyde Law Review 133-140, 137.
[45] Ibid.
[46] Sung Eun(Summer) Kim, 'Dynamic Corporate Residual Claimants: A Multicriteria Assessment' [2021] 25(1) Chapman Law Review 67-96, 85; Alchian and Demsetz (n 43) 782–783.
[47] Ibid.
[48] Adolf A Berle and Gardiner C Means, *The Modern Corporation and Private Property* (2nd edn, Routledge Taylor and Francis Group 1991) 76-82; FrankH Easterbrook and Daniel R Fischel, 'Voting in Corporate Law' [1983] 26(1) Journal of Law and Economics 395-427, 407.
[49] Robert F Gox and Thomas Hemmer, 'On the relation between managerial power and CEO pay' [2020] 69(2-3) Journal of Accounting and Economics 1-22,1.
[50] Bebchuk and Fried (n 17), 75.
[51] Ibid; Kenneth J Martin and Randall S Thomas, 'The Effect of Shareholder Proposals on Executive Compensation' [1999] 67(4) University of Cincinnati Law Review 1021-1082, 1064.
[52] Bebchuk and Fried (n 17), 76.
[53] N Minnow, 'Should shareholders have a say on pay?– Yes' (*Investment News*, 21 May 2007) <https://www.investmentnews.com/industry-news/news/should-shareholders-have-a-say-on-pay-yes-9201> accessed 21 December 2023.

In justifying say-on-pay, it is important to examine the alternative view to the managerial power perspective, which views the agency problem from the lens of the 'optimal contracting' perspective.[54] This popular view asserts that executive pay arrangements are set by the board with the objective of minimizing agency costs by maximizing shareholder value and aligning shareholder interests with directors' interest, by creating an 'optimal principal-agent contract'.[55] The limitations of this perspective primarily begins with traditional consensus that the CEO 'dominates' the director appointment process, considering the rather infrequent use of independent nominating committees.[56] Additionally, market forces, such as the market for managerial labor or corporate control, cannot be depended on to align shareholders' and directors' interests. Bebchuk, Fried and Walker convey this by referring to the unlikely risk of executive dismissal on the basis of executive compensation levels, as such an occurrence would be strongly dependent on the company's overall performance.[57] Further reiterating this is the argument that any added takeover risks are unlikely to deter executives from proposing the most generous pay possible for themselves.[58] Considering that, even though a rather dated study on Forbes 800 firms demonstrated that takeovers are more likely to take place in industries with overpaid CEOs, no difference was found between the remuneration levels of targeted and untargeted companies.[59] Current compensation practices mirror a blended mix of the optimal contracting and managerial power perspectives, therefore without any oversight from shareholders, it is plausible that managers will receive pay that is not so optimal, perhaps even not optimal for shareholders.[60] This demonstrates that the practice of say-on-pay is essential to reduce the level of executive compensation levels to some degree.

Say-on-pay on remuneration reports has the potential to transform the executive pay status quo for corporations with 'unusually excessive' remuneration arrangements, especially in poorly performing firms. While empirical data was yielded in support of that in both the UK and the US, where it was noted that boards have reacted to dissenting votes, it is important to note that this was only within the remit of firms with excessive CEO compensation as well as low financial performance.[61] Furthermore, the votes still had no significant general impact on the average level of CEO pay.[62] Even though the impact is reportedly limited to underperforming firms with overly excessive remuneration, it cannot be overlooked that say-on-pay has the prospective of putting a stop to 'rewards for failure' by enhancing the link between pay and performance.[63] However, the practice of this can demoralize not just executives but employees as well because the corporation's performance is based on a 'team's effort' in an environment generated by them as stakeholders.[64] It is important to consider that this could lead to a 'luck-based' pay practice where executives receive higher compensation if profits increase, even if this was manifested by external factors instead of their efforts.[65] Additionally, the rationale of 'pay for performance' embraces excessive executive pay if it is proportionate to the financial performance, which negates the purpose of say-on-pay in both the UK and US and brings into question whether 'pay for performance' is the

[54] Bebchuk and Fried (n 17), 71-76.
[55] Lucian A Bebchuk, Jesse M Fried and David I Walker, 'Executive Compensation in America: Optimal Contracting or Extraction of Rents?' (2001) National Bureau of Economic Research Working Paper No. 8661, 1-2 <https://www.nber.org/papers/w8661accessed> 25 December 2023.
[56] Ibid, 14.
[57] Ibid, 24.
[58] Ibid, 26.
[59] Ibid.
[60] Ibid, 3.
[61] Fisch, Palia, et al. (n 32), 103 ; Petrin (n 9), 199.
[62] Ibid.
[63] Ferri and Maber (n 16), 558.
[64] Jeffrey N Gordon, '"Say on Pay": Cautionary Notes on the UK Experience and the Case for Shareholder Opt-In ' [2009] 46(1) Harvard Journal on Legislation 323-367, 328.
[65] Bebchuk and Fried (n 16), 77

ultimate objective.[66] Having said that, even in light of the COVID-19 pandemic, the increase in investor scrutiny was still attributable to the strengthened spotlight on pay for performance, as the level of support received in the US for non-binding say-on-pay votes was less than 65% in 14 companies in the S&P 500 in 2021.[67] As Mason et al. contend, the say-on-pay movement was driven by the 'public interest theory' and was manifested to address market failures and develop public good.[68] The consideration of market forces as 'not sufficiently strong and fine-tuned' enough is a coherent argument when taking into account the limitations of the labor market for executives, the market for corporate control and capital.[69] This concern needs to be emphasized when attempting to achieve the desired outcomes of the 'optimal contracting model'.

Meanwhile, some of the notable success of say-on-pay is evidenced by the increased likelihood of boards to adopt 'reasonable' pay policies.[70] For instance, Imperial Brands Group in the UK was influenced by its investors to rescind a large bonus increase to their CEO.[71] On the other hand, BP Plc proposed a pay policy to cut the CEO's remuneration by 40%, which received considerable approval from their investors.[72] Regardless, these reactions to binding policy say-on-pay votes differs vastly to remuneration report non-binding votes. Exemplifying this is the binding 96% favoring vote to the company's remuneration policy with a simultaneous 58% opposing majority of shareholders in Crest Nicholson to the remuneration implementation report, yet the remuneration proposal remained unchanged.[73] The enforceability of the vote for remuneration implementation reports is still an issue in the UK and the achievement of 'public-good' is somewhat within reach if the harmful impact of that issue is unaccounted.[74] In all cases, the concern stands in the US as the weight of the policy vote has remained advisory since its implementation and is not supplemented with a binding vote on remuneration policy.[75] Despite some of these retrospective successes, the degree of meaningfulness of the dual vote say-on-pay in the UK in reducing excessive remuneration and achieving a sense of public-good is debatable given that the average CEO pay is 118 times that of the average UK worker whilst the latter is 'grappling' amidst the cost-of-living crisis in spite the increase of wages of most workers.[76]

D. THE SHORTCOMINGS AND POTENTIAL IRRELEVANCE OF SAY-ON-PAY

[66] Gordon (n 64), 328.

[67] Ben Ashwell, 'Support for Say-on-Pay Votes Continues to Erode in US, Warn Compensation Advisers' (*Governance Intelligence*, 21 May 2021) <https://www.governance-intelligence.com/shareholders-actisism/support-say-pay-votes-continues-erode-us-warn-compensation-advisers> accessed 21 December 2023.

[68] Mason (n 3), 284.

[69] Bebchuck and Fried (n 16), 74.

[70] Katarzyna Chalaczkiewicz-ladna, 'Failed reform of say on pay in the UK? The future of shareholder engagement with executive pay' [2019] 40(2) Company Lawyer 47-53, 48.

[71] Kate Burgess, 'Debt misaligns Reckitt's risk profile and shareholder returns' (*Financial Times*, 13 February 2017) <https://www.ft.com/content/61ba823e-f1d5-11e6-8758-6876151821a6> accessed 21 December 2023.

[72] Andrew Ward, 'Shareholders back BP move to cut chief's pay' (*Financial Times*, 17 May 2017) <https://www.ft.com/content/c0924a70-3b0f-11e7-821a-6027b8a20f23> accessed 21 December 2023.

[73] Judith Evans and Kate Burgess, 'Housebuilder Crest Nicholson loses vote on pay' (*Financial Times*, 23 March 2017) <https://www.ft.com/content/5f8a7042-0fe3-11e7-b030-768954394623> accessed 21 December 2023.

[74] Mason et al (n 3), 284.

[75] The Dodd-Frank Wall Street Reform and Environmental Protection Act 2010; The Securities Exchange Act 1934, s.14A.

[76] Jamie Nimmo, 'Pay Gap Widens Between CEOs and Employees at Top UK Firms' (*BNN Bloomberg*, 18 December 2023) <https://www.bnnbloomberg.ca/pay-gap-widens-between-ceos-and-employees-at-top-uk-firms-1.2012987#:~:text=The%20CEOs%20of%20companies%20included,cost%2Dof%2Dliving%20crisis.> ace sed 21 December 2023; ICAEW insights, 'Executive pay rises amid cost-of-living crisis' (Institute of Chartered Accountants in England and Wales ('ICAEW'), 31 August 2023) <https://www.icaew.com/insights/viewpoints-on-the-news/2023/aug-2023/executive-pay-rises-amid-costofliving-crisis> accessed 21 December 2023.

Bainbridge unwaveringly contended that the framework of 'say-on-pay' continues to be equivalent to that of a 'toothless tiger'.[77] His argument is sustained by the observable pattern of shareholders 'rubber-stamping' CEO pay, which is conveyed in the Sembler Brossy report on say-on-pay votes in 2021 in Russell 3000 companies which indicated a rise in the rate of majority dissatisfied shareholders from 1.9% to 3.3%.[78] Even though shareholder votes on remuneration reports are found to be the most capable of attracting dissents than other resolutions, it remains unguaranteed that shareholders' voices will be taken into account and that the remuneration report will be improved as say-on-pay does not have 'real teeth'.[79]

In a much broader context, it is arguable that the say-on-pay frameworks in the US and the UK aim to solve a matter that cannot be considered as problematic.[80] The exponential growth of executive compensation is unquestionable; however, it has remained open to question time and time again whether this should be a cause for concern.[81] This is especially the case when considering that other occupations generate pay as generous as executives', if not more, such that being actors, footballers, investment bankers to name a few.[82] This renders the framework as a 'lukewarm' attempt to 'fix' something that is not 'broken'.[83] Then again, this would overlook the fact the executives have the freedom to set their own pay and do not bargain at arms-length in the manner that other employees do.[84] Alternatively, the degree of academic anticipation towards the failure of the say-on-pay framework in reducing excessive executive remuneration could perhaps convey that, despites its intended purpose to do so in design, it cannot resolve all issues within that context.[85] It is instead an 'important step' toward enhancing 'boardroom practices', which is one of the many external factors affecting executive pay.[86]

One of the many other rationales reiterating Bainbridge's view is the low frequency of shareholder dissent to high executive compensation policies. The effective application of say-on-pay rests on the consensus that shareholders do not have their own 'individual investment horizon' or aggregately diversified portfolios to rely on.[87] This is clearly not the case as the size of each investor's holdings vary.[88] While rational shareholders are expected to intervene by making a well-informed decision regarding executive remuneration if the benefits outweigh the costs, this remains as a rather rare occurrence because they hold diversified stocks and ultimately just care

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[77] Stephen Bainbridge, 'Say on Pay Remains a Toothless Tiger: So What's the Point?' (*ProfessorBainbridge.com*, 04 June 2021) <https://www.professorbainbridge.com/professorbainbridgecom/2021/06/say-on-pay-remains-a-toothless-tiger-so-whats-the-point.html> accessed 21 December 2023.

[78] Ibid; Semler Brossy, '2021 Say on Pay Reports 2021 Russell 3000 Average Vote Stays Consistent with Prior Years Despite an Uptick in Failures' (*Semler Brossy*, 27 January 2022) <https://semlerbrossy.com/insights/2021-say-on-pay-report/#:~:text=2021%20Say%20on%20Pay%20Reports%202021%20Russell%203000%20Average%20Vote,Despite%20an%20Uptick%20in%20Failures&text=Our%20year%2Dend%20report%20recaps,uptick%20in%20failures%20(63).> accessed 23 December 2023.

[79] Bainbridge (n 77); Chalaczkiewicz-ladna (n 70), 50; Gerner-Beuerle and Kirchmaier (n 28), 7.

[80] Bainbridge (n 8), 42.

[81] Ibid, 44

[82] Ibid, 42

[83] Petrin (n 9), 204.

[84] Bainbridge (n 8), 42-43.

[85] David F. Larcker, Brian Tayan, et al, 'Ten Myths of 'Say on Pay'' (2012) Stanford Closer Look Series: Topics, Issues and Controversies in Corporate Governance (No. CGRP-26), 2 <https://ssrn.com/abstract=2094704> accessed 23 December 2023.

[86] Keith L Johnson and Daniel Summerfield, 'Shareholder Say on Pay – Ten Points of Confusion' (2008) Harvard Law School Forum on Corporate Governance, 2 <https://corpgov.law.harvard.edu/wp-content/uploads/2008/11/say-on-pay-ten-points.pdf> accessed 23 December 2023.

[87] Mason et al (n 3), 310.

[88] Ibid.

about the firm's overall performance.[89] However, studies have found that institutional investors and mutual funds are more likely to vote against 'abnormally' high executive pay if they hold a lower fraction shares within their portfolios, meanwhile another study finds that short-term institutional investors are more likely to abstain as a way to avoid monitoring costs .[90] Regardless, it is important to note that investors' behavior tends to 'deviate from economic rationality', whilst some retail investors might prefer to exercise rational apathy.[91] This inconclusiveness significantly impacts voting patterns,[92] which reduces say-on-pay's ability to reduce overall excessive executive remuneration.

On the other hand, based on the premise of director primacy, the matter of executive remuneration should not be subjected to much shareholder interference.[93] The exercise of effective board accountability by shareholders is hindered by information asymmetry and report complexity, which could lead to confusion about the criteria used in pay reports or possessing insufficient information of comparative groups' income from consultants.[94] Such asymmetry may take place when shareholders carry the onus of higher monitoring costs than of residual losses resulting from suboptimal monitoring.[95] Within the scope of that issue, it has been contended that the lack of accessible readability of remuneration reports in the UK are used as a ploy to 'bamboozle' shareholders into assenting for high pay based on the finding that '17 years of education - or a post graduate qualification' are essential to comprehensively decipher and vote on the report.[96] On the other hand, the use of 'plain English' rule may have significant impact on the length of the report, which also hinders its readability.[97] Furthermore, shareholders may base their decisions on their own short-term goals, which can be harmful to other stakeholders in the firm, or they may depend on proxy vote advisors.[98] The latter raises new issues of accountability related to conflicts of interests as such advisors tend to want to please directors.[99] Inevitably, shareholders will recognize the high cost of obtaining adequate information required to effectively interfere in corporate management and will therefore abstain from doing so.[100] It is clear that majority of shareholders prefer not to 'second-guess' the board, given that no 'shareholder revolt' has taken place.[101] The current utilization of say-on-pay, or lack thereof, reaffirms that an inherent sense director-primacy norm prevails to some degree, which hinders the meaningfulness of say-on-pay in reducing excessive executive remuneration.

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[89] Ibid, 307-308.
[90] Ibid, 299; Miriam Schwartz-Ziv and Russ Wermers, 'Do Institutional Investors Monitor their Large-Scale vs. Small-Scale Investments Differently? Evidence from the Say-On-Pay Vote' (2022) European Corporate Governance Institute (ECGI) - Finance Working Paper No. 541/2017, 35 <https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3096745> accessed 23 December 2023; Konstantinos Stathopoulos and Georgios Voulgaris, 'The Impact of Investor Horizon on Say-on-Pay Voting' [2016] 27(4) British Journal of Management 796-818, 798.
[91] Ibid, 308; David A Hoffman, 'The "Duty" to be a Rational Shareholder' [2006] 90(1) Minnesota Law Review 537-611, 543.
[92] Mason et al (n 3), 299.
[93] Jingchen Zhao and Zhihui Li, 'The Regulatory Framework of Executive Remuneration: Contributions from Shareholder Activism and Board Accountability' [2019] 15(2) Hastings Business Law Journal 203-252, 224.
[94] Charlotte Villiers, 'Executive Pay: Beyond Control' [1995] 15(2) Legal Studies 260-282, 264.
[95] Walker (n 42), 671.
[96] Tamara Heath, 'Companies bamboozling shareholders into voting for big pay rises for executives' (*The University of Melbourne - Newsroom*, 4 May 2023) <https://fbe.unimelb.edu.au/newsroom/companies-bamboozling-shareholders-into-voting-for-big-pay-rises-for-executives> accessed 1 January 2024.
[97] Reggy Hooghiemstra, Yu Flora Kuang and Bo Qin, 'Does obfuscating excessive CEO pay work? The influence of remuneration report readability on say-on-pay votes' [2017] 47(6) Accounting and Business Research 695–729, 696.
[98] Petrin (n 9), 197.
[99] Ibid, 203.
[100] Bainbridge (n 8), 47.
[101] Mason et al (n 3), 310.

The root of the concerns against say-on-pay is applicable to the UK and US as it lies with the 'inhibit[ion]' of the boards and executive management's ability to model the optimal remuneration package that maximizes the welfare of the contracting parties.[102] Exemplifying this are companies willing to offer high pay to 'attract, motivate and retain' their directors in response to the internationalization of the labor market.[103] Considering the 'deep' pool of talent that the US has, directors with US board past experience are on somewhat of a pedestal, as they tend to receive higher compensation than those that do not globally.[104] Even though high pay was perceived as 'demoralizing' by some, a recent study finds that there is a 'general employee insensitivity' towards CEO pay and that negative effects are conditional upon high media coverage of the remuneration and over-compensation specifically in the financial sector.[105] The case for reducing executive remuneration by the implementation of report remuneration say-on-pay is rather weak when a UK-based company wants to either compete with US-based companies or even attract a director with US-board experience.[106]

Beyond that, the concern of the federal legislation of say-on-pay in the US is that it reinforces the federalization of corporate law, which has an adversarial impact on the operation of the capital market in the US.[107] This simplistic 'one-size-fits all' model of governance constrains states from utilizing the 'valuable opportunity' of trying 'novel social and economic experiments' without risking other states, which could potentially produce an efficient corporate law rule addressing the issue of excessive executive remuneration.[108] Though, relying on individual states to provide this efficient corporate law rule is highly optimistic, and runs on the risk that a state might abstain from providing any kind of oversight, because directors are viewed as 'platonic guardians' of a corporation.[109] Alternatively, there is no guarantee that this hypothetical rule will have any meaningful impact on reducing excessive executive remuneration.

E. ARE THE CURRENT SAY-ON-PAY FRAMEWORKS THE END ALL BE ALL SOLUTION FOR EXCESSIVE REMUNERATION?

In spite of the many shortcomings of the dual vote say-on-pay that were addressed, claiming that its potential is 'superfluous' would be very misguiding.[110] Rather, its current application is unsatisfactory and the meaningfulness of say-on-pay as a legal tool to reduce excessive remuneration can be enhanced by strengthening it. In conjunction with the vote, it is highly

[102] Hemphill and Lillevik (n 1); Claudine Mangen and MIchel Mangan, '"Say on Pay": A Wolf in Sheep's Clothing?' [2012] 26(2) Academy of Management Perspectives 86-104, 87.
[103] Ernestine Ndzi, 'UK Shareholder Voting on Directors' Remuneration: Has Binding Vote Made Any Difference?' [2017] 38(5) Company Lawyer 139-149, 148.
[104] Randall Thomas and Brian R Cheffins, 'The Globalization (Americanization?) of Executive Pay ' [2004] 1(2) Berkley Business Law Journal 233-290, 256.
[105] Jospeh J Gerakos, Joseph D Piotroski and Suraj Srinivasan, 'Do US Market Interactions Affect CEO Pay?: Evidence from UK Companies' (2011) Harvard Business School Working Paper 11-075, 11 <https://www.hbs.edu/ris/Publication%20Files/11-075_0646e2d8-cbc6-49af-a694-0149594ce1e1.pdf> accessed 25 December 2023.
[106] Ibid, 31.
[107] Stathopolous and Voulgaris (n 6), 363, Bainbridge (n 8), 45.
[108] H Kent Baker and Rob Weigand, 'Corporate Dividend Policy Revisited ' [2015] 41(2) Managerial Finance 126-144, 139; Bainbridge (n 8), 46; *New State Ice Co. v. Liebmann*, 285 U.S. 262 (1932), 285.
[109] Stephen Bainbridge, 'Director Primacy in Corporate Takeovers: Preliminary Reflections' [2002] 55(1) Stanford Law Review 791-818, 791.
[110] Christoph Van der elst, 'A Plea for a Better Response to a Failed Say on Pay Vote' (*The CLS Sky Blue Blog*, 26 August 2016) <https://clsbluesky.law.columbia.edu/2016/08/26/a-plea-for-a-better-response-to-a-failed-say-on-pay-vote/> accessed 25 December 2023.

recommended to enforce employee engagement in pay-related decisions through employee representatives, as an extension of Regulation 13 of the Companies (Miscellaneous Reporting) Regulations 2018 with a clearer scope. This is advantageous because employee representatives are strongly argued to have incentives to prevent expropriations and manipulations in earnings, hold very firm-specific knowledge and have a long-term interest in the company, as opposed to retail and short-term institutional investors.[111] Based on the rational choice theory, the behavior of other employees in the company is 'completely determined' by incentives, including an overall sense of fairness and risk aversion, which can be manifested with the implementation of this suggestion.[112] However, based on behavioral economics, people tend to make decisions in methods that 'systematically departs' from what has been predicted by the rational choice theory.[113] In that light, the enactment of a compulsory requirement of that nature is easier said than done, as it was previously considered by the Government in the UK and was dismissed from the 2016 published reports.[114] Because the business community strongly rejected this proposal and the distortion it may cause to the unitary-board system, a non-compulsory form of employee board representatives was introduced in 2018.[115] While the enforcement of employee involvement in the executive pay-setting process could be transformative in employee-management engagement and reducing excessive executive remuneration as the empirical evidence from the German jurisdiction demonstrates,[116] it can be predicted that it will not be well-received by the business communities in the UK and the US. This prediction is based on the past reception in the UK and the complexities associated with the call for federal legislation for employee-board representatives in the US which would entangle corporate state law with federal labor law.[117]

Encouraging the increase of the percentage value of the long-term incentive plans ('LTIPs') from the overall compensation package, by setting a specific cap on the number of shares that can be issued under LTIPs, could enhance the impact or say-on-pay. While LTIPs have been rising in popularity amongst companies, as most are using three to four different schemes to renumerate their top executives,[118] the enforcement of such a specific percentage value and cap on shares would prompt performance-based payments on a wider scale. Moreover, this restriction on LTIPs can limit the nullification of the shares through unloading and hedging transactions in order to reduce risk-bearing costs, essentially offsetting any possible gains or losses.[119] Specifically with the introduction of environmental, social and governmental ('ESG') metrics, management will be highly incentivized to 'deliver change' given the tensions between maximizing profits and the changes required to mitigate ESG matters.[120] Furthermore, environmental and sustainable metrics

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[111] Conny Overland and Niuosha Samani, 'The Sheep Watching the Shepherd: Employee Representation on the Board and Earnings Quality' [2021] 31(5) European Accounting Review 1299-1336, 1299.
[112] Stephen M Bainbridge, 'Law and Economics' in Stephen M Bainbridge (ed*), Corporation Law and Economics* (New York Foundation Press 2002) 18-38, 23.
[113] Ibid, 25.
[114] Tobore O Okah-Avae, 'Recent Developments in Executive Pay Legislation: How Effective Have These Been in Making Executive Pay Fairer? ' [2019] 30(6) International Company and Commercial Law Review 327-339, 334.
[115]Financial Reporting Council (FRC), UK Corporate Governance Code 2018 (FRC, July 2018), 5 <https://www.frc.org.uk/library/standards-codes-policy/corporate-governance/uk-corporate-governance-code/#:~:text=UK%20Corporate%20Governance%20Code%202018%20(Current%20edition),-Current%20edition&text=The%20Code%20is%20separated%20into,'comply%20or%20explain'%20basis> accessed 25 December 2023.
[116] Felix Hörisch, 'The Macro-Economic Effect of Co-determination on Income Equality' (2012) Working Paper 147/2012 <https://www.mzes.uni-mannheim.de/publications/wp/wp-147.pdf> accessed 25 December 2023.
[117] Lenore Palladino, 'Economic Democracy at Work: Why (and How) Workers Should be Represented on US Corporate Boards' [2021] 1(3) Journal of Law and Political Economy 373-396, 375.
[118] Martin and Thomas (n 49), 1030.
[119] Nitzan Shelon, 'Replacing Executive Equity Compensation: The Case for Cash for Long-Term Performance' [2018] Delaware Journal for Corporate Law (Forthcoming) 1-40, 8
[120] PwC, 'Brining ESG into Executive Pay' (*PwC*, 2020), 2 <https://www.pwc.co.uk/human-resource-services/pdf/bringing-esg-into-executive-pay-v3.pdf> accessed 28 December 2023

are pragmatically long-term in nature and will encourage long-term strategic focus.[121] Even though LTIPs, used in conjunction with say-on-pay, has the potential to decrease the excessive levels of executives' remuneration, the concerns discussed in section III regarding pay-for-performance still stand. Perhaps, the most effective way to enhance the ability of say-on-pay to reduce excessive executive remuneration is to set pay caps.[122] Because of its restrictive nature and conflict with the foundation of the free market that the UK and the US operate in,[123] it is unsurprising to predict that this suggestion will not be very welcomed nor enforced in the foreseeable future.

Given that the policy vote is non-binding in the US, some American scholars agree that a possible way for shareholders of US-based companies to demonstrate their dissatisfaction would be to 'vote with their feet' through selling all or part of their shares.[124] This is more of a quick-fix band-aid solution for shareholders themselves due to the lack of teeth in their votes, resultantly this will not prompt a reduction of executive pay or any meaningful impact on distributive justice as they can be easily replaced by other investors. Meanwhile, strengthening shareholder education on the impact of their utilization of the advisory say-on-pay on the way that they hold their board accountable, as well as the company's performance, has some degree of potential to create a governance-related changes to the current pay practices. The success of this and its ability to create value would largely depend on the board responsiveness – which cannot be guaranteed – and whether the vote has a binding impact.[125]

F. CONCLUSION

The dilemma posed by the current pay practices reflects the broader issues reflecting the toxicity in the free-market capitalist system.[126] Theoretically, a say-on-remuneration report has the potential to play some part, however miniscule, in reducing exorbitantly high executive pay. However, the success of that would be not only be contingent upon the overly optimistic creation of a holistic change in shareholder behavior and attitude, but also in changing its nature to binding. The grant of advisory power by the US framework is more limited, given that both policy and remuneration report votes are advisory, and is arguably implemented as a political response to 'popular outrage'.[127] While several suggestions were made to enhance the say-on-pay framework, the preservation of the existing model in the UK and US, as Villiers reiterates bearing in mind the current business climate, is likely to cause disappointment.[128] Having examined the extent to which say-on-pay on remuneration reports is meaningful in reducing excessive executive pay, it is evident that the attitude and degree of rationality of shareholders towards using their own voice have both played a significant role in the ineffective use of the vote. Needless to say, the issues surrounding say-on-pay are so much more deep-seated, to the point where the interests of managers and shareholders and more often than not, unaligned. It remains of the utmost significance that the

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[121] Ibid, 4.
[122] Okah-Avae (n 114), 336.
[123] Ibid.
[124] Stathopoulos and Voulgaris (n 6), 360.
[125] Jie Cai and RalphA Walking, 'Shareholders' Say on Pay: Does It Create Value?' [2011] 46(2) The Journal of Financial and Quantitative Analysis 299-339, 325.
[126] Villiers (n 26), 153; High Pay Commission, Cheques With Balances: why tackling high pay is in the national interest (High Pay Center, 2021), 68 < https://highpaycentre.org/wp-content/uploads/2020/10/Cheques_with_Balanceswhy_tackling_high_pay_is_in_the_national_interest.pdf> accessed 25 December 2023.
[127] Hemphill and Lillevik (n 1), 114.
[128] Villiers (n 26), 154.

appropriate steps are undertaken to eliminate the weaknesses of the current say-on-pay model in order to reduce high executive payments and to foster a sense of distributive justice.

DEFENDING CLIMATE ACTION IN INVESTOR-STATE DISPUTE SETTLEMENT (ISDS): AN ANALYSIS OF FAIR AND EQUITABLE TREATMENT (FET) AND THE RIGHT TO REGULATE IN THE AGE OF THE ENERGY TRANSITION

*Maxron Holder**

A. INTRODUCTION

B. A SPACE FOR DEFENDING CLIMATE ACTION IN INTERNATIONAL INVESTMENT LAW UNDER THE FET STANDARD?

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- **(2) Climate Action and FET: What is the Scope of Investor Protection?**
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C. CREATING A SAFE HARBOUR FOR DEFENDING CLIMATE ACTION: THE RIGHT TO REGULATE

- **(1) Definition of the Right to Regulate**
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E. WHY NOT MODERNISE THE IIAS?

F. CONCLUSIONS

A. INTRODUCTION

Climate Change is the most catastrophic challenge of contemporary times. There is an abundance of scientific evidence supporting it as a significant global challenge, with human activity being the main contributing factor.[1] This phenomenon is largely caused by the emission of greenhouse gases into the atmosphere, a majority of which is a result of the use of fossil fuels for energy production, which according to Climate Watch, accounted for about 73.2% in 2016 of all worldwide

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[1] Intergovernmental Panel on Climate Change, *Climate Change 2013: The Physical Science Basis. Contribution of Working Group I to the Fifth Assessment Report of the Intergovernmental Panel on Climate Change*' <https://www.ipcc.ch/site/assets/uploads/2018/02/WG1AR5_all_final.pdf> accessed 03 May 2023, which stated that climate change is real and human activity is the main contributor. The IPCC report issued in 2022 determined that behavioural change played a crucial role in the fight against climate change. *See also*, Paul Nicklen, '26 Facts That Bring Home the Reality of Climate Change' (*National Geographic*, 5 November 2021) <https://www.nationalgeographic.co.uk/26facts>accessed 3 June 2023.

emissions.[2] As a result, States signed ambitious international conventions on climate change,[3] and have since then taken steps to shift from traditional fossil-fuel-based energy sources to low-carbon renewable energy sources in pursuit of an ambitious long-term goal to limit global warming below 2° Celsius.[4] This has led to what is known as the 'energy transition'. It involves a shift towards renewable energy such as wind, solar, and hydroelectric power, away from traditional sources such as oil, coal, and natural gas, among others.[5] However, this transition to renewable energy faces several obstacles, prominent is the law protecting foreign direct investments, and investor-state dispute settlement (ISDS). Most fossil-fuel-based energy companies are multinationals, and foreign investors (investors), and their investments are often protected by multiple International Investment Agreements (IIA) and Free Trade Agreements (FTA) with an investment chapter (both IIAs and FTAs are referred to as IIAs in this article). Thus, while climate change-related policies may be necessary to tackle climate change and the goals of the energy transition, they raise important legal questions,[6] impugning the standards of protection such as most-favored-nation treatment (MFN), national treatment, fair and equitable treatment **(**FET**)**, and protection against expropriation.

As a result of these contentious actions, several countries have chosen to withdraw from IIAs that protect fossil-fuel-based energy investments such as the Energy Charter Treaty (ECT). For Example, the United Kingdom announced its withdrawal in 2024,[7] Denmark announced its withdrawal in 2023,[8] Spain, Germany, and the Netherlands in 2022.[9] Consequently, for the ECT, unless it is terminated its provisions continue to apply to investments made for 20 years from such

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[2] Hannah Ritchie and Max Roser, 'CO2 and Greenhouse Gas Emissions' (Our World in Data 2020) <https://ourworldindata.org/emissions-by-sector#energy-use-in-industry-24-2> accessed 03 May 2023

[3] UN Framework Convention on Climate Change (adopted 09 May 1992, entered into force 21 March 1994) 1771 UNTS 107 (UNFCCC); Paris Agreement (adopted 12 December 2015, entered into force 4 November 2016) U.N. Doc. FCCC/CP/2015/L.9/Rev/1.

[4] Intergovernmental Panel on Climate Change, *Climate Change 2022: Mitigation of Climate Change. Contribution of Working Group III to the Sixth Assessment Report of the Intergovernmental Panel on Climate Change*' <https://www.ipcc.ch/report/ar6/wg3/downloads/report/IPCC_AR6_WGIII_FullReport.pdf> accessed 3 June 2023. *See also* Sebastian Modak, '10 Countries Doing the Most to Fight Climate Change' (*Condé Nast Traveler*, 2 June 2017) <https://www.cntraveler.com/gallery/countries-doing-the-most-to-fight-climate-change> accessed 3 June 2023.

[5] UNDP, 'Energy Transition: United Nations Development Programme' (*UNDP*) <https://www.undp.org/energy/our-work-areas/energy-transition> accessed 3 June 2023.

[6] Pekka Niemelä and others, 'Risky Business: Uniper's Potential Investor-State Dispute against the Dutch Coal Ban' (*EJIL*, 19 March 2020)< https://www.ejiltalk.org/risky-business-unipers-potential-investor-state-dispute-against-the-dutch-coal-ban/ > accessed 3 June 2023.

[7] Graham Stuart, 'UK withdrawal from the Energy Charter Treaty' (UK Parliament, 22 February 2024) <https://questions-statements.parliament.uk/written-statements/detail/2024-02-22/hcws279> accessed 16 March 2024.

[8] Susannah Moody, 'Denmark Announces Plans to Exit ECT' (*Global Arbitration Review*, 14 April 2023) <https://globalarbitrationreview.com/article/denmark-announces-plans-exit-ect> accessed 6 June 2023.

[9] Toby Fisher, 'Spain Announces Withdrawal from ECT' (*Global Arbitration Review*, 13 October 2022)<https://globalarbitrationreview.com/article/spain-announces-withdrawal-ect> accessed 6 June 2023; Rachel More, 'German Cabinet Approves Exit from Energy Charter Treaty' (*Reuters*, 30 November 2022) <https://www.reuters.com/business/energy/german-cabinet-approves-exit-energy-charter-treaty-2022-11-30/> accessed 6 June 2023; Lisa Bohmer, 'Dutch Government Announces Intention to Withdraw from Energy Charter Treaty' (*Investment Arbitration Reporter*, 18 October 2022) <https://www-iareporter-com.ezproxy.is.ed.ac.uk/articles/denmarks-government-announces-intention-to-withdraw-from-the-ect/> accessed 6 June 2023.

date.[10] Other IIAs must also be terminated. Thus recently, due to the rights guaranteed under IIAs, several multinational companies have requested arbitrations due to the effects and expected consequences of sweeping climate change measures (climate action) implemented, ranging from indirect expropriation to a breach of FET. This article will be limited to FET.

This article argues that defending climate action in ISDS during the energy transition requires balancing FET with the Host State's (State) 'right to regulate', even without an expressed treaty carve-out. This carve-out would cover reasonable measures linked to reducing greenhouse gas emissions. Part II provides an overview of recent climate action and the challenges posed by ISDS. Then, it conducts a legal analysis of FET, highlighting the barriers to defending climate action. Part III then goes on to explore the potential solution of utilising the general principle of the 'right to regulate' as a carve-out, and through detailed examination discusses how it should be effectively employed to defend climate action in ISDS. Before concluding, Part IV concisely elucidates the complexities underlying the modernisation of IIAs, reinforcing the importance of the right to regulate.

B. A SPACE FOR DEFENDING CLIMATE ACTION IN INTERNATIONAL INVESTMENT LAW UNDER THE FET STANDARD?

The vast number of countries that are signatories to the United Nations Framework Convention on Climate Change (UNFCCC) and the Paris Agreement illustrates the strong commitment of the international community to combat the global challenge of climate change.[11] The phasing out of fossil-fuel-based energy is considered one of the best ways to mitigate the climate crisis. This Part discusses why phasing out fossil-fuel-based energy is effective in mitigating the climate crisis, and then the legal challenge to these measures.

(1) Policy Justifications for Climate Action and the Threat Posed by ISDS

Under the UNFCCC, States committed to the stabilisation of greenhouse gas concentrations in the atmosphere at a level that would prevent dangerous anthropogenic interference with the climate system.[12] These include policies to reduce greenhouse gas emissions, and subsidising renewable energy.[13] Further, under the Paris Agreement, States set a long-term goal to keep the global temperature increase well below 2° Celsius above pre-industrial levels and to pursue efforts to limit the temperature increase to 1.5° Celsius; to increase the ability to adapt to the adverse impacts of climate change and fostering climate resilience and low greenhouse emission development; and to make finance flows consistent with low greenhouse gas emissions pathway and climate-resilient development.[14] States agree to undertake ambitious efforts to the global response to climate change such as preparing and maintaining successive nationally determined contributions that it intends to achieve and pursue domestic mitigation measures to achieve the

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[10] Energy Charter Treaty (adopted 17 December 1994, entered into force 16 April 1994) 2080 UNTS 1995 (ECT), Article 17.

[11] UNFCCC, 'Parties to the United Nations Framework Convention on Climate Change' (*UN Climate Change*)<https://unfccc.int/process/parties-non-party-stakeholders/parties-convention-and-observer-states> accessed 3 June 2023, 197 signatories; UNFCCC, 'Paris Agreement - Status of Ratification' (*UN Climate Change*)<https://unfccc.int/process/the-paris-agreement/status-of-ratification> accessed 3 June 2023, 195 signatories.

[12] UNFCCC, Article 2.

[13] Bodansky Daniel and others, *International Climate Change Law* (OUP 2017), 12.

[14] Paris Agreement, Article 2.

objectives, and that each successive nationally determined contribution should represent a progression and adjustments to enhance a party's level of ambition.[15] In achieving these measures, States are required to take measures that will include reducing primary energy from coal and other fossil-fuel-based sources, and shifting to low- or zero-carbon fuels.[16] This may be in the form of carbon taxes, emission trading systems, or a complete ban on fossil-fuel-based energy sources. These policies are crucial to implementing mitigation and adaptation measures, and to support the transition towards low-carbon, climate-resilient pathways. By aligning investments with the objectives of the UNFCCC and the Paris Agreement, States can effectively mitigate change.

Building upon these requirements, several States have implemented several measures to comply with their climate change obligations. Notably among them is the phasing out of fossil-fuel-based sources of energy in a move towards green energy. For Example, in 2019 Italy announced its plans to block the issuing of permits for the exploration of oil and gas as part of its plans to cut its carbon footprint.[17] Also in 2019, the Netherlands adopted the 'Law prohibiting the use of coal with the Production of Electricity'.[18] Under this law, as of 1 January 2020, inefficient coal plants with an electrical efficiency rate below 44%, that cannot produce any renewable energy through biomass, and that do not produce renewable heat, are prohibited. As of 1 January 2025, inefficient coal plants with an electrical efficiency rate below 44%, that cannot produce renewable energy through biomass, and that can produce renewable energy through biomass, and that can produce renewable heat, will be prohibited. And as of 1 January 2023, all coal plants will be prohibited. Furthermore, in 2020, Denmark brought an end to oil and gas exploration in the Danish North Sea.[19] This is part of its plan to phase-out fossil fuel extraction by 2050.[20] Additionally, in 2021, Spain passed a climate law committing to cut emissions by 30% by 2025.[21] The law banned all new gas and oil explorations and production permits and subsidies with immediate effect.[22] In 2022, Germany approved a law to phase-out coal-fired power plants in the western state of North Rhine-Westphalia by 2030 instead of the previously decided 2038.[23] This also is part of the country's effort to speed up the cutting of greenhouse gas emissions.[24] In addition to phasing out fossil-fuel-based energy sources, several countries have also been introducing carbon taxes and carbon trading marketing to create financial disincentives for greenhouse gas emissions and to generate revenue to finance climate change mitigation and

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[15] Paris Agreement, Articles 3 & 4.

[16] UNFCCC, ' Report of the Third Session of the Conference of the Parties serving as the meeting of the Parties to the Paris Agreement (Glasgow, 1–12 November 2021)' FCCC/PA/CMA/2021/2/Add.2, 4.

[17] Reuters Staff, 'Italy Ready to Block Issuance of Oil and Gas Exploration Permits' (*Reuters*, 9 January 2019) <https://www.reuters.com/article/italy-drilling-idUKS8N1YP08R> accessed 4 July 2023.

[18] Law of December 11, 2019, containing Rules for producing electricity using coal (Coal Production Act) (The Netherlands), *see also* Stan Putter, 'The Netherlands Coal Phase-Out and the Resulting (RWE and Uniper) ICSID Arbitrations' <https://arbitrationblog.kluwerarbitration.com/2021/08/24/the-netherlands-coal-phase-out-and-the-resulting-rwe-and-uniper-icsid-arbitrations/> accessed 3 June 2023.

[19] Climate Act, Act No. 965 of 26 June 2020 (Denmark).

[20] Julian Ambrose, 'Denmark to End New Oil and Gas Exploration in North Sea' (*The Guardian*, 4 December 2020) <https://www.theguardian.com/business/2020/dec/04/denmark-to-end-new-oil-and-gas-exploration-in-north-sea> accessed 3 June 2023.

[21] Act 7/2021 on Climate Change and Energy Transition (Spain).

[22] ibid, *See also* Isabelle Gerretsen, 'Spain to End Fossil Fuel Production by 2042 under New Climate Law' (*www.euractiv.com*, 17 May 2021)<https://www.euractiv.com/section/climate-environment/news/spain-to-end-fossil-fuel-production-by-2042-under-new-climate-law/> accessed 3 June 2023.

[23] Act to Reduce and End Coal-Powered energy and Amend other Laws (Coal Phase-Out Act) 2020 (Germany).

[24] ibid, *See also* Markus Wacket and Others, 'Germany's Cabinet Approves Accelerated Coal Exit by 2030 in Western State' (*Reuters*, 2 November 2022) <https://www.reuters.com/business/energy/germanys-cabinet-approves-accelerated-coal-exit-by-2030-western-state-2022-11-02/> accessed 3 June 2023.

adaptation efforts.[25] Carbon taxes impose a fee on each ton of carbon dioxide emitted, encouraging industries and individuals to reduce their emissions to avoid the tax burden.[26] On the other hand, carbon trading establishes a market for trading emission permits allowing entities to buy and sell the right to emit greenhouse gases.[27] These mechanisms play a vital role in achieving emission reduction targets and transitioning to a low-carbon economy.

Scientific evidence shows that phasing out fossil-fuels-based sources of energy is essential in mitigating climate change.[28] Fossil fuels are the primary source of carbon dioxide (CO_2) emissions, which is the prevalent greenhouse gas responsible for global warming. According to the Intergovernmental Panel on Climate Change (IPCC), limiting warming to 1.5° Celsius requires greenhouse gas emissions to decrease by 43% by 2030 and 84% by 2050.[29] This can only be achieved with a fundamental and rapid transformation in global energy systems.[30] Estimates of future CO_2 emissions from existing fossil fuel infrastructure already exceed remaining cumulative net CO_2 emissions in pathways limiting warming to 1.5° Celsius.[31] Decommissioning and reducing utilisation of existing fossil fuel installations in the energy section as well as cancellation of new installations are required.[32] Thus, by transitioning away from fossil-fuel-based energy, carbon emissions can be significantly reduced. This is critical in mitigating climate change. These measures align with the commitments made by States under the UNFCCC and the Paris Agreement to prevent dangerous interference with the climate system and promote development on a global scale. Further, these government policies have been informed by the political will of their citizens.[33] As citizens have become more aware of the threat of climate change, and the specific health and environmental threats of fossil fuel extraction in their communities, they have increasingly engaged

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[25] I Tiseo, 'Carbon Taxes Worldwide by Country 2022' (*Statista*, 6 February 2023) <https://www.statista.com/statistics/483590/prices-of-implemented-carbon-pricing-instruments-worldwide-by-select-country/> accessed 23 June 2023.

[26] Center for Climate and Energy Solution, 'Carbon Tax Basics' (*Center for Climate and Energy Solutions*, 21 October 2021) <https://www.c2es.org/content/carbon-tax-basics/> accessed 23 June 2023.

[27] Center for Climate and Energy Solution, 'Cap and Trade Basics' (*Center for Climate and Energy Solutions*, 6 August 2021) <https://www.c2es.org/content/cap-and-trade-basics/> accessed 23 June 2023.

[28] Intergovernmental Panel on Climate Change, *Climate Change 2023: Synthesis Report. Sixth Assessment Report of the Intergovernmental Panel on Climate Change*' <https://www.ipcc.ch/report/ar6/syr/downloads/report/IPCC_AR6_SYR_SPM.pdf > accessed 04 May 2023, which stated that global warming this century is on course to exceed an agreed 1.5 degree celsius limit without drastic and immediate cuts to greenhouse gas emissions, and the phasing out of fossil fuels.. *See also* Tim Donaghy, '8 reasons why we need to phase out the fossil fuel industry' (*Greenpeace* , 22 November 2021) <https://www.greenpeace.org/usa/research/8-reasons-why-we-need-to-phase-out-the-fossil-fuel-industry> accessed 4 June 2023.

[29] IPCC (n4) 21.

[30] ibid 97.

[31] ibid 57.

[32] ibid 16.

[33] Damian Carrington and Damien Gayle , 'Climate Activists Vow to Take to Streets to Stop Fossil Fuel Extraction' (*The Guardian*, 16 January 2023) <https://www.theguardian.com/environment/2023/jan/16/climate-activists-vow-to-take-to-the-streets-to-stop-fossil-fuel-extraction> accessed 4 July 2023; See also, Australian Associated Press, 'Blockade Australia Climate Protests Cause Traffic Chaos in Brisbane and Melbourne' (*The Guardian*, 19 June 2023) <https://www.theguardian.com/environment/2023/jun/20/blockade-australia-climate-protests-cause-traffic-chaos-in-brisbane-and-melbourne> accessed 4 July 2023; See also Sandra Laville, 'Climate Protesters Gather in Parliament Square as Fossil Fuel Deadline Passes' (*The Guardian*, 24 April 2023) <https://www.theguardian.com/environment/2023/apr/24/climate-protests-london-xr-the-big-one-fossil-fuel-deadline> accessed 4 July 2023.

in large-scale protests, physical blockades, and domestic litigation to challenge the power of the fossil fuel industry.[34]

However, as countries pursue the further phase-out of fossil-fuel-based energy, and devise their nationally determined contributions certain inherent risks must be considered.[35] One significant concern, according to Sarvarian, is the potential for increased investor claims arising from regulatory measures implemented to mitigate greenhouse gas emissions.[36] Indeed, this heightened risk is rooted in the pivotal role foreign investors play within the energy market. 45-50% of oil and gas projects are financed by foreign companies while 40% of power generation projects are financed through foreign direct investment.[37] Therefore, they are protected under international investment law, which can give rise to several ISDS claims arising from IIAs. These claims can be based on various grounds such as FET which is the theme of this article. Thus, States, as they exercise their right to regulate to address greenhouse gas emissions, may encounter claims stemming from actions such as revoking, delaying, or refusing permits for projects, terminating or withholding concession, imposing stricter regulations, emission reduction legislation, imposing fines or penalties for environmental regulations, cancelling agricultural projects or supply contracts based on environmental grounds, or establishing environmental reserves affecting relevant lands.[38] Additionally, there is also a risk of legal claims arising from stranded infrastructure where the transition away from fossil-fuel-based energy renders existing infrastructure, such as power plants, refineries, and pipelines, economically obsolete, leading to financial losses for investors.[39]

The year 2022 witnessed notable developments that underscore these potential challenges. The IPCC acknowledged that ISDS cases could lead to States refraining from, or delaying, measures to phase-out fossil fuels.[40] During the same year, significant procedural developments occurred in two ISDS cases against the Netherlands arising from its decision to phase-out coal-fired power by 2030,[41] and against the United States for the US President's cancellation of the Keystone XL Pipeline.[42] Additionally, the decision in *Rockhopper v Italy* was issued, wherein Italy was found to have violated the ECT by imposing a legislative ban on offshore oil and gas exploitation activities concerning an existing project, and was ordered to pay over €190 million in compensation.[43] Although the Tribunal found it unnecessary to determine a breach of the FET standard, the decision underscores the ongoing tension between investors' rights and States' right to regulate, especially when it comes to environmental concerns. A few years prior, Germany had been sued twice by the Swedish energy company Vattenfall. The first instance pertained to environmental regulations imposed on a coal power station,[44] while the second centred on

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[34] Ibid.

[35] O Akinkugbe and A Majekolagbe, 'International Investment Law and Climate Justice: The Search for a Just Green Investment Order' [2023] 46(2) FILJ 169, 191.

[36] Arman Sarvarian, 'Invoking the Paris Agreement in Investor-State Arbitration' [2023] ICSID Review 1, 12-13.

[37] International Energy Agency, *The Oil and Gas Industry in the Energy Transition: Insights from the IEA Analysis*. *World Energy Outlook Special Report 2020* <https://iea.blob.core.windows.net/assets/4315f4ed-5cb2-4264-b0ee-2054fd34c118/The_Oil_and_Gas_Industry_in_Energy_Transitions.pdf> accessed 03 May 2023, 6, 19, 26.

[38] Sarvarian (n35) 13-14.

[39] Firdaus Nur and Mori Akihisa, 'Stranded assets and sustainable energy transition: A systematic and critical review of incumbents' response ' [2023] 73 ESD 76, 81.

[40] IPCC (n4) 81.

[41] *RWE AG v the Netherlands*, ICSID Case No. ARB/21/4; *Uniper SE v the Netherlands*, ICSID Case No. ARB/21/22.

[42] *TC Energy Corporation and TransCanada Pipelines Limited v United States of America*, ICSID Case No. ARB/21/63.

[43] *Rockhopper Italia S.p.A.* v *Italy*, ICSID Case No. ARB/17/14, Award 23 August 2022.

[44] *Vattenfall AB, Vattenfall Europe AG, Vattenfall Europe Generation AG v. Federal Republic of Germany,* ICSID Case No. ARB/09/6.

Germany's decision to phase-out nuclear energy following the Fukushima disaster.[45] On both occasions, the government settled the case after making concessions to the company. These cases are predicted to be the first of many, as to achieve the goal of the Paris Agreement of limiting the rise in global average temperatures to 1.5° Celsius, States need to prevent the exploitation of many known fossil fuel reserves.[46]

Indeed, some countries have offered compensation to these companies, as compensation to aggrieved investors.[47] However, there is no rational reason why fossil fuel companies should be entitled to compensation from States for climate action.[48] As this article will show, States have a right to regulate. Providing compensation does not only increase the cost of the energy transition for States but, it perversely shifts resources away from States that are already facing costs associated with climate adaptation and climate loss and damage. This transfers resources to fossil fuel corporations that are some of the entities most responsible for causing climate change and that have already reaped substantial profits from activities that have caused climate change.[49] Thus, these legal considerations further complicate the process of transitioning away from fossil-fuel-based energy and require careful legal analysis to mitigate potential legal liabilities while ensuring a fair and balanced approach to the energy transition.

(2) Climate Action and FET: What is the Scope of Investor Protection?

Part II thus far relayed that phasing out fossil-fuel-based energy is a desirable policy instrument that can mitigate climate change, and the threat posed by the investment regime. However, if these policies are to succeed, sufficient policy space needs to be provided under international investment law for a legal justification. This section of Part II seeks to outline the standard of protection and the legal limits to defending climate action under IIAs.

IIAs create obligations that require States to protect private investors. One of the most contentious aspects in this regard is FET, which according to Lim, has garnered considerable attention due to its flexibility, seemingly broad scope, and growing popularity.[50] In typical IIAs:

> 'Each Contracting Party shall, at all times accord to the Investments of investors of other Contracting Parties fair and equitable treatment.'[51]

As Schreuer explains, FET is an open-textured guarantee designed to 'allow for independent and objective third-party determination of [a respondent's] behaviour on the basis of a flexible

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[45] *Vattenfall AB and others v. Federal Republic of Germany*, ICSID Case No. ARB/12/12.

[46] Joshua Paine and Elizabeth Sheargold, 'A Climate Change Carve-Out for Investment Treaties' [2023] 26 JIEL 285, 286.

[47] Flues Fabian , 'Billions paid out to coal companies show how investment rules are obstructing the green transition' (Business & Human Rights Centre, 23rd May) <https://www.business-humanrights.org/en/blog/billions-paid-out-to-coal-companies-show-how-investment-rules-are-obstructing-the-green-transition/> accessed 5 August 2023.

[48] Julia Dehm, OECD Public Consultation on Investment Treaties and Climate Change. in Investment Division, Directorate for Financial and Enterprise Affairs, Organisation for Economic Co-operation and Development Paris, France, Investment Treaties and Climate Change OECD Public Consultation | January - March 2022 Compilation of Submissions (OECD 2022), 86.

[49] ibid.

[50] CL Lim and others, *International Investment Law and Arbitration* (2nd edn, CUP 2021), 332.

[51] Energy Charter Treaty (ECT) (1991) 2080 UNTS, Article 10, Agreement between the United States of America, the United Mexican States, and Canada (adopted 30 November 2018, entered into force 01 July 2020) (USMC), Article 14.6.

standard'.[52] In the context of the energy transition, the criteria against which tribunals may evaluate a State's conduct in applying FET include:

(a) whether the State breached the investor's reasonable and legitimate expectations when the investment was made;
(b) whether the State acted unjust or arbitrarily; and
(c) whether the State acted transparently.

Recent cases involving companies such as RWE AG and Uniper SE, Vattenfall AB, and TC Energy Corp amplify these. They alleged that climate action measures were adopted against their legitimate expectations. Additionally, they assert that the actions of the respective governments were unjust, arbitrary, and were not transparent. According to them, these measures are predicted to result in a reduction in demand for their products, ultimately leading to a decline in profits, and rendering their investment valueless.[53]

This Part now examines the relevance of these three important facets of FET in the energy transition. Although some of these disputes have been discontinued,[54] one remains ongoing,[55] and as previously predicted more claims will arise. Thus, it is timely and appropriate to analyse how climate action may be treated under FET to determine whether there is space for defending them.

Legitimate expectations

Several arbitral tribunals have interpreted FET extensively to include the obligation on the part of the State to protect an investor's legitimate expectations and provide a stable legal environment.[56] The Tribunal in *Tecmed v Mexico* ruled that:

> 'the foreign investor expects the Host State to act in a consistent manner, free from ambiguity and totally transparent in its relations with the foreign investor, so that it may know beforehand any and all rules and regulations that will govern its investments, as well as the goals of the relevant policies and administrative practices or directives, to be able to plan its investments and comply with such regulations.'[57]

Advances in scientific knowledge around climate change require a constant adaption of a State's environmental laws which makes interpretation of legitimate expectation crucial.[58] Investors' legitimate expectations are based on the State's legal framework and any undertakings and representations made explicitly or impliedly by the State.[59] The regulatory framework on which the

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[52] Christoph Schreuer, 'Fair and Equitable Treatment in Arbitral Practice' (2005) 6 JWIT 357, 365.

[53] Stan Putter, 'The Netherlands Coal Phase-Out and the Resulting (RWE and Uniper) ICSID Arbitrations' <https://arbitrationblog.kluwerarbitration.com/2021/08/24/the-netherlands-coal-phase-out-and-the-resulting-rwe-and-uniper-icsid-arbitrations/> accessed 3 June 2023; Daniela Páez-Salgado, 'A Battle on Two Fronts: Vattenfall v. Federal Republic of Germany' <https://arbitrationblog.kluwerarbitration.com/2021/02/18/a-battle-on-two-fronts-vattenfall-v-federal-republic-of-germany/> accessed 4 June 2023; Rithika Krishna, 'TC Energy Seeks NAFTA Damages over Canceled Keystone XL Project' (*Reuters*, 23 November 2021) <https://www.reuters.com/legal/litigation/tc-energy-seeks-nafta-damages-over-canceled-keystone-xl-project-2021-11-23/> accessed 4 June 2023.

[54] Oberlandesgericht Köln, 19 SchH 14/21; Oberlandesgericht Köln, 19 SchH 15/21.

[55] *TC Energy Corporation and TransCanada Pipelines Limited v. United States of America*, ICSID Case No. ARB/21/63.

[56] *Thunderbird v Mexico*, UNCITRAL, Award, 26 January 2006. para 147; *Saluka v Czech Republic*, UNCITRAL, Partial Award, 17 March 2006, para 302; *Novenergia II v Spain*, Final Award, 15 February 2018, para 648.

[57] *Tecnicas Medioambientales Tecmed SA v Mexico*, ICSID Case No. ARB(AF)/00/2, Award, 29 May 2003, paras 152-156.

[58] Camille Martini, 'Balancing Investors' Rights with Environmental Protection in International Investment Arbitration: An Assessment of Recent Trends in Investment Treaty Drafting (2017) 50 (3) IL 529, 538.

[59] Rudolf Dolzer and others, *Principles of International Investment Law* (3rd edn, OUP 2022) 208.

investor is entitled to rely consists of legislation,[60] treaties[61] and assurances contained in decrees, licences, and executive statements.[62] A pertinent example unfolds with the discontinued case of *RWE and Uniper v The Netherlands* where RWE and Uniper argued that they had a legitimate expectation that they would be allowed to operate Eemshaven, a coal-fired power plant based on irrevocable permits.[63] Under the Environmental Permit, Eemshaven was allowed to fire coal to generate electricity. It argued that that expectation was legitimate and that it is entitled to expect that the State will honour the irrevocable lawful permits, and not withdraw or invalidate them for reasons lying outside the applicable law to the permits themselves. While it may be argued that concerns about climate change and fossil fuels contributing to climate change existed when the ECT and most IIAs were signed in 1995, and the UNFCCC being signed months before, numerous explicit representations given by the Respondent in public statements created an expectation on the part of the claimant, which cannot be ignored. These include statements in Energy Reports, where the Respondent openly advocated for the construction of new coal-fired plants, arguing for the need until 2050.[64] Further, it promised not to ban certain technology such as coal, and in 2017 it concluded that a coal ban was unnecessary to meet its climate goals.[65] In light of these arguments, it appears that RWE and Uniper may have a valid claim to legitimate expectations. The State's numerous representations and indications through legislation and licenses, expressing the necessity of coal until 2050 and the absence of plans to phase it out until recently contribute to a compelling case for legitimate expectations. Similarly, in *TC Energy Corporation and TransCanada Pipelines Limited v. United States of America*, the Claimant asserts that they were invited by the Respondent to apply for a Presidential permit, and was issued the permit twice on the condition that they commence construction of the cross-border segment of the KXL Pipeline within five years after the permit was issued, then revoked the permit.[66] These factors place an impediment to the phasing-out of fossil-fuel-based energy. The *Tecmed* interpretation places an expansive burden on States to safeguard investors' legitimate expectations and ensure a dependable legal framework. This can inadvertently clash with environmental measures. When States have previously extended assurances and commitments that align with fossil-fuel-based investments, these assurances become ingrained in investors' legitimate expectations. As a result, transitioning away from such investment, even in the face of pressing climate change concerns, can trigger a breach of legitimate expectations. Investors may argue that such an abrupt shift in policies or regulations undermines the stability and transparency they were initially assured. Thus, this broad interpretation of legitimate expectations presents a significant obstacle in defending climate action in ISDS.

Transparency

Transparency means that the legal framework for the investors' operations is readily apparent and that any decision affecting investors can be traced to that legal framework.[67] Transparency would also include the obligation to be informed of intended significant policy or regulatory changes, to

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[60] *Novenergia II v Spain*, SCC Case No. 2015/063, Final Award, 15 February 2018, paras 662-667, 681, 697.

[61] *Antin v Spain*, Award, ICSID Case No.ARB/13/31, Award, 15 June 2018, para 532.

[62] Dolzer (n58) 209.

[63] *RWE AG and RWE Eemshaven Holdings II BV v The Netherlands*, ICSID Case No ARB/21/4, Claimant's Memorial, 18 December 2021, para 529-534; *Uniper SE, Uniper Benelux Holding B.V. and Uniper Benelux N.V. v The Netherlands*, ICSID Case No. ARB/21/22, Claimant's Memorial, 20 May 2022, para 447.

[64] ibid.

[65] ibid.

[66] *TC Energy Corporation and TransCanada Pipelines Limited v. United States of America*, ICSID Case No. ARB/21/63, Request for Arbitration, 2 November 2021, para 96.

[67] *Frontier Petroleum v Czech Republic*, UNCITRAL, Final Award, 12 November 2010, para 285; *Micula v Romania I*, ICSID Case No. ARB/05/20, Award, 11 December 2013, para 520.

allow Investors to plan 'adequately' and 'engage' in any necessary 'dialogue about protecting its legitimate expectations'.[68]

Although transparency was not argued in *RWE and Uniper* it is still relevant in the age of the energy translation. This is so for several reasons. First, investments in the energy sector often involve long payback periods. Transparent information about policy shifts, regulations, and market trends allows investors to plan for the long term and make strategic decisions that align with evolving energy goals. Second, the energy transition brings about risks and uncertainties, including shifts in market demand, technological advancements, and changing consumer preferences. Transparent disclosure of policy and regulatory changes allows investors to provide input, express concerns, and collaborate with policymakers to shape effective and balanced regulations that align with their interests and contribute to sustainable energy development. This may lead to a just energy transition. However, considering the scale and number of investors involved in fossil-fuel-based energy industries and the urgency of climate action, it may be impractical and burdensome for States to individually approach and consult every investor regarding significant policy changes. However, this is expected by FET. Thus, this may yet present another obstacle to defending climate action in ISDS.

Unjust and arbitrary treatment

Freedom from unjust and arbitrary treatment is also inherent in FET.[69] This includes an obligation not to purposefully inflict damage upon an investment.[70] This can include unreasonable measures. In *Mondev v United States*, it was held that unjust and arbitrary treatment is "a wilful disrgard of due process of law".[71] Another tribunal ruled that these measures include those not founded in reason or fact but on caprice, prejudice, or personal preference.[72]

In *RWE and Uniper*, the Claimants argued that the decision to phase-out fossil-fuel-based energy was not reviewed to determine whether the period for transition was adequate, whether a biomass conversion was feasible, and what steps the companies were taking to mitigate CO_2 emissions, in breach of the prohibition of unjust and arbitrary treatment.[73] Similarly in *TC Energy Corporation and TransCanada Pipelines Limited*, the Claimants argued that the revocation of the presidential permit for climate change concerns, was in breach of the prohibition of unjust and arbitrary treatment. While these arguments raise valid concerns regarding whether the measures adopted by the State were justified, it must be recognised that climate change is not a recent phenoman. States have been aware of climate change for years, yet they continued to encourage foreign direct investment in the energy sector which contributed to greenhouse gas emissions. It can be argued, that for years they have reaped the benefits of these types of investments. Therefore, it is imperative for the State to take measures that would achieve a just transition. This includes consultation with affected stakeholders, robust assessments of the environment impact of proposed policies, and proactive efforts to mitigate adverse effects on existing investments. While States have limited resources and cannot conduct individual assessments for every investment, it is only through these concerted efforts that a State can address both the interest of investors and the imperative to combat climate change. Where the State fails to adequately evaluate these factors,

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[68] *Electrabel S.A. v Hungary,* ICSID Case No. ARB/07/19, Decision on Jurisdiction, Applicable Law and Liability, 30 November 2012, para 7.79.

[69] *S.D. Myers v Canada,* UNCITRAL, Award on Liability 13 November 2000, para 263.

[70] *Vivendi v Argentina*, ICSID Case No.ARB/97/3, Resubmitted Case: Award, 20 August 2007, para 7.4.39.

[71] *Mondev International Ltd v United States of America*, Award, 11 October 2002, para 127

[72] *Plama Consortium Ltd. v Bulgaria*, ICSID Case No. ARB/03/24, Award, 27 August 2008, para 184.

[73] *RWE AG and RWE Eemshaven Holdings II BV v The Netherlands*, ICSID Case No ARB/21/4, Claimant's Memorial, 18 December 2021, para 432; *Uniper SE, Uniper Benelux Holding B.V. and Uniper Benelux N.V. v The Netherlands*, ICSID Case No. ARB/21/22, Claimant's Memorial, 20 May 2022, para 462.

the State can be seen to have disregarded the legitimate interests and concerns of affected investors. The lack of comprehensive review could be seen as indicative of a decision being made without proper consideration of the potential impacts on existing investments or a failure to take reasonable steps to minimise the adverse effects on investors. These issues can present yet an obstacle to defending climate action in ISDS.

(3) Bringing It Together: A Safe Harbour for Defending Climate Action or a 'Regulatory Chill' Effect?

This Part has explored the policy justifications for climate action, the looming threat posed by ISDS, the relevant facets of FET, and the potential for defending climate action. However, as we have observed, there are obstacles to defending climate action within the FET standard. FET places a heavy burden on States to defend their climate action, as investors go through a laundry list of all that the State should have done but failed to do. This may result in a 'regulatory chill', which emerges when the government, cognisant of potential ISDS claims, is hesitant to enact or enforce regulatory measures for fear of investor claims.[74] For Example, in 2022, New Zealand's climate change minister indicated that his government had slowed the pace of phasing-out fossil fuels to reduce the likelihood of ISDS claims arising from existing projects.[75] This chilling effect can impede the timely implementation of climate action measures, potentially hindering the pursuit of vital climate action, although adopted in good faith. The urgency of mitigating climate change's profound impacts is set in a precarious balance against the potential legal ramifications, resulting in a delicate dance between environmental concerns and legal prudence. Thus, in light of these formidable challenges, in the next Part, I introduce the 'right to regulate' of States as providing a safe harbour for defending climate action.

C. CREATING A SAFE HARBOUR FOR DEFENDING CLIMATE ACTION: THE RIGHT TO REGULATE

While there may be differing opinions on the suitability of the current system of the IIAs for facilitating the energy transition, I firmly believe that with the appropriate utilisation of the applicable law, defending climate action does not have to be an insurmountable challenge within the existing framework of IIAs. The State has the 'right to regulate' (some authors refer to it as a 'margin of appreciation' or 'regulatory space') and can change the existing regulatory framework for the energy transition and phase-out fossil-fuel-based energy to reduce greenhouse gas emissions and mitigate the effects of climate change. Such a decision would be consistent with IIAs and would not necessarily violate treaty provisions on the protection of foreign investments.

The requirement of FET is not a rule in international law requiring a State to freeze its regulatory regime,[76] or limit its powers to alter the regulatory framework applicable to investments that would undermine investors' investments. Thus, in this Part, I discuss the 'right to regulate' as a potential carve-out to FET and a safe harbour to defend climate action. I begin by defining the right to regulate. Subsequently, I delve into its status as a general principle of international law, and

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[74] Kyla Tienhaara, 'Regulatory Chill in a Warming World: The Threat to Climate Policy Posed by Investor-State Dispute Settlement' [2018] 7(2) TEL 229, 235.

[75] Elizabeth Meager, 'Cop26 Targets Pushed Back Under Threat of Being Sued', *Capital Monitor*, 14 January 2022, <https://capitalmonitor.ai/institution/government/cop26-ambitions-at-risk-from-energy-charter-treaty-lawsuits/> accessed 5 August 2023.

[76] Diego Zannoni, 'The legitimate expectation of regulatory stability under the Energy Charter Treaty' (2020) 33 LJIL 451, 455.

its recognition within IIAs. I then explore the potential application of the right to regulate in establishing a safe harbour that can be utilised to defend climate action in ISDS.

(1) Definition of the Right to Regulate

States are simply required to treat investments fairly, and that requirement by no means deprives the State of the right to exercise its regulatory powers.[77] States are sovereign and they are seized with powers to make laws for peace, order, good governance, and the protection of their citizens and the environment. This is known as the right to regulate. It is defined by Titi as 'the legal right exceptionally permitting the State to regulate in derogation of international commitments undertaken by means of an investment agreement without incurring a duty to compensate'.[78] As a result of the negative environmental impacts of the burning of fossil fuels to produce energy, governments around the world have increasingly committed to reducing emissions from fossil-fuel-based energy generation. Therefore, arbitral tribunals must acknowledge and respect this 'right to regulate' as a carve-out when investors allege a breach of the FET standard.

(2) The Status of the Right to Regulate in International Law

The right to regulate derives from two sources: (1) general international law, and (2) IIAs. For the first category, States incorporate the right to regulate in IIAs, through the inclusion of preambles, 'general provisions', or specific exemptions. The second refers to the right to regulate as a general rule whose content is general and abstract.[79]

(3) The Right to Regulate as a General Principle of International Law

It is important to recognise that international investment law is not an isolated system but is rooted in general international law, with its specific characteristics. It operates within a broader juridical framework where rules from various sources can be integrated.[80] In this context, Arbitrators guided by the Vienna Convention on Law of Treaties (VCLT), can take into account other international norms when interpreting IIAs.[81] However, for this to apply to ISDS, there must be a foundation in law. I am of the view that the right to regulate is a general principle of international law, recognised under Article 38(1) of the ICJ Statute.[82] Hence, the legitimate basis for its utilisation in ISDS.

General principles of international law are logical inferences that can be found in any legal system or are related to international law.[83] The identification of general principles of law derived from national legal systems is generally considered to consist of a two-step analysis: first, determining the existence of a principle common to the principal legal systems of the world; second, ascertaining the transposition of that principle to the international legal system.[84]

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[77] Vaughan Lowe, 'Regulation or Expropriation?' (2002) 55 (1) CLP 447, 450.

[78] Aikaterini Titi, *The Right to Regulate in International Investment Law* (Nomos 2014), 33.

[79] Marcelo Kohen and Bérénice Schramm, (2019) *General principles of law*, *General Principles of Law*. Available at: <https://www.oxfordbibliographies.com/display/document/obo-9780199796953/obo-9780199796953-0063.xml> accessed 05 June 2023.

[80] *Asian Agricultural Products Ltd v Sri Lanka* ICSID Case No.ARB/87/3, Award, 27 June 1990, para 21.

[81] Vienna Convention on the Law of Treaties (VCLT) (1969) 1155 UNTS 33, Article 31(3)(c).

[82] Statute of the International Court of Justice (1945) 59 STAT 1055, Article 38(1).

[83] Kohen and Schramm (n77).

[84] International Law Commission, 'Report of the International Law Commission on the Work of its 62nd Session' (1 April–5 June and 6 July-7 August 2020) Second report on general principles of law, UN Doc A/CN.4/741, 6.

Is it a common principle to the principal legal systems of the world?

The starting point for the present analysis is Article 38, paragraph 1 (c), of the Statute of the International Court of Justice, which in itself provides some guidance.[85] The provision requires that a general principle of law be recognised by the community of nations, which suggests that, for a general principle of law to exist, it must be generally recognised by the members of the community of nations.[86] It cannot be disputed that the right to regulate exists as a general principle of law. This is because the principle refers to the State's sovereign authority to regulate and govern within its territory in pursuit of public interest objectives. The principle is inherent in the functioning of any legal system and is crucial for maintaining order, protecting public welfare, and advancing national interests. In the domestic context, the right to regulate reflects the principle of State autonomy and acknowledges that States possess the authority and discretion to regulate matters within their unique social, cultural, economic, and political context. This right is reflected in the constitution of all States. For example, in the Commonwealth Caribbean, the Constitution recognises the right of the legislature of the State to make laws for peace, order, and good governance.[87] A similar provision is found in the Constitutions of Canada and the United States of America.[88] Therefore, States should have the space to maneuver in adopting measures that may have an impact on their international obligations.

Can it be transposed to the international legal system?

The second step is ascertaining whether the principle common to the principal legal systems of the world is transposed to the international legal system. Transposition, therefore, does not occur automatically. State practice and jurisprudence show that, for a principle common to the principal legal systems of the world to be elevated to a general principle of law, that principle must be compatible with the fundamental principles of international law.[89] This compatibility test serves to ensure that a legal principle is not only recognised by the community of nations as just but also as capable of existing within the broader framework of international law.[90] Another requirement for the transposition of a principle common to the principal legal systems of the world is that the conditions exist to allow the adequate application of the principle in the international legal system.[91] This serves to ensure that the principle can properly serve its purpose in international law, avoiding distortions or possible abuses.[92] The right to regulate is recognised in IIAs (as discussed in the following section) and has been applied by international courts and tribunals (although not acknowledging it as a general principle). For example, the European Court of Human Rights has repeatedly referred to the 'margin of appreciation' in its jurisprudence.[93] The Court recognises 'a State is entitled to a certain 'space to maneuver', within which its conduct is exempted from full-

[85] ibid 7.

[86] ibid.

[87] Antigua & Barbuda s46; Barbados s48; Belize s68; Grenada s38; Jamaica s46; St. Lucia s40; St. Kitts Nevis s37; St. Vincent & the Grenadines s37.

[88] Constitution Acts, 1876 to 1982 (Canada), Section 91; Constitution of the United States of America, Article 1.

[89] ILC (n82) 22.

[90] ibid.

[91] ibid 23.

[92] ibid 27.

[93] *Greece v UK*, App No 176/56, 1958-I D&R 181, para 318; *Denmark v Greece*, App No 3321/67, 12 YB Eur Conv HR (1969) 1, para 114; *Lawless v Ireland*, App No 332/57, 1 Eur Ct HR (ser B), at 56 (1960–61), para 90 For discuss on the ECHR's approach to the Margin of Appreciation: See Yucal Shany 'All Roads Lead to Strasbourg?: The Application of the Margin of Appreciation Doctrine by the European Court of Human Rights and the UN Human Rights Committee [2018] 9 JIDS 180.

fledged review'.'[94] This is also now being recognised in the investment context. For Example, the Tribunal in *Phillip Morris v Uruguay* held, in the context of public health-related regulations, that:

> 'the 'margin of appreciation' is not limited to the context of the ECHR but 'applies equally to claims arising under BITs,' at least in contexts such as public health. The responsibility for public health measures rests with the government and investment tribunals should pay great deference to governmental judgments of national needs in matters such as the protection of public health.'[95]

Thus, it appears that there will be no obstacle in transposing the right to regulate that exists within the domestic context into the international legal system. This will provide an avenue for defending climate action. It offers a framework for reconciling a State's regulatory authority with its international commitments, especially in the context of addressing environmental concerns like climate change. However, it is difficult to ascertain the acceptable margin of change in the exercise of the State's normal regulatory power in pursuance of public interest. The *Hydro* Tribunal has explained that 'the State is entitled to a high measure of deference' [96] but this does not give arbitrators enough direction.

(4) The Right to Regulate as a Provision In IIAs

The new generation of IIAs are not revolutionary but rather makes explicit the regulatory power of States under general international law that had already been inferred by investment tribunals operating under the first generation of treaties.[97] Only a small proportion of bilateral investment treaties (estimated at 3,300 today) contain a general exemption modelled on Article XX of the General Agreement on Tariffs and Trade or a more limited compliance-measures clause.[98] In the US-Argentina BIT (1991) for example, there is such a specific carve-out. It states:

> 'This Treaty shall not preclude the application by either Party of measures necessary for the maintenance of public order, the fulfillment of its obligations with respect to the maintenance or restoration of international peace or security, or the Protection of its own essential security interest.'[99]

Similar provisions have been seen in recent IIAs such as Burkina Faso–Türkiye BIT (2019):

> '1. Nothing in this Agreement shall be construed to prevent a Contracting Party from adopting, maintaining or applying non-discriminatory legal measures:
>
> (a) designed and applied for the protection of human, animal or plant life or health, or the environment;
>
> (b) related to the conservation of living or non-living exhaustible natural resources.
>
> […]
>
> 4. This Agreement shall not imply in any way an obligation for the Contracting Parties to relax their laws and regulations regarding health, safety or environment

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[94] ibid.

[95] *Phillip Morris v Uruguay* ICSID Case NoARB/10/7, Award, 8 July 2016, para 339.

[96] *Hydro Energy I v Spain* ICSID Case NoARB/15/42, Decision on Jurisdiction, Liability and Directions on Quantum, 9 March 2020, para 676(8).

[97] Freya Baetens, 'Protecting Foreign Investment and Public Health Through Arbitral Balancing and Treaty Design' [2022] 71(1) ICLQ 139, 172.

[98] Sarvarian (n35) 14.

[99] US-Argentina BIT (1991), Article XI.

> in order to encourage investment. Neither Contracting Party is under any obligation to waive or otherwise derogate, or to offer to waive or otherwise derogate from such measures for the purpose of encouraging the establishment, acquisition, expansion or the maintenance of an investment in its territory by an investor of the other Contracting Party.'[100]

The use of these clauses has never been clear-cut. Tribunals applying the US-Argentina BIT 1991 have imposed a significant burden on the State, similar to the necessity requirement explained under the Commentary to Article 25 of the ILC Articles on State Responsibility for Internationally Wrongful Acts (ARSIWA).[101] Tribunals have also restricted the scope of what falls under these carve-out clauses. They have ruled that there must exist an impairment of an essential interest of the State or those of the international community as a whole.[102] Furthermore, they have recognised that this is a self-judging clause, where the State is the sole arbiter of the scope and application of the rule. Thus, if the legitimacy of such measures is challenged, it is for an international tribunal to determine whether the plea of necessity can exclude the wrongfulness of the action.[103] As seen in the decisions, this substantive review is conducted according to customary international law as reflected in Article 25 of the ARSIWA.[104] However, one Annulment Committee has submitted that Article XI and Article 25 are substantively different. The first covers measures necessary for the maintenance of public order or the protection of each Party's essential security interests, without qualifying such measures.[105] The second subordinates the State of necessity to four conditions.[106] It requires for instance that the action taken 'does not seriously impair an essential interest of the State or States towards which the obligation exists, or of the international community as a whole', a condition which is foreign to Article XI.[107] Thus, a Tribunal which treats these the same may make a manifest error of law. The challenge to defending climate action under these specific carve-out clauses lies in the interpretation and application of the provision. While the clause allows parties to take measures necessary for the maintenance of public order, the fulfillment of international obligations regarding peace or security, or the protection of essential security interests (which deals with measures necessary to deal with certain situations such as climate change and protects the regulatory powers of the State), its application has been subjected to inconsistency. Where a tribunal takes the approach that these carve-out clauses are to be interpreted similarly to Article 25, the State must demonstrate a compelling justification for the

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[100] Burkina Faso–Türkiye BIT (2019), Article 5.

[101] International Law Commission, Articles on Responsibility of States for Internationally Wrongful Acts (ARSIWA), 56th Sess., A/RES/56/83 (2002), Article 25 provides:- '1. Necessity may not be invoked by a State as a ground for precluding the wrongfulness of an act not in conformity with an international obligation of that State unless the act: (a) is the only way for the State to safeguard an essential interest against a grave and imminent peril; and (b) does not seriously impair an essential interest of the State or States towards which the obligation exists, or of the international community as a whole.' *see usage* in *CMS Gas Transmission Company v Argentina* ICSID Case No. ARB/01/8, Award, 13 May 2005, paras 353-378; *Enron Corporation v Argentina* ICSID Case No. ARB/01/3, Award, 22 May 2007, paras 322-342; See also *Sempra Energy International v Argentina* ICSID Case No. ARB/02/16, Award, 28 September 2007, para 375 where the tribunal rules that the clause is not self-judging but proceeded to review under the rules of necessity similar to previous tribunals.

[102] ibid.

[103] *CMS Gas Transmission Company v Argentina* ICSID Case No. ARB/01/8, Award, 13 May 2005, para 373; *Enron Corporation v Argentina* ICSID Case No. ARB/01/3, Award, 22 May 2007, paras 334; *Sempra Energy International v Argentina* ICSID Case No. ARB/02/16, Award, 28 September 2007, para 388.

[104] ibid.

[105] *CMS Gas Transmission Company v Argentina* ICSID Case No. ARB/01/8, Decision on Annulment, 25 September 2007, para 130.

[106] ibid.

[107] ibid.

phasing-out of fossil-fuel-based energy, showing that the climate crisis is an impairment of an essential interest of the State or the international community as a whole. While previous sections of this article have discussed the legitimate policy objective of climate actions, the concept of necessity is subject to a high threshold. It requires a situation requiring a grave and imminent peril. Climate change is a phenomenon that unfolds over decades or even centuries, making it distinct from more immediate threats typically associated with the concept of 'grave and imminent peril'. Further, climate change predictions are based on scientific models and projections, which can involve uncertainties and varying degrees of confidence. This also undermines the claim that climate change constitutes a 'grave and imminent peril'. While Article 3 of the UNFCCC calls for precautionary measures to anticipate and prevent climate change, and the lack of full scientific certainty should not hinder action to prevent serious or irreversible damage,[108] the UNFCCC has no direct application in ISDS, and tribunals have no jurisdiction to arbitrate claims concerning the treaty. To apply in an international investment dispute, there must be a basis in an investment treaty, contract, or law.

Recently, in *Eco Oro v Colombia*[109], the Tribunal construed Article 2201(3) of the Columbia-Canada FTA (which is *pari materia* to Burkina Faso–Türkiye BIT) as being permissive, ensuring a Party is not prohibited from adopting or enforcing a measure to protect human, animal, or plant life and health, provided that such measures are not arbitrary or unjustifiable discriminatory between investment or between investors or a disguised restriction on international trade or investment. However, according to the Tribunal, there is no provision in Article 2201(3) permitting such action to be taken without the payment of compensation.[110] A similar approach was taken by the Tribunal in *Infinito Gold v Costa Rica.*[111] The approach by these two tribunals undermines the existence of the clause and the principle of the right to regulate. The clause exists as a carve-out for measures taken by the State for the reasons listed. If compensation is still required despite the allowance of protective measures, it questions the practical value and purpose of Article 2201(3) itself. In defending climate action this interpretation causes a financial burden to States, especially developing countries or those with limited resources. These funds could be allocated to other pressing priorities. Moreover, this deters policy implementation, as the fear of potential legal challenges and financial liabilities may lead governments to be more cautious and hesitant in enacting measures that could impact investors, as discussed earlier. This can also lead to inequality and the perception of investor privilege, as the requirement for the government to pay substantial compensation can reinforce the perception that the law favours the interest of large multinationals over local companies and the public interest. Thus, these provisions may not provide a safe harbour for defending climate action without more words such as 'will not give rise to compensation'. Such language would clarify that compensation is not required for measures taken to protect the environment, allowing governments to pursue climate action without undue financial burden or concerns about investor backlash. Interestingly, both *Eco Oro* and *Infinito Gold* stand in contrast to the earlier decision of *David Aven v Costa Rica* where the Tribunal held that the rights of investors are subordinate to the rights of the State to ensure that investments are carried out in a manner sensitive to environmental concerns, according to the carve-out provision contained in Article 10.11 of Chapter Seventeen of the Central America-Dominican Republic-United States Free Trade Agreement.[112]

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[108] UNFCCC, Article 3.

[109] *Eco Oro Minerals Corp. v Republic of Colombia*, ICSID Case No. ARB/16/41, Decision on Jurisdiction, Liability and Directions on Quantum, September 8, 2021, para. 829.

[110] Ibid.

[111] *Infinito Gold Ltd v. Republic of Costa Rica*, ICSID Case No. ARB/14/5, Award, 2 June 2021.

[112] *David Aven v Republic of Costa Rica*, UNCITRAL Case No. UNCT/15/3, Award 18 September 2018. para 412.

On the other hand, recent IIAs make explicit recognition of the right to regulate in their IIAs. They have included the States' regulatory powers within a 'general provisions' clause which appears to be written in preambular language. For Example, the 2018 EU–Singapore BIT uses the following language:

> '1.The Parties reaffirm their right to regulate within their territories to achieve legitimate policy objectives, such as the protection of public health, social services, public education, safety, environment or public morals, social or consumer protection, privacy and data protection and the promotion and protection of cultural diversity.'[113]

Some IIAs have also included this explicit recognition with similar wording in their preambles, for example, the Comprehensive and Economic Trade Agreement (CETA).[114] Moreover, the Trans-Pacific Partnership Agreement (TPP) in its preamble also recognises the 'inherent right of the parties to regulate and resolve to preserve the flexibility of the Parties to set legislation and regulatory priorities, safeguard public welfare, and protect legitimate public welfare objectives such as public health, the environment, the conservation of living or non-living exhaustible natural resources, the integrity and stability of the financial system and public morals'.[115] Further, the Myanmar–Singapore BIT (2019), Preamble:

> 'REAFFIRMING the Parties' right to regulate and to introduce new measures, such as health, safety, and environmental measures relating to investments in their territories in order to meet legitimate public policy objectives.'[116]

Additionally, the EU–United Kingdom Trade and Cooperation Agreement (2020), Preamble:

> 'RECOGNISING the Parties' respective autonomy and rights to regulate within their territories in order to achieve legitimate public policy objectives such as the protection and promotion of public health, social services, public education, safety, the environment including climate change, public morals, social or consumer protection, animal welfare, privacy and data protection and the promotion and protection of cultural diversity, while striving to improve their respective high levels of protection, […]'[117]

In the Colombia–Spain BIT (2021), Preamble:

> 'Convinced that investment has the potential to contribute to sustainable development and increase prosperity in both countries. Reaffirming the right of each Contracting Party to regulate the Investments made in its Territory to meet objectives legitimate public welfare concerns, which can be achieved without lowering your standards of health, public order and safety, labor and environmental rights of general application.'[118]

According to Baltga, the purpose of such clauses is to rectify that the mere exercise of a State's regulatory powers does not amount to a breach of investors' rights, provided it was done to achieve

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113 EU-Singapore nvestment Protection Agreement (2018) (not yet entered into force), Article 2.2.

114 Comprehensive and Economic Trade Agreement (CETA) (2016) in the preamble 'RECOGNISING that the provisions of this Agreement preserve the right of the Parties to regulate within their territories and the Parties' flexibility to achieve legitimate policy objectives, such as public health, safety, environment, public morals and the promotion and protection of cultural diversity'. Repeated again in Article 8.9.

115 Trans-Pacific Partnership Agreement (TPP) (2016) UNCTAD/WEB/DITC/2016/3.

116 Myanmar–Singapore BIT (2019), Preamble.

117 EU–United Kingdom Trade and Cooperation Agreement (2020), Preamble.

118 Colombia–Spain BIT (2021), Preamble.

legitimate public policy objectives.[119] Indeed, these clauses are located in the preamble or preambular. However, although the preamble is non-binding, the language may be consequential.[120] They do not attempt to establish clear hierarchies of norms but instead affirm that investment and other norms coexist harmoniously.[121] According to the VCLT, a tribunal should consider the context of the terms used and the treaty's object and purpose. Article 31(2) of the VCLT expressly provides that the preamble is part of the context for the interpretation of a treaty.[122] The provision establishes a positive right, specifying that the mere fact of changing a law, adversely affecting the parties' expectations (of profits) does not amount to a breach of an investment protection obligation.[123] According to Van Harten, these provisions give ISDS adjudicators, an interpretive source to weigh investors' rights against the good faith choices of legislatures, governments, and courts.[124] While these clauses have not yet been the subject of interpretation by an ISDS tribunal, *prima facie* it appears that arbitrators should appreciate the purpose of the provision is to strike a balance between protecting investors' rights and allowing States to regulate in the public interest. A tribunal should analyse whether the challenged measure is a legitimate policy objective such as the protection of public health, social services, public education, safety, environment or public morals, social or consumer protection, privacy, and data protection, and the promotion and protection of cultural diversity. These clauses may present an opportunity to defend climate action because they explicitly recognises the protection of the environment as a legitimate policy objective. Climate action such as the phasing out of fossil-fuel-based energy, and transitioning to renewable energy sources, contributes to the protection and preservation of the environment. Moreover, Climate change poses a significant risk to public health and safety, including increased frequency and intensity of natural disasters, heatwaves, and the spread of diseases. By regulating and implementing climate action policies, parties can mitigate these risks, safeguard public health, and ensure the safety of their citizens. These clauses recognise the importance of protecting public health and safety as legitimate policy objectives, thereby providing a basis for defending climate action. Indeed, these preambular clauses may provide a safe harbour for defending climate action. However, for the avoidance of doubt, they too may need more qualifying words such as 'will not give rise to compensation', thereby clarifying that such a measure does not trigger a requirement for compensation. Such clarification would alleviate concerns and provide a stronger basis for defending climate action within the framework of IIAs.

In light of the foregoing discussion, the right to regulate is crucial to defending climate action. It upholds State autonomy and acknowledges its unique circumstances, allows the State to prioritise public interest objectives such as climate change, and it strikes a balance between investors' rights and public interest objectives. Indeed, most investment treaties do not include reference to environmental concerns or include carve-out related to climate change, however, this

[119] Crina Baltag and others, 'Recent Trends in Investment Arbitration on the Right to Regulate, Environment, Health and Corporate Social Responsibility: Too Much or Too Little?' [2023] ICSID Review 1, 7.

[120] Noam Zamir & Paul Barker, 'The Trans-Pacific Partnership Agreement and States' Right to Regulate under International Investment Law' (2017) 45(2) DJILP 205, 215.

[121] MH Hulme, 'Preambles in Treaty Interpretation' (2016) 164 UPLR 1281, 1323.

[122] VCLT, Article 31.

[123] European Parliament, 'Outcome of the special European Council (Article 50) of 29 April 2017 Meeting' (*European Parliament*, February 2017) <https://www.europarl.europa.eu/RegData/etudes/ATAG/2017/603226/EPRS_ATA%282017%29603226_EN.pdf> accessed 27 June 2023.

[124] Gus Van Harten, 'ISDS in the Revised CETA: Positive Steps, But Is It a "Gold Standard"?' (Centre for International Governance Innovation , 20th May) <https://www.cigionline.org/publications/isds-revised-ceta-positive-steps-it-gold-standard/> accessed 27 June 2023.

does not mean that environmental concerns have no relevance in ISDS.[125] It is a general principle of international law that must be considered as an applicable law. Further, it is becoming increasingly important in the face of evolving global challenges like climate change. Indeed, tribunals have recognised the right to regulate, but they have done so in an abstract manner without sufficient guidance, resulting in inconsistency. The energy transition, with its aim of reducing emissions from fossil-fuel-based energy, presents new complexities and necessitates a reevaluation of the right to regulate. Thus, not only must tribunals continue to take into account the right to regulate when assessing potential breaches of FET but must recognise the origin, which will highlight the limits to applying the doctrine. In the next section of this Part, I will discuss how the right to regulate should be used by arbitrators to create a safe harbour for defending climate action.

(5) Using the Right to Regulate to Defend Climate Action

In defending climate action in ISDS, the effective utilisation of the right to regulate is crucial. It serves as a tool for maintaining a harmonious equilibrium between safeguarding the public interest and protecting the rights of investors, and arbitrators are faced with the task of striking a delicate balance between these two competing interests. Thus, in this section to this Part, I answer the critical question for arbitrators: How should the right to regulate be used?

Wide margin, only drastic change?

Some tribunals in determining what constitutes an acceptable margin of change have granted a 'high measure of deference which international law generally extends to the right of national authorities to regulate matters within their own borders'.[126] As a result, 'only a radical change to a regulatory regime satisfies this high threshold'.[127] This is based on the 'perceived need to expand judicial deference in investor-state arbitration where tribunals are faced with disputes that implicate the public interest, including, for example, disputes over the effects of fundamental State regulatory policy in areas like the environment, health, or public morals, as well as State action in the context of emergencies'.[128] Further, supporters of the margin in the ISDS context question whether non-national arbitrators ought to pass judgment on the State's domestic regulatory policy.[129] While this approach respects national sovereignty, *prima facie* it lacks clarity as to when defence should be given. It lacks a precise criterion on what constitutes a radical change which may lead to inconsistent outcomes and legal uncertainty. Further, this wide margin may also favour the State's interest over those of investors, leading to a potential imbalance that can arise in investment proceedings. This potential imbalance, while it can defend climate action, can be subject to abuse by the State which may discourage future investment. Therefore, another approach must be considered.

Flexibility to arbitrators?

Burke-White and von Staden stress that the right to regulate envisions different degrees of deference in different contexts.[130] Therefore, where an investment dispute has a public character,

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[125] Valentina Vadi, 'Beyond Known Worlds: Climate Change Governance by Arbitral Tribunals?' [2015] 48(5) VJTL 1285, 1343.

[126] *Antaris v Czech Republic* PCA Case No.2014-01, Award, 2 May 2018, para 360; *Eskosol S.p.A v Italy* ICSID Case NoARB/15/50, Award, 4 September 2020, para 433.

[127] Jack Biggs, 'The Scope of Investors' Legitimate Expectation under the FET Standard in the European Renewable Energy Cases' [2021] 36(1) ICSID Review 1, 113.

[128] Julian Arato, 'The Margin of Appreciation in International Investment Law' [2014] 54(3) VJIL 545, 557.

[129] ibid.

[130] William W Burke-White and Andreas von Staden, 'Private Litigation in a Public Law Sphere: The Standard of Review in Investor-State Arbitrations' [2009] 35(283) YJIL 283, 305-306.

the margin of appreciation allows the arbitrator the flexibility to determine whether a wide or limited degree of deference would be appropriate.[131] This perspective introduces a nuanced approach to the right to regulate. Similarly, this approach introduces ambiguity and subjectivity into the decision-making process of tribunals due to the lack of clear criteria and guidelines. The discretionary nature of this approach raises the potential for abuse and bias in decision-making. Arbitrators may favour certain parties or interests, which undermines the balance between investor-rights and the State's regulatory powers. These concerns may lead to potential inconsistent outcomes which compromises the fairness and integrity of the ISDS system.

Necessity?

Titi argues that the right to regulate under general international law is a reflection of customary international law and is reflected in the ARSIWA.[132] As discussed earlier, the Tribunals *CMS*, *Enron*, and *Sempra* imported the customary law requirements of necessity into their analysis and required Argentina to show that the actions it took were the only ones available to the government to respond to the crisis.[133] Admittedly, this standard derives from a source in international law – the necessity defence in customary law.[134] The necessity defence is a narrow carve-out of general customary law rules of state responsibility. It is extraordinarily narrowly defined and almost impossible to satisfy.[135] Moreover, the right to regulate is a primary rule and should not be underpinned by secondary obligations such as those found under the ARSIWA. The right to regulate refers to the State's inherent authority to adopt and enforce regulations within its territory in pursuit of public interest objectives. It is not necessarily an exception from a previous breach. Instead, it represents a State's sovereign power to govern and make decisions within its legal framework. Therefore, caution should be exercised in relying on the necessity defence in the right to regulate to defend climate action.

Good faith and proportionality?

Arato argues that the right to regulate entails no particular standard of review.[136] However, considering that this principle is a general principle of law existing in domestic legal systems, its operation in the domestic context must also be adopted. In domestic legal systems, when laws passed by their legislatures are challenged, domestic courts generally look at whether the law is reasonably required and reasonably justifiable.[137] There must be 'clear and compelling evidence that the State erred or acted improperly'.[138] In the absence of such, Tribunals should consider themselves bound to accept the justification given by States.[139] Thus, the principle reflects the principle of good faith and proportionality. Von Staden supports this view.[140] He argues that

[131] ibid.

[132] Titi (n76), 66-72.

[133] See *CMS Gas Transmission Company v Argentina* ICSID Case No. ARB/01/8, Decision on Annulment, 25 September 2007, para 130.

[134] ARSIWA, Article 25.

[135] ibid.

[136] Arato (n126) 558.

[137] Antigua & Barbuda CAP II; Barbados CAP III; Belize CAP II; Grenada CAP I; Jamaica s13; St. Lucia CAP I; St. Kitts Nevis CAP II; St. Vincent & the Grenadines CAP I; Constitution Acts 1982 (Canadian Charter of Rights and Freedoms) (Canada).

[138] *Saluka v Czech Republic,* UNCITRAL, Partial Award, 17 March 2006, para 272.

[139] ibid.

[140] Andreas von Staden, 'Deference or No Deference, That is the Question: Legitimacy and Standards of Review in Investor-State Arbitration' (Investment Treaty News, 19 July) <https://www.iisd.org/itn/en/2012/07/19/deference-or-no-deference-that-is-the-question-legitimacy-and-standards-of-review-in-investor-state-arbitration/> accessed 6 June 2023.

recognising, in principle, the appropriateness of deferential standards of review does not imply the necessity, much less the suitability, of a general, one-size-fits-all standard that would need to be added to the treaty as a whole.[141] According to him, what it requires, though, is that tribunals carefully scrutinise the provisions invoked in a given dispute and inquire whether they include substantive terms or concepts that point toward the legitimate role of regulatory action by the respondent State.[142] It is not for the tribunal to replace the State's assessment of what public purposes should be pursued with its own,[143] as long as the stated purpose is not a mere pretense.[144] This scrutiny can better be understood in the international context through the analysis conducted by the WTO's Appellate Body on 2.2 of the Technical Barriers to Trade (TBT) Agreement. This Agreement deals with technical regulations and conformity assessment procedures which have the potential to create barriers to international trade.[145] The Appellate Body in *US – Tuna II (Mexico)* provided the following guidance to panels adjudicating claims under Article 2.2 of the TBT Agreement:

> 'a panel must assess what a Member seeks to achieve by means of a technical regulation. In doing so, it may take into account the texts of statutes, legislative history, and other evidence regarding the structure and operation of the measure…Subsequently, the analysis must turn to the question of whether a particular objective is legitimate, pursuant to the parameters set out above…Further, the word 'objective' describes a 'thing aimed at or sought; a target, a goal, an aim'. The word 'legitimate', in turn, is defined as 'lawful; justifiable; proper'. Taken together, this suggests that a 'legitimate objective' is an aim or target that is lawful, justifiable, or proper.'[146]

The Appellate Body further explained in the context of Article 2.2:

> 'the assessment of 'necessity' involves a relational analysis of the trade-restrictiveness of the technical regulation, the degree of contribution that it makes to the achievement of a legitimate objective, and the risks non-fulfilment would create'.[147]

The articulation of such standards of review domestically can range from highly deferential judicial review at one end of the scale under a residual 'good faith' standard to a much more demanding and intrusive review of the merits of a decision under a strict scrutiny standard.[148] Good faith review, for example, merely inquires whether there was honest and fair dealing on the part of the respondent party and whether there had been at least a prima facie rational basis for its action.[149] Further, good faith is an extremely lenient standard.[150] It allows States to balance conflicting rights and interests and defers to the State's resolution of that balancing, as long as the State's determination was made in good faith and was reasonable. It requires States to internalise the

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[141] ibid.

[142] ibid.

[143] *ADC Affiliate Ltd. & ADC & ADMC Management Ltd. v. Republic of Hungary* ICSID Case No. ARB/03/16, Award of Oct. 2, 2006, paras. 429-433.

[144] ibid.

[145] Agreement on Technical Barriers to Trade (1995) 1868 UNTS 120.

[146] Appellate Body Report, *United States – Measures Concerning the Importation, Marketing and Sale of Tuna and Tuna Products*, WT/DS381/AB/R, adopted 13 June 2012, DSR 2012:IV, para. 314.

[147] ibid 322.

[148] Andreas von Staden, 'The democratic legitimacy of judicial review beyond the state: Normative subsidiarity and judicial standards of review' [2012] 10(4) IJCL 1, 17.

[149] ibid.

[150] William W Burke-White (n128) 312.

balancing process and offer a rational basis for their ultimate determinations.[151] By contrast, under a strict scrutiny standard of review, the court's inquiry is much more detailed and seeks to determine whether the governmental measure at issue 'is narrowly tailored to achieve a compelling governmental purpose' and is the 'least restrictive or least discriminatory alternative'.[152] This is known as the proportionality review. As the legitimacy of the Investor-State Dispute Settlement system continues to face concerns some argue that privileging majority voting among a small number of unelected and unaccountable judges, disenfranchises ordinary citizens and brushes aside cherished principles of representation, and such resolution should be entrusted to the representatives and electronically accountable legislatures.[153] Thus, international investment arbitration tribunals should adopt an approach similar to that which exists in the domestic context and is reflected in the practice of the WTO.

International Arbitration Tribunals need to accept that this is the appropriate standard to approach State regulations, especially climate action. This approach balances the rights of investors and the right to regulate in that it ensures that the State's decision-making is respected and upheld, as long as it is proportionate and in good faith. In the context of the energy transition and the phasing out of fossil-fuel-based energy, Tribunals should in light of evidence determine whether the measures taken were reasonably required and reasonably justifiable. First, there must be a showing that the measures taken by a State contributed to a legitimate aim, and, second, the tribunal must determine whether there were 'reasonably available alternatives' more compliant with the State's international obligations 'while providing an equivalent contribution to the achievement of the objective pursued'. Indeed, the legitimate aim for phasing out fossil-fuel-based energy is to mitigate climate change. This can be inferred by the fact that they are based on scientific evidence as recognised by several international law instruments ratified by the overwhelming majority of States.[154] Further, the lack of visible alternatives to the phasing-out of fossil-fuel-based energy sources provides a compelling justification for considering it as a reasonable and proportionate decision by the State. This approach allows Tribunals to weigh the right to regulate of the State and by extension the international community as a whole, against the infringement on investors' rights. By taking this approach to the right to regulate, States will be able to defend climate action and in doing so, the legitimacy of international arbitration tribunals can be preserved.

No ICSID tribunal has seriously engaged with the right to regulate and the appropriate standard of review to apply in cases that raise public interest issues. This good faith and proportionality analysis would lead to a more consistent and coherent approach to reviewing public regulation, especially relating to climate change. As the ECtHR observed in *Broniowski*, 'tribunals will respect the legislature's judgment as to what is 'in the public interest' unless that action is manifestly without reasonable foundation'.[155] Thus, it would be wise for international tribunals to embrace the good faith and proportionality analysis, this will defend climate action in the age of the energy transition. As discussed above RWE and Uniper have argued that it had a legitimate expectation that they would be allowed to operate Eemshaven, a coal-fired power plant based on irrevocable permits,[156] they were entitled to a stable legal environment as the ban on fossil fuels is

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[151] ibid.

[152] ibid.

[153] Jeremy Waldron, 'The Core of the Case against Judicial Review' [2006] 115 YLJ 1346, 1353. *See also* Yuval Shany, 'Towards a General Margin of Appreciation Doctrine in International Law' [2006] 16(5) EJIL 907, 920.

[154] Vadi (n123) 1328.

[155] *Broniowski v Poland*, Application no. 31443/96 (2005), para 54.

[156] *RWE AG and RWE Eemshaven Holdings II BV v The Netherlands*, ICSID Case No ARB/21/4, Claimant's Memorial, 18 December 2021, para 529-534; *Uniper SE, Uniper Benelux Holding B.V. and Uniper Benelux N.V. v The Netherlands*, ICSID Case No. ARB/21/22, Claimant's Memorial, 20 May 2022, para 447.

a departure from previous positions taken when the IIAs were signed, and the decision to phase-out fossil-fuel-based energy was not reviewed to determine whether the period for transition was adequate, whether biomass conversion was feasible, and steps the companies were taking to mitigate CO_2 emissions.[157] While these are valid points, they must be outweighed by the pressing need to address climate change and transition to more sustainable energy sources. Ultimately, the application of good faith and proportionality analysis by international arbitration tribunals can help to strike this balance between investors' rights and the State's right to regulate. This approach takes into account the gravity of the climate crisis and the urgent need for action. This approach will create a safe harbour for defending climate action.

D. WHY NOT MODERNISE THE IIAS?

As discussed earlier, fossil fuel investors have increasingly used the IIAs to challenge climate action. Thus, in an age characterised by the pressing need to address climate change and transition to more sustainable energy practices, the call for reevaluating and updating IIA provisions has grown louder. In June 2022, the Contracting Parties to the ECT finalised discussions on the modernisation of the ECT, and an agreement in principle was reached to be adopted by the Energy Charter Conference in November 2022. However, the European Union was been unable to adopt a common position in favour of the modernised ECT, leading to two postponements of the final vote. At the time of writing, no new date for the vote has been fixed.

The agreed modernised ECT continues to protect both existing and new investments in fossil fuels. However, Contracting Parties can exclude investment protection for fossil fuels in their territories.[158] The modernised ECT also extends investment protection to new energy activities and fuels, such as carbon capture, utilisation and storage, hydrogen, anhydrous ammonia, biomass, biogas, and synthetic fuels.[159] Further, the modernised text also seeks to clarify some of the substantive standards on investment protection,[160] notably 'fair and equitable treatment' now provides for a list that designates certain measures that would constitute a violation of this standard, including the frustration of investors' legitimate expectations.[161] Additionally, a new article reaffirms the Contracting Parties' right to regulate to achieve such legitimate policy objectives.[162]

While some writers view these changes positively,[163] there are issues associated with the modernisation of the ECT. First, obtaining a unanimous agreement for its adoption may prove challenging, given the opposition of Switzerland, the United Kingdom, Japan, and Kazakhstan.

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[157] *RWE AG and RWE Eemshaven Holdings II BV v The Netherlands*, ICSID Case No ARB/21/4, Claimant's Memorial, 18 December 2021, para 432; *Uniper SE, Uniper Benelux Holding B.V., and Uniper Benelux N.V. v The Netherlands*, ICSID Case No. ARB/21/22, Claimant's Memorial, 20 May 2022, para 462.

[158] ECT Agreement in Principle, Annex NI, Section B, Article 1.

[159] ibid Article 1(5); Annex EM I; Annex NI, Section B.

[160] ibid Article 10.

[161] ibid.

[162] ibid New Article: Right to Regulate.

[163] Maria José Alarcon, 'ECT Modernisation Perspectives: Revamping International Investment Law: A Comparative Look at Substantive ISDS Reform in the ECT and Beyond' (Kluwer Arbitration Blog, 10th May) <https://arbitrationblog.kluwerarbitration.com/2023/05/10/ect-modernisation-perspectives-revamping-international-investment-law-a-comparative-look-at-substantive-isds-reform-in-the-ect-and-beyond/> accessed 13 August 2023; Simon Maynard and Mikhail Kalinin, 'ECT Modernisation Perspectives: Unpacking the Impact of the Revised ECT Text on Dispute Resolution' (Kluwer Arbitration Blog, 6th November)< https://arbitrationblog.kluwerarbitration.com/2022/11/06/ect-modernisation-perspectives-unpacking-the-impact-of-the-revised-ect-text-on-dispute-resolution/> accessed 13 August 2023.

Second, for the revised ECT to become effective, it requires ratification by three-fourths of the Contracting Parties,[164] a process that might span several years as it requires approval from national parliaments. Third, the rationale for modernisation remains unclear. As this article has demonstrated, the right to regulate already exists as a general principle of international law that can be used to defend climate action, negating the immediate need for modernisation. Verbeek asserts that the turn of events concerning the ECT also has implications for the other IIAs currently in force because many of these treaties still contain old-style provisions on investment protection, which are incompatible with climate change objectives.[165] Again, as discussed, the right to regulate can be used to defend climate action.

E. CONCLUSION

In the face of a climate change disaster, it is argued that ISDS presently stands as a barrier to effective climate change mitigation. While the imperative to address climate change may urge a reevaluation of IIAs, the process of modernization is not easy. This article has highlighted the potential risks and challenges faced by States when attempting to balance the interest of investors and realising their climate change objectives. The complexities of climate action, as well as the potential for retroactive changes to the regulatory framework in the energy transition, can create uncertainty and increase the risk of ISDS. Thus, it is imperative for tribunals not to interpret the FET standard in isolation but to acknowledge and embrace the right to regulate as a carve-out. The interpretation of the right to regulate should be guided by principles of good faith and proportionality. By conducting this thorough analysis, tribunals ensure that regulatory measures adopted in response to climate change are reasonable, and do not unduly encroach upon the rights of investors. This approach preserves the sovereignty of States envisaged by international law and will provide a safe harbour for defending climate action in ISDS.

[164] ECT, Article 42.

[165] Bart-Jaap Verbeek, 'The Modernization of the Energy Charter Treaty: Fulfilled or Broken Promises?' [2023] 8 BHRJ 97, 102.

DEFENDING THE BEST INTERESTS PRINCIPLE: CARING FOR CRITICALLY ILL CHILDREN

*Ambareen Huq**

A. INTRODUCTION
B. TOWARDS AN UNDERSTANDING OF THE BEST INTERESTS PRINCIPLE
C. CHARLIE'S LAW: A CALL FOR THE SIGNIFICANT HARM THRESHOLD (SHT)
D. DISPUTING THE ASSUMPTION OF PARENTAL AUTHORITY
E. HISTORICAL CONTEXT AND THE DEVELOPMENT OF DIMINISHING PARENTAL AUTHORITY
F. A HUMAN RIGHTS DEFENCE OF THE BEST INTEREST PRINCIPLE
G. DEFENDING THE INVOLVEMENT OF THE COURT
H. CONCLUSION

A. INTRODUCTION

The best interests (BI) principle is one of the most widely discussed principles of medical ethics and within the wider discussion on human rights. The principle is recognised as one of the core principles of the United Nations Convention on the Rights of the Child (UNCRC)[1] and is domestically entrenched within the Children Act 1989.[2] Increasingly, the BI principle has attracted widespread criticism spurred by the landmark cases of *Gard* and *Evans.*[3] Such cases have attempted without success to augment parental authority in decisions regarding the treatment of critically ill children, especially in situations where disputes arise between healthcare practitioners and parents. Considering this, I discuss the question of whether the BI principle is fit for purpose with continued reference to parental authority. In this paper, I begin by clarifying the BI principle by looking at the principle and its application at the court. By addressing the strong presumption of continued medical treatment, the point at which the court intervenes with the BI principle is addressed. The factors assessed when ascertaining the BI of the child are then clarified to understand how the diverse range of factors considered mirrors the diverse nature of cases presented. Whilst embracing critics' views, I argue that though the principle is fit for purpose, there is merit in embracing criticism to push for greater transparency of the process. The BI principle is then contrasted with the call for a significant harm threshold (SHT) as proposed in the landmark *Gard* case.[4] Whilst comparing the two approaches, the current law is defended and the wider discourse concerning parental authority is introduced. By engaging in such a discourse, the BI principle can finally be defended under a human rights framework. I argue that the BI principle is

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[1] Convention on the Rights of the Child (adopted in 1989) UNTS 1577.

[2] Children Act 1989.

[3] *Great Ormond Street Hospital v Yates* [2017] EWHC 1909 (Fam) and *Alder Hey Hospital v Evans* [2018] EWHC 308 (Fam).

[4] *Great Ormond Street Hospital v Yates* [2017] EWHC 1909 (Fam).

a necessary safeguard for children from medical neglect. Finally, this essay justifies the court's intervention in this matter. The BI principle employed by the court effectively promotes the welfare of critically ill children as it is concerned with both private and public concerns, which is crucial for upholding values and providing binding decisions that contribute to the consistency and clarification of the law. Hence, I argue that the BI principle remains fit for purpose when it comes to the care of critically ill children. Consequently, a fundamental change in the law is not required, however, clarification over the process of ascertaining the BI of the child is advised to increase transparency and clarity between the healthcare practitioners and parents.

B. TOWARDS AN UNDERSTANDING OF THE BEST INTERESTS PRINCIPLE

Courts have understood the process of withholding or withdrawing life-sustaining treatment from critically ill children as a joint decision between doctors and those with parental responsibility.[5] Whilst individuals with parental responsibility are obligated to make decisions in accordance with the child's BI, and crucially not their own,[6] doctors, despite involving those with parental responsibility in decision-making,[7] are not legally obliged to provide treatment if the prevailing medical opinion assumes it contrary to the patient's BI or even futile.[8] It is important to note that the majority of disputes regarding life-sustaining treatment are resolved through mediation without the need for the court's intervention.[9] Consequently, in cases which do appear in front of the court, the process requires an objective exploration of a broad range of factors including medical, emotional, and all other aspects of welfare.[10] Notably, there is a strong presumption in favour of maintaining ongoing treatment.[11] The court is tasked with weighing competing factors to ascertain what is in the child's BI, which will undoubtedly vary from case to case.[12] The Children Act 1989 explicitly states that when a court determines any matter related to the upbringing of a child or the management of a child's property, the child's welfare shall be the primary consideration[13], which echoes international law standards as well.[14] Thus, it would appear as though the current legal framework, at least as a principle, is simple. It is the application of the principle that complicates the process.

Criticism of the BI principle is intriguing considering two salient opposing perspectives. Critics of the BI principle can be categorised into two main groups: those who argue that the principle is applied too objectively and those who contend that it is applied too narrowly. The first group maintains the framework concerns only the biomedical interests of the child, and consequently, children's family lives are not accounted for.[15] Indeed, Diekema criticises the

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[5] *Re J (A Minor) (wardship: medical treatment)* [1990] 3 All ER 930 (CA).

[6] Children Act 1989

[7] *Glass v United Kingdom* (App No 61827/00) [2003] ECHR 719.

[8] *Re A (a child)* [2016] EWCA Civ 759.

[9] Joe Brierley, Jim Linthicum, and Andy Petros, 'Should Religious Beliefs be Allowed to Stonewall a Secular Approach to Withdrawing and Withholding Treatment in Children' (2013) 39 J Med Ethics 573.

[10] *Wyatt v Portsmouth NHS Trust* [2005] EWHC 117.

[11] *Re A (a child)* [2016] EWCA Civ 759.

[12] *Re A (Medical Treatment: Male Sterilisation)* [2000] 1 FLR 549.

[13] Children Act 1989 s1(1).

[14] Convention on the Rights of the Child (adopted in 1989) UNTS 1577.

[15] Vic Larcher and others, 'Making decisions to limit treatment in life-limiting and life-threatening conditions in children: A framework for practice' 100 Archives of disease in childhood s3.

frequent reduction of the principle to solely objective medical interests[16], a criticism that is situated within the broader context of diminishing parental authority, a topic that will be further explored in this paper. However, this seems to be in stark contrast to the findings of Birchely who conducted interviews with clinicians to ascertain what factors contribute to the BI of the child. There was extensive reference to what is best for the child.[17] Such a conception is influenced by nuanced considerations of the wishes of the family whilst balancing any negative impact on the child.[18] Hence, when healthcare professionals evaluate the BI of the child, it is inherent to the application of the principle that they will assess the potential harms and benefits of various treatment options, including those proposed by parents. The second group argue that the principle is inherently subjective and considering differing values and how to balance competing childhood interests it is difficult to conclude the BI.[19] Such criticism alludes to the idea that there is inconsistency in the application of the principle. However, I believe that this more accurately points to the diverse nature of cases presented and the diverse factors the courts must account for when ascertaining the BI of the individual child. Such an approach seems to be embraced by the court. In *Barts Health NHS Trust v Raqeeb*, although doctors considered the continuation of Tafida's life-sustaining treatment was not in her BI, Justice McDonald undertook a careful and balanced approach to identify what was in her BI.[20] During the process, Justice McDonald asserted that to answer the objective BI test, subjective or highly valued ethical, moral and religious factors intrinsic to the child must be assessed.[21] More recently, in *Re Archie Battersbee* the court reaffirmed such a stance by drawing the parameters of the BI principle beyond the medical issues at stake, and campaigning for the child, his personality and wishes at the centre of the process and not viewing him as simply the raft of medical complexity.[22] Whilst I believe it is clear that the BI principle is broad and value-laden, and consequently fit for purpose, there is merit in acknowledging the criticisms. Such views draw attention to the lack of transparency in the process of identifying the BI of the child and indeed the factors that influence it. Thus, it would be beneficial to the treatment of critically ill children if the law better clarified the criteria which would have implications for greater transparency between healthcare professionals and parents.

C. CHARLIE'S LAW: A CALL FOR THE SIGNIFICANT HARM THRESHOLD (SHT)

As alluded to earlier in this paper, *Gard* was a significant case within the discourse concerning the treatment of critically ill children, not least because of its calling into question who has the ultimate say over a child's medical treatment. But further, it has given rise to questions regarding the relationship between the state and its citizens, and questions where the legitimate boundaries for state interference in family and private life should be set. In *Gard*, the parents of the infant, diagnosed with infantile-onset encephalomyopathic mitochondrial DNA depletion syndrome, a rare condition, contested the application of the BI principle. A disagreement between the parents and Great Ormond Street Hospital (GOSH) regarding the administration of experimental

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[16] Douglas S Diekma, 'Parental Refusal of Medical Treatment: The Harm Principle as Threshold for State Intervention' (2004) 25 Theoretical Medicine and Bioethics 243.

[17] Giles Birchely, 'The Harm Threshold: A View from the Clinic' in Imogen Goold, Jonathan Herring and Cressida Auckland (eds) *Parental Rights, Best Interests and Significant Harms* (1st edn, Hart Publishing 2019) 107.

[18] Ibid.

[19] Erica K Salter, 'Deciding for a child: a comprehensive analysis of the best interest standard' (2012) 33 Theoretical Medicine and Bioethics 179.

[20] *Barts Health NHS Trust v Raqeeb* [2019] EWHC 2530.

[21] Ibid.

[22] *Dance & Ors v Barts Health NHS Trust (Re Archie Battersbee)* [2022] EWCA Civ 1106.

treatment. GOSH maintained that Charlie should not receive the treatment and was unwilling to administer it, despite the parents' wish. Whilst typically a refusal by a hospital to administer treatment would preclude the possibility of receiving such treatment, a hospital in the US expressed willingness to provide the experimental nucleoside therapy. The parents were seeking permission to transfer Charlie to a hospital that was willing to treat their son. With the plausibility of receiving treatment elsewhere, the case introduced a new question to the court regarding the application of the BI principle. Since the parents were not attempting to persuade GOSH to treat Charlie, the key issue became whether a specific threshold should be established before the court intervenes in parents' medical decisions regarding their children. A SHT was suggested which would declare that the court could intervene only at the point at which the parent's decision exposed the child to a risk of serious harm. The proposal was promptly rejected by the court with Lady Hale explicitly supporting the BI asserting that parents cannot demand treatment that is not in the BI of the child. Though the proposal was rejected, the public endorsement of the threshold has greatly contributed to the widespread campaign for the adoption of what is now understood as Charlie's Law.[23]

D. DISPUTING THE ASSUMPTION OF PARENTAL AUTHORITY

It is evident that the campaign for a SHT is based on the assumption that parental authority should be sovereign. However, as will now be discussed, this assumption is not, and should not be considered, absolute. The SHT relies upon the assumption that parental authority should prevail in situations of disagreement, which means it is useful to assess the concept as part of the framework governing the *zone of parental discretion*. This zone safeguards a realm where parents can rightfully make decisions for their children, even if these choices are suboptimal and not the absolute best.[24] Within this realm, parental decisions that are *good enough* suffice as long as they do not cause significant harm to the child.[25] Within the available literature, it is uncontroversial to assert that parents maintain a justified right to make decisions for their children with this being limited by the principle of significant harm. Certainly, a common suggestion is that parents maintain an ethical right to make medical decisions for their children, guided by their understanding of a good life.[26] Others justify parental authority not merely through presumption but by invoking John Stuart Mill's harm principle.[27] Within this perspective, parental autonomy can be seen as an extension of personal autonomy. However, adopting this view should be criticised for the implications it has on how we view the parent/child/doctor relationship, which is fundamentally different from the relationship between the state and the individual. Indeed, the freedom of an individual to make choices as to how they lead their life does not extend to nor encompass the freedom to make parental choices, that is choices over another human being's life.[28] As Taylor crucially reminds us, the most important component of parental responsibility is that

[23] Imogen Goold, 'Evaluating 'Best Interests' as a Threshold for Judicial Intervention in Medical Decision-Making on Behalf of Children' in Imogen Goold, Jonathan Herring and Cressida Auckland (eds) *Parental Rights, Best Interests and Significant Harms* (1st edn, Hart Publishing 2019) 2.

[24] Lynn Gillam, 'The Zone of Parental Discretion: An Ethical Tool For Dealing with Disagreement between Parents and Doctors about Medical Treatment for a Child' (2016) 11 Clinical Ethics 1.

[25] Ibid.

[26] Ibid.

[27] Douglas S Diekma, 'Parental Refusal of Medical Treatment: The Harm Principle as Threshold for State Intervention' (2004) 25 Theoretical Medicine and Bioethics 243.

[28] David Archard, Emma Cave, and Joe Brierley, 'How should we decide how to treat the child: harm versus best interests in cases of disagreement' (2023) 0 Medical Law Review 1.

the parental role is one of responsibility to children rather than proprietary rights over them.[29] Thus, it is my view that permitting parents to make medical decisions that are not in the BI of the child is inappropriate considering the baseline assumption of parental authority is not correct and encouraging such a shift in the law would be synonymous with viewing children as property of their parents. Indeed, the BI principle within this context remains an effective system to protect children from this form of exploitation.

E. HISTORICAL CONTEXT AND THE DEVELOPMENT OF DIMINISHING PARENTAL AUTHORITY

In high-profile cases such as *Gard and Evans*, the courts made it clear that they retained jurisdiction to intervene whenever a child's welfare is an engaged concern. However, in their judgements, it was not made clear where this jurisdiction is found. The court's *parens patriae* doctrine, the foundation of its inherent jurisdiction, has been developing since feudal times. This concept originated from the idea that the monarch, acting as the ultimate authority, had jurisdiction over justice and even had a parental role, known as *parens patriae*, to care for those who could not care for themselves in the country.[30] Feudal lords held this power until it was conveyed to the courts in the sixteenth century. Consequent case law developed in the 19th century appears to further support this role. Indeed, in *Re Flynn (1848)* the court maintained this role in order to protect children from their parents' decisions where again their safety and welfare would be significantly impacted by the decision.[31] *Re Gyngall* upheld the role of the court by asserting that the court, under the Crown's prerogative, is situated as the ultimate parent of children. The court is obligated to wield its jurisdiction in accordance with the actions of a wise, affectionate, and careful parent.[32] Until this point, it would appear that the powers of the court were limited by a *parent's know best* view which was gradually subordinated by various statutes and case law in the latter half of the 19th century. Indeed, the Guardianship of Children Act 1886 standardised parental rights and made the welfare of the child a statutory factor, whilst the Custody of Children Act 1891 gave the court power to interfere with parental rights in the interests of the child. *Re McGrath (Infants)*[33] unequivocally emphasised that the court's paramount concern is the comprehensive welfare of the child. Such a stance was repeatedly affirmed during the first half of the 20th century through statutory and case law developments.[34] Indeed, *J v C* established that parental rights had been subordinated by the paramountcy of the BI of the child.[35] The stance of the court was explicitly reaffirmed in Gillick suggesting that in common law common law parental rights have never been treated as sovereign or beyond review and control**.** Indeed, parental rights exist for the performance of their duties and responsibilities to the child, thus such rights must be exercised

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[29] Rachel Taylor, 'Parental Decisions and Court Jurisdiction: Best Interests or Significant Harm?' in Imogen Goold, Jonathan Herring, and Cressida Auckland (eds) *Parental Rights, Best Interests and Significant Harms* (1st edn, Hart Publishing 2019) 141.

[30] Graeme Laurie,'Parens Patriae Jurisdiction in the Medico-Legal Context: The Vagaries of Judicial Activism' (1999) 3 Edinburgh Law Review 95.

[31] *Re Flynn* (1848), 2 DeG. &Sm. 457, 64 E.R. 205.

[32] *R v Gynall* (1893) 2 QB 232.

[33] *Re McGrath (Infants)* [1893] 1 Ch 143.

[34] Cressida Auckland and Imogen Goold, 'Parental Rights, Best Interests and Significant Harms' (2019) 78 Cambridge Law Journal 287.

[35] *J v C* (1970) AC 668.

with regard to the BI of the child.[36] By assessing the historical intervention of the court, the reliability of the institution as a safeguard of children's welfare can be established.

F. A HUMAN RIGHTS DEFENCE OF THE BEST INTEREST PRINCIPLE

The final argument I offer in support of the BI approach to caring for critically ill children is the human rights one. I maintain that the BI principle remains an effective way of protecting children from medical neglect, at least in a situation where the SHT is the alternative option. Indeed, within the human rights law sphere, the vulnerability of children continues to be the driving force for advancing their rights. The preamble of the UNCRC highlights the UN's acknowledgement that childhood is deserving of special care and assistance.[37] It serves as a reminder that due to the physical and mental immaturity of children, they require particular safeguards and care.[38] Accordingly, the BI of children should be the primary consideration in all actions considering children.[39] The treatment of children within the private sphere is a matter of particular concern when considering children's rights. Generally, the state upholds the family as champions of children's rights by acknowledging a zone of privacy within the household.[40] However, such a position has come under rightful scrutiny as privacy and autonomy have been positioned as a cover for child abuse and neglect.[41] As Cronin elucidates, to compensate for *natural guardians'* failure of duty, there is a shift of responsibility to state-appointed experts, including medical practitioners, to compensate for this shortcoming.[42] A crucial aspect of the discussion on the domestic abuse of children revolves around the issue of medical neglect. Whilst it can be contested what constitutes medical neglect of children, a constructive interventionist approach seems appropriate considering its capacity to illustrate the complexity of the situation.[43] Such an approach identifies what the child needs and how best this can be provided.[44] Under this framework it would appear that adopting the SHT considering its willingness to overlook the BI of the child, runs the risk of permitting medical neglect of children, thus violating their rights. Hence, the BI principle remains well-suited for protecting the rights of critically ill children. It is noteworthy that there appears to be a literary deficit in explicitly discussing the link between the pursuit of the SHT and its potential to promote medical neglect of children. Such an exploration should be encouraged to better clarify how we promote children's welfare, especially those who are critically ill and lack autonomy in making decisions about their medical care.

G. DEFENDING THE INVOLVEMENT OF THE COURT

This paper has maintained that the current law governing the care of critically ill children through the BI principle is still very much an effective means for promoting children's welfare. Within this wider discourse lies the question regarding whether the court is the best forum for dealing with

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[36] *Gillick v West Norfolk and Wisbech Area Health Authority* [1986] A.C. 112.
[37] Convention on the Rights of the Child (adopted in 1989) UNTS 1577.
[38] Ibid.
[39] Convention on the Rights of the Child (adopted in 1989) UNTS 1577 s3(1).
[40] Kieran Corin, 'What About Children's Rights?' (2011) 62 The Furrow 387.
[41] Ibid.
[42] Ibid.
[43] Howard Dubowitz and others, 'A conceptual definition of child neglect' (1993) 20 Criminal Justice and Behaviour 2.
[44] Ibid.

disagreements regarding the treatment of critically ill children. Whilst I am of the view that a judicial process which employs the BI principle is still fit for purpose, it would be fruitful to engage with this issue further to establish why this is the case. Critics of the process suggest that court involvement impinges on a fair and expedient process.[45] However, such requirements are often competing within this context. Indeed, principles of fairness, such as due process, potential for deeper reflection, gathering of all relevant information and potential to contest a decision, can result in decisions not being expedient.[46] Simultaneously, an expedient process, such as unilateral and final decision-making by a clinician, would not be fair. Furthermore, appeal mechanisms are pertinent to safeguard against the power of the state and help prevent subpar or arbitrary decision-making.[47] Even within the context of the *Gard* case, the applicants appealed to three tiers of the court, hence it is clear that even if individual courts have the capacity to make decisions quickly, it is not necessarily conducive to a fair process. Instead, the current involvement of the court supports the values required in such cases. It is also important to remember that the issue of treating critically ill children is a matter of both private and public concern. The private element is clear in that applicants are private individuals bringing cases forward against medical practitioners, however, the decision of the court has implications for the public too. Indeed, the court will make public statements and provide binding decisions.[48] Whilst private individuals may be faced with decisions in clear opposition to their wishes, this may be necessary in order for the courts to clarify the law and the process of decision-making. It is further worth reminding that the application of the BI principle necessitates analysis of the interests of the individuals involved. Such a trade-off further promotes long-term benefits to the consistency and clarification of the law.

Further criticism of the court's involvement in this process surrounding *Gard* includes the issue of adversarialism.[49] It may be challenging to prevent conflict and negative emotions, as either compelling healthcare practitioners to act against their conscience or discontinuing treatment against parents' views is likely to generate such tensions, even with a highly sensitive decision-making process. Consequently, the involvement of the court may be ideal in disputes considering its independent nature. Though some adversarialism is inevitable, addressing concerns regarding cost and delay related to the process may be plausible through empowering quasi-judicial multi-member tribunals which are often multidisciplinary and can assemble panels with both clinical and ethical expertise.[50] For the UK to extend its tribunal process into this area it may allow the law to operate with greater flexibility, speed, and inquisitorial capacity, which provides potential for the fair and expedient forum campaigned for by Wilkinson and Savulescu.[51] Indeed, tribunals are not rigidly bound by rules of evidence, allowing them to operate more efficiently and explore a wider range of issues beyond the constraints imposed by the involved parties. There is developing support for the use of clinical ethical committees.[52] These committees centre their concern around the provision of ethical advice regarding the BI of critically ill children. It is hoped that utilising these services as a primary forum for these kinds of disputes would reduce the consequences of the limitations of the law. That is to say, they carry the potential to mitigate costs to both parties,

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[45] Dominic Wilkinson and Julian Savulescu, 'Hard lessons: learning from the Charlie Gard case' (2018) 44 Journal of Medical Ethics 44.

[46] Eliana Close and others, 'Charlie Gard: in defence of the law' (2018) 44 Journal of Medical Ethics 476.

[47] Ibid.

[48] Ibid.

[49] Dominic Wilkinson and Julian Savulescu, 'Hard lessons: learning from the Charlie Gard case' (2018) 44 Journal of Medical Ethics 44.

[50] Terry Carney and David Tait, *The Adult Guardianship Experiment: Tribunals & Popular Justice* (7th edn, Federation Press 1997) 229.

[51] Dominic Wilkinson and Julian Savulescu, 'Hard lessons: learning from the Charlie Gard case' (2018) 44 Journal of Medical Ethics 44.

[52] Richard Huxtable, 'Clinic, courtroom or (specialist) committee' (2018) 44 Journal of Medical Ethics 471.

including financial, legal and emotional costs considering the sensitive nature of such cases.[53] Certainly, it seems evident that clinicians, patients, and the court share the belief mediation should be pursued prior to resorting to legal intervention. Healthcare practitioners frequently advocate for reaching a compromise with parents before escalating the matter to court.[54] Additionally, for parents, involvement in the court process can be distressing.[55] Francis J in *Gard* further stressed that mediation should be attempted in all cases, even if all that is achieved by this is a greater understanding of each party's position.[56] There are clear similarities between the tribunal and ethical committee frameworks, however, I am of the view that the former is more appropriate within this context. Though both models allow for obtaining ethical and medical evidence, tribunals are able to represent the state and their decisions are generally legally enforceable. Whilst the tribunal will not necessarily be able to form binding precedents, it still maintains a duty to provide publicly available reasons for the decisions. Hence the model could promote transparency and contribute to greater certainty of future decision making.

H. CONCLUSION

Therefore, this essay has expressed that the BI principle remains a crucial and effective framework for the care of critically ill children. The prevailing legal framework, grounded in both domestic and international laws, emphasises collaborative decision-making amongst healthcare practitioners, parents, and the courts. Whilst critics debate the breadth and narrowness of its application, a nuanced understanding reveals that practitioners consider a diverse range of factors, including family wishes. Criticisms mirror the diversity of cases requiring the BI principle, but they overlook evolving case law acknowledging subjective and ethical factors. Cases like *Raqeeb* and *Batersbee* demonstrate the court's openness to incorporating intrinsic child factors. Whilst embracing the criticisms, I contend that concerns can be addressed within the existing legal framework. I have then assessed the suitability of the BI principle in light of the currently widely campaigned alternatives. As such, the shortcomings of the proposed SHT, as raised in *Gard,* have been used to justify the suitability of the BI principle. The rejection of Charlie's Law has been defended, emphasising the continued importance of the BI principle in protecting children from potential harm. The analysis contended that the assumption of absolute parental authority, as implied by the proposed legal reform, is flawed. Parental authority is not absolute and the BI principle serves as a necessary safeguard against potential harm caused by suboptimal parental decisions. By looking at the historical context of diminishing parental authority, the court's traditional role in intervening when a child's welfare is at stake has been used to further justify the reliability of the principle. I further presented the human rights perspective as a strong defence of the current law, emphasising the vulnerability of children and the need for their BI to be the primary consideration. Within the framework of human rights, the BI principle is posited as a robust mechanism for protecting children from medical neglect. Finally, this essay has defended court involvement in disputes, countering critics who argue for alternative forums. I have maintained that the judicial process of employing the BI principle is justified by the court's concern for fairness, due process, and the safeguarding of both private and public concerns. Thus, this paper has argued that the BI test when caring for critically ill children, as embodied in the current legal framework, is argued to be fit for purpose. Whilst acknowledging criticisms, the paper asserts that the existing system is

[53] Ibid.

[54] Giles Birchely and others, 'Best interests' in paediatric intensive care: an empirical ethics study' (2017) 102 Archives of Disease in Childhood 930.

[55] Richard Huxtable, 'Clinic, courtroom or (specialist) committee' (2018) 44 Journal of Medical Ethics 471.

[56] Great Ormond Street Hospital v Yates [2017] EWHC 1909 (Fam).

effective, adaptable, and aligned with human rights principles. The call for greater transparency and clarification of criteria within the law can be met without necessitating a fundamental shift away from the BI principle.