Legal Review: Scotland and England
Year ending 31 December 2006

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INTRODUCTION

I am very pleased to introduce another bumper issue of our annual legal review. Once again, there has been prolific "legal" activity during the year both at home and in Europe affecting corporate businesses in the UK.

This year, for the first time, we have produced, separately, a number of industry specific supplements. We have also produced an international edition featuring contributions from many of the countries in which we or DLA Piper Group firms have offices. If you have only received this review in hard copy, you will need to email your usual contact for links to each of these (as well as a link to the electronic version of this edition).

In the UK, the new Companies Act 2006, rushed into force before Christmas, has dominated. Amongst other things, it includes new rules relating to communications to shareholders (paragraph 7.2) and financial reporting, (paragraph 8.3), and implementation of the Takeovers Directive (paragraph 35.1).

Other key legal issues of general interest include:

- consumer credit: new law (paragraph 12.1);
- corporate crime: provisions relating to serious organised crime (paragraph 13.1), a new Fraud Act (paragraph 13.5), and the new corporate manslaughter (in Scotland, corporate homicide) offence (paragraph 13.7);
- data protection: possible problems for financial institutions (paragraph 15.5);
- age discrimination (paragraph 17.4.1) and new rights relating to maternity and adoption leave and pay (paragraph 17.7.2);
- significant activity in the environment area: climate change (paragraph 18.1), provisions aimed at the disposal of waste electrical and electronic equipment (paragraph 18.3) and new measures requiring manufacturers, importers and the like to show that their products can be used safely (paragraph 18.5);
- the impact, in the UK, of the Markets in Financial Instruments Directive (paragraph 20.5);
- wholesale reform of the law relating to fire safety in non-domestic premises (paragraph 23.4);
- pensions: A-Day "simplification" (paragraph 38.1), age discrimination (paragraph 38.2) and consultations with employees about pensions (paragraph 38.3); and
- Real Estate Investment Trusts (REITs) (paragraph 42.2).

In many cases, sources of further information have been given although partners and staff here at DLA Piper will be pleased to give advice. Details of key contact partners are set out in appendix 1.

Nigel Knowles
January 2007
1. **ADVERTISING**

1.1 **Premium rate telephone numbers**

In an effort to protect "vulnerable groups", the Independent Committee for the Supervision of Standards of Telephone Information Services is to review the practices of quiz shows on television which charge viewers via premium rate phone numbers. In certain cases, individuals are charged whether or not they get through to the show. In addition, the House of Commons culture, media and sports committee is also undertaking an inquiry into the growing number of premium rate television quiz channels.

In August 2006, the Gambling Commission launched its own public consultation into premium rate competitions in an effort to clarify the current law surrounding lotteries, prize competitions and free draws. In the wake of a series of high profile complaints (for example, in connection with Big Brother voting), this is likely to be a hot topic in 2007.

1.2 **Children and junk food**

Ofcom has announced a total ban on advertisements featuring foods high in fat, sugar and salt around all childrens' programming (and adult programming watched by a significantly high proportion of children). It is intended that the ban will come into force before the end of January 2007.

Specifically, the measures will apply to: all pre-school childrens' programmes; all programmes on mainstream channels aimed at children; all cable and satellite children's channels; programmes aimed at young people (for example, music shows); and general entertainment programmes which would appeal to a "higher than average" number of under 16's.

1.3 **Consumer credit**

For information about consumer credit advertising, see paragraph 12.4.

1.4 **Television**

For further information about advertising and product placement on television, see the separate Media supplement.

2. **ARBITRATION**

2.1 **International arbitrators: conflicts of interest and bias?**

Two interrelated criticisms of international arbitration, frequently advanced by exponents of domestic litigation, are the potential for arbitrators to fall foul of a conflict of interest and that an arbitrator may be biased towards his or her appointing party.
While critics may well support their arguments against international arbitration with specific examples, those examples are the exception rather than the rule and the arguments themselves are flawed in a number of respects.

2.1.1 Conflict of interest

Given the ability to challenge an award based on certain categories of procedural unfairness (see, for example, section 68(2)(i) of the English Arbitration Act 1996), the international arbitration community has become thorough and adept in dealing with the question of an arbitrator’s actual, or apparent, conflict of interest.

As a starting point, all of the recognised arbitration rules invariably provide that the arbitrators must be independent of the parties (see, for example, article 7 of the ICC Rules). The rules also typically provide that the arbitrators must disclose, at the earliest stages of the proceedings, any possible connection with any of the parties or indeed any apparent pre-disposition as to the likely issues in the case. These disclosures then typically form part of the arbitration’s terms of reference, which are agreed to and countersigned by the parties.

In addition, the International Bar Association published guidelines on 22 May 2004 setting out the best current practice for the identification and subsequent disclosure of conflicts of interest in international arbitration. The guidelines are split into two parts. The first sets out the seven general principles (referred to as the General Standards). The importance of independence is set out in General Standard.

The second part deals with the question of practical application and divides potential conflicts of interest into three colour-coded lists: the Red List, the Orange List, and the Green List. The Red List sets out “severe” conflicts of interest where an arbitrator cannot act (or those situations where he/she can act only with the express consent of the parties); the Orange List sets out the situations where a conflict could exist in the eyes of the parties; and the Green List sets out a list of situations which do not give rise to an actual or apparent conflict.

The arbitrators’ duty to disclose any relevant (or potentially relevant) information enables the parties to form a view on the appointment of the arbitrator based on a full understanding of his or her background. This is a luxury not available in domestic litigation.

2.1.2 Perceived bias

To an untrained eye, the following necessarily gives rise to the potential for bias: an arbitrator relies on appointments in order to make a living; a party appoints an arbitrator to resolve a dispute; certain arbitrators are regularly appointed by the same parties/practitioners.

While there may be examples where an arbitrator appears to favour the party which has appointed him or her, these are usually instances of misguided perception. Such criticisms fail to take into account the ability of some of the best judicial minds in the world to draw the requisite distinction between personal interest and judicial fairness; as such, these examples could be characterised as insulting.
There is a rational counter argument. Arbitrators rely on the parties for appointments, thus, could it not be said that their independence, credibility, and capability is under constant scrutiny and review? Therefore, if an arbitrator is found lacking in any of these areas, it will undoubtedly have a negative impact on that arbitrator's reputation. In this way, only the best candidates will find themselves being regularly appointed by the international arbitration practitioners.

By contrast, the "check" for judges in domestic litigation remains the desire not to be overturned on appeal. Thus, the continuous need to demonstrate independence, credibility and capability is significant, but perhaps not as acute as is the case for international arbitrators who rely on the users for future appointments.

2.2 Assignment of arbitration clauses under English law

Are the arbitration provisions of an assignable contract themselves assignable? This is an important question given the frequency and ease with which corporate entities regularly merge with one another. If these clauses are not assignable, a defendant could easily terminate its obligations to arbitrate by simply merging with another entity.

The English courts recently confirmed, in The Republic of Kazakhstan v Istil Group Inc, that the presence of an arbitration clause in a contract which is by its nature assignable will not prevent assignment of the entire contract, including its arbitration provisions, as arbitration clauses are by their nature assignable.

2.2.1 Assignment once arbitration has commenced

The possibility of assignment of arbitration provisions once the arbitration has commenced is a rather more difficult question and raises two important questions: whether arbitration clauses can be assigned (post commencement of arbitral proceedings); if so, in what circumstances such an assignment would be valid?

This issue was also considered in The Republic of Kazakhstan v Istil Group Inc.

The defendant (Istil) was the successor of a company called Metalsrussia (BVI) Ltd. The latter company changed its name to Metalsrussia Corp. Ltd in 1991 and then in April 2002 merged into its parent company Metalsrussia Group Holdings Ltd. This company then in turn merged into Istil. The consequence of each merger was that Metalsrussia (BVI) Limited and Metalsrussia Group Holdings Limited ceased to exist by virtue of section 70 of the British Virgin Island International Business Companies Act.

The approach adopted in the 1990 case, The Jordan Nicolov, was confirmed ie that an arbitration clause is assignable even after arbitration proceedings have commenced, and the assignee may simply take over the assignor's proceedings without the need to start afresh.

2.2.2 Validity of the assignment

It is important to note that the usual rules as to the assignability of contracts will govern the fate of the arbitration clause. For example, if the main contract is one involving personal services or is otherwise not assignable, any purported assignment is void and the assignee cannot be regarded as a party to any arbitration clause.
Equally, if the contract is by its nature assignable but contains a non-assignment clause which is effective to prevent any interest being assigned, then plainly any dispute arising under the contract which is required to go to arbitration cannot be pursued by or against any purported assignee of the contract or its benefits.

As to the principle of assignability, there are two qualifications. First, the arbitrator must be given notice of a change of claimant. If notice to the arbitrator is not given within a reasonable time, the assignee loses the right to participate in the arbitration proceedings. Secondly, if required by the other party, the assignee must prove title to sue by providing evidence that there has been an absolute assignment of the clause, in writing with notice to the other party.

2.3 Annulment: a delaying tactic for ICSID respondents?

Parties to arbitrations before the International Centre for Settlement of Investment Disputes ("ICSID") have the right to apply for annulment of the final arbitral award. This is a crucial difference between the ICSID Arbitration Rules and those of other established international arbitration institutions. This is likely to have a significant impact on the timetable for final resolution of a dispute. The ICSID annulment procedure can potentially be used as a delaying or negotiation tactic by ICSID respondents.

2.3.1 ICSID arbitration

The ICSID Convention provides an international regime for arbitration of investment disputes arising under public international law, under both bilateral and multilateral investment treaties. Investment treaties commonly allow an individual investor of one contracting party state to submit to binding arbitration before ICSID a claim under the treaty against a counter-party state where the investment was made. There are presently 143 parties to the ICSID Convention.

2.3.2 ICSID annulment procedure

In contrast to other commonly used rules of international arbitration (such as the ICC, LCIA, SCC, and the UNCITRAL rules), the ICSID Arbitration Rules allow a party to request the establishment of a second, new ICSID panel (referred to as an ad hoc Committee) to consider the annulment of the final award on certain prescribed grounds.

The grounds for annulment are:

- the tribunal was not properly constituted;
- the tribunal manifestly exceeded its powers;
- there was corruption on the part of a tribunal member;
- there was a serious departure from a fundamental rule of procedure; or
- the award failed to state the reasons upon which it was based.
If the ad hoc Committee determines that one of these grounds exists, then, at the request of either party, the dispute will be reheard by a newly constituted ICSID tribunal.

Recently, Argentina was successful in obtaining a continued stay of enforcement in *CMS Gas Transmission Company v Argentine Republic*. This was the first ICSID award made against Argentina arising from the economic crisis which led to repeal of currency convertibility laws and adoption of "pesification" in early 2002. The arbitration was registered in 2001, and now appears unlikely to reach final resolution for some time yet.

### 2.3.3 Comfort for the claimant

A certain degree of comfort may, however, be taken by successful claimants in the event an annulment application is made: the prejudice suffered as a result of the delay caused by the application can be redressed by an award of interest; and, although it is not expressly provided for in the ICSID Arbitration Rules, the ad hoc Committee can require the respondent seeking annulment of the award to post a bond or provide a guarantee.

### 3. BANKING

See also COMMERCIAL, Trade and commodity finance, section 5 and FINANCIAL SERVICES AND MARKETS, section 20.

#### 3.1 Fixed charges over plant and machinery and book and other debts

2006 saw the court consider purported fixed charges over plant and machinery and book and other debts in light of the House of Lords 2005 decision in *Re Spectrum Plus Limited*.

In *Beam Tube Products Limited* ("Company") joint administrative receivers of the Company applied for directions regarding a debenture containing purported fixed charges over the Company's assets including, among other things, moveable plant and machinery and all book and other debts. It was supported by a "catch all" floating charge. The Company was permitted to open a collections account with an approved bank and to draw freely on amounts standing to the credit of the account. The Company was obliged by the debenture to pay all book debts into the collections account and, until such payment in, to hold all monies on trust for the lenders. The debenture included a "New Bullas" style provision stating that, until a defined event of default had occurred, any monies paid into the collections account would, upon payment in, be released from the fixed charge on book debts and become subject to a floating charge. In addition, the Company had been free to buy and sell items of plant and machinery as it saw fit, with no recourse to the chargee.

The court's view in this case was that "it was all or nothing". The clause had to create a fixed charge over all of the assets to which it referred or it creates a fixed charge over none of them.

The court noted that the parties to the debenture contemplated that the Company would have free use and right to dispose of the assets and, therefore, the charge over the items of plant and machinery which were not fixtures would be considered to be a floating charge.
In addition, the court confirmed that, although the debenture intended there to be a fixed charge over the book debts and a floating charge over the proceeds, in such circumstances recent authority has held that the whole charge will be considered to be floating. Mr Justice Blackburne stated that any subsequent attempts to exercise control over the proceeds was too late and the wording of the debenture was inconsistent with the charge holder having the degree of control requisite for a fixed charge. The judge relied on the *Re Spectrum Plus Limited* decision.

Although this is only a first instance decision, being the first of its kind after *Spectrum*, it is of importance and Mr Justice Blackburne’s “all or nothing” approach to the charge over plant and machinery must be considered in relation to security reviews and drafting.

### 3.2 Subordination provisions

In January 2006, the Court of Appeal handed down its decision in the case of *Robinson (and others) v AIG Europe (UK) Limited and others* also known as the Save Service Stations Limited ("SSSL") litigation. The case relates to a multi-party subordination agreement. The court held that the deed of indemnity containing the subordination provisions under consideration could be enforced by each party to it, by injunction if necessary, and therefore upheld the integrity of debt subordination provisions.

SSSL, Save Group plc ("Group") and other group companies (together the "Save group") operated as petrol retailers. Group borrowed money for the Save group and lent on to SSSL. Group also bought petrol products and sold them to SSSL. This created substantial inter company debt.

AIG Europe (UK) Limited ("AIG") entered into a facility with Group to provide bonds to Customs & Excise guaranteeing the payment of duty on fuel. In support of the facility, all companies in the Save group (including SSSL) executed an indemnity in favour of AIG. The indemnity included a subordination clause which purported to prevent any company within the Save group from proving in the estate of any other until AIG had been paid in full for any sum demanded.

All companies in the Save group entered into administration in 2001 and liquidation in 2002. During the administration the assets of the group were sold. The assets were owned predominantly by SSSL and Group's liquidators submitted a proof in SSSL's liquidation and sought to challenge the enforceability of the subordination clause and its supporting trust provision which stated that any Save group company was to hold payments for distributions, received contrary to the subordination clause, on trust for AIG and to pay them over forthwith.

In relation to the subordination clause, the court found that the intention was to create a multi-lateral obligation, enforceable not only by AIG but also by every other Save group company, to ensure that inter company debts were left out of accounts until AIG had been paid in full. It stated that "if group companies enter into subordination agreements of this nature with their creditors while solvent they, and the creditors, should be held to the bargain when the event for which the agreement was intended to provide (insolvency) occurs". In this case, the court noted that reliance upon the trust provision, in isolation, would produce a better return to AIG than would be the case if the provisions of the subordination clause were to be upheld. If the parties had intended AIG to benefit from an arrangement which entitled it to receive whatever was paid by way of dividend to each company, that could have been achieved by omitting the subordination clause altogether. This suggested that the clause was intended to
have some purpose which could not be defeated by a unilateral waiver by AIG. It is therefore important for financial institutions to consider their intentions as regards waiver of subordination clauses and ensure such intentions are clearly reflected in their documents.

Due to the findings, it was not necessary for the court to consider whether the requirement in the deed of indemnity to hold, on trust, dividends received in breach of the subordination provisions amounted to a registrable charge. However, it upheld the trial judge’s conclusions that on its correct construction, the trust provision created a trust, as opposed to a security interest, and was therefore neither a charge over book debts nor any other type of charge which amounted to a registrable charge.

The decision in this case demonstrates that, subject to proper drafting, subordination clauses will be effective in an insolvency situation and any supporting trust obligation will not give rise to a security interest requiring registration.

3.3 Abolition of prohibition on financial assistance provisions in the Companies Act 1985

The Companies Act 2006 was given royal assent on 8 November 2006. Paragraph 7.1 provides a summary of the Act and its provisions but it is important to mention here that, although the Companies Act 2006 abolishes the prohibition on financial assistance by private companies for the purchase of its own shares or shares in its private holding company, and so will remove the "whitewash" procedure in sections 155 to 158 of the 1985 Companies Act, it is unclear as to what conditions banks and financial institutions will require to be satisfied in order to be comfortable with such transactions.

Although, strictly, the prohibition on financial assistance by private companies will be abolished when the relevant section of the Act is implemented and these changes should simplify the financing of acquisitions, group reorganisations and take privates, the sections in the Companies Act 1985 were generally considered to have replaced the common law maintenance of capital rules. Abolition therefore will cause the common law rules to be effectively reinstated, although this is arguable. It is possible that these capital rules could result in a more restrictive regime for private companies. However a saving provision has been included by the government to the effect that private companies may still enter into transactions which they can lawfully enter into now under the whitewash procedure and the existing exemptions will remain. There are uncertainties as to the application of these exemptions. It is unclear at this time the extent to which the prohibition on financial assistance will therefore cause the financing of corporate transactions to be more straightforward as banks and funders are likely still to require comfort in some form similar to elements of the whitewash and may seek to extend their covenants or conditions precedent in this regard. Comfort from auditors may well still be required.

Financial assistance by or in relation to a public company will remain unlawful. Therefore pre or post acquisition assistance by a private company in relation to the acquisition of its shares in a public company will still be prohibited.

For a case relating to financial assistance, see Anglo Petroleum Limited v TFB (Mortgage) Limited, paragraph 7.4.
3.4 Securitisation: VAT and assignment of receivables

See paragraph 45.10.8 for a case where an assignment of receivables was held not to be a supply for VAT purposes.

3.5 Commonholds become bankable

See paragraph 42.14 for information about commonholds as security.

3.6 Freezing orders

For cases relating to freezing orders, see paragraph 34.11.

4. CHARITIES

2007 promises to be an interesting year for England and Wales’ 190,000 registered charities, with the new Charities Act 2006 (http://www.opsi.gov.uk/acts/acts2006/20060050.htm) set to alter several aspects of the regulatory framework in which they currently exist.

4.1 Charities Act 2006

Whilst this may have been a long time coming - with a proposal being published in May 2004 and the Act finally receiving royal assent in November 2006 - it now looks set to make its mark on the way charities in England and Wales are set up and operated. It has been described as a "modernisation" of the existing framework, to reflect both the changes in society and in the charity sector over the past decade but some commentators argue that it goes beyond this. The main provisions, and the impact of these on existing law, are summarised below.

4.2 Definition of charity

Whether or not a particular organisation had the "charitable purpose" necessary to qualify it for charitable status, including the favourable tax treatment this affords, was left open-ended by the previous legislation, making it open to much interpretation by the courts, public and press alike. The new Act aims to end this uncertainty by including a list of some 13 purposes which will be deemed as charitable - now, if you're not on the list, you're not getting in! Any purpose previously deemed charitable will continue to be so, but all new charities will need to show that they are within one of the other categories before they can be considered for registration.

In addition to the "charitable purposes" test, the requirement that an organisation acts for the "public benefit" has been retained, still without any further explanation of what this requires exactly. One change here however is that certain categories of organisation who have previously been presumed to meet this requirement, including organisations for the advancement of education, relief of poverty etc, will no longer benefit from this automatic presumption and will thus have to satisfy the public benefit test in order to retain their charitable status. In particular, those organisations such as private schools and private hospitals who charge relatively high fees will now have to justify their favourable treatment.
4.3 Charitable Incorporated Organisations ("CIO")

It has always been possible for charitable organisations to adopt a more corporate structure, with many choosing the incorporated charity as their vehicle of choice. However, this route has never been as popular as it perhaps ought to be, owing largely to the increased regulatory burden associated with it. Previously, incorporated charities were obliged to report both to the Charity Commission and Companies House.

Under the 2006 Act, any organisation wishing to follow the corporate route can choose to set up as a CIO, answerable only to the Charity Commission. This ought to allow charities to take advantage of the corporate structure, in particular the limited liability associated with this, without the burden of dual regulation. However, all those keen charities out there will have to wait, as this aspect of the legislation is only due to be implemented in early 2008.

4.4 Other changes

- The income threshold for compulsory registration has been increased from £1,000, with some exceptions, to £5,000. However, organisations with an income below this threshold can register voluntarily.

- The Charity Commission has been given new, more far-reaching powers, such as the power to seize charity assets and freeze bank accounts.

- A new body known as the Charity Tribunal has been set up to deal with appeals against and reviews of Charity Commission decisions, including their assessments of whether or not the public benefit requirement has been met. Previously, such cases could only be dealt with by the High Court.

- The rules governing charitable trustees have been relaxed in order to protect existing trustees and encourage new recruits. Charity trustees will now be able to receive payment for any ancillary professional or business services provided to the charity, subject to certain requirements, and it is now much less onerous to obtain trustee indemnity insurance using charity funds.

- A more coherent licensing system has been introduced for all "public charitable collections", with the definition of "public spaces" being widened to include privately owned properties to which the public has access. Short-term, local collections will usually be exempt from licensing and merely need to be notified to the relevant local authority, so no need to worry about next Christmas' carol singing!

5. COMMERICAL: SCOTLAND

For COMMERCIAL: ENGLAND, see section 6.

5.1 Interpretation of contracts and jurisdiction of the Scottish courts

It is often the case that contracts contain a clause which stipulates that disputes which arise out of the contract should be governed by Scots law and the jurisdiction of the Scottish courts. In a case before the Scottish courts in 2006 one party to the contract contested that such a clause covered the claim before the court. They suggested that that the pursuers' claim for 'repetition' (or return) of sums which had been overpaid was not a claim arising from rights in the contract. Instead they argued that the claim had its legal basis in the principle of
Mackays Stores Limited v Topward Limited

For a copy of the judgment, see the Scottish Courts Service website:


5.2 Implied terms

The Scottish courts have the power to imply terms into a contract between parties in order to give the contract 'business efficacy'.

This widely reported Sherriff Court case related to the introduction of a candidate to a law firm by a recruitment agency. Following a successful introduction a recruitment agency is ordinarily entitled to a fee in accordance with their terms and conditions. In this case however the candidate put forward by the agency decided not to change jobs before being interviewed by the law firm. No fee was therefore due. However the same candidate was later introduced to the firm by another agency and subsequently employed by the firm. The law firm paid the second agency a fee. On discovering the position the first agency raised an action for recovery of their fee against the law firm. This was contested by the law firm and a question arose as to whether there was implied into the contract between the parties a term to the effect that the first agency would only be entitled to a fee if they were the 'effective cause' of the candidate's employment. The court held that such a term was implied into the contract between the parties and in the circumstances the recruitment agency was not the effective cause of the candidates' employment. That being so the recruitment agency was not entitled to a fee and the action was dismissed.

G2 Legal v Adie Hunter, 2006 SLT (Sh Ct) 63

5.3 Claims and contractual terminology

This case emphasized the importance of ensuring that a claim falls within the specific provisions of a contract before raising an action. In this action, the Court of Session held that a seller was unable to recover interest from a purchaser who failed to settle on the date agreed. Although the contract provided for interest, it stipulated that interest ran from the date of entry to the subjects to the date of resale by the seller. In this action the seller had not re-sold the property in question at the time of the action. Her claim therefore failed as it did not fall within the specific provisions of the contract.

Black v McGregor

For further information, see http://www.scotcourts.gov.uk/opinions/2006CSIH45.html
5.4 Fraudulent misrepresentation

What does a litigant have to demonstrate when making a claim based on fraudulent misrepresentation?

The Sheriff Court held in this 2006 case that any claimant must set out (1) that the representation was made; (2) that it was false; (3) that the maker knew that it was false (or did not know or was indifferent to whether it was true or false); and (4) that the claimant was induced by the representation to enter into the contract. All these elements must be present to allow the claim to proceed.

*Towns v Insurance Direct (Underwriting) Limited*

For the judgment, see [http://alpha.bailii.org/scot/cases/ScotSC/2005/85.html](http://alpha.bailii.org/scot/cases/ScotSC/2005/85.html)

6. COMMERCIAL: ENGLAND

See also INTERNET AND ELECTRONIC COMMERCE, section 32, OUTSOURCING, section 36 and PRODUCT LIABILITY, section 40. For COMMERCIAL: SCOTLAND, see section 5.

This section includes a review of structured trade and commodity finance (see paragraphs 6.22, 6.23, 6.24).

6.1 Assignment

*Can an assignee recover loss which the assignor did not suffer?*

The order of events was (i) a soil report was obtained by S from T in respect of a sloping site (ii) the land to which the report related was sold by S to L (iii) an unpredicted landslip occurred and (iv) the benefit and right to sue under the soil report was legally assigned by S to T.

The problem was, therefore, that at the time of the landslip, when damage was caused to third parties for which T as the then owner of the land was liable, T did not have the legal benefit of the soil report and/or the right to sue thereunder. The question which arose for decision was whether the fact of the subsequent assignment could place T, as assignee, in a better position than S, the assignor, who had in fact suffered no loss since it was no longer the owner of the land at the time of the landslip.

The Court of Appeal pointed to the cause of action - namely the breach of contract - which it said was complete when the report was given by T to S. It then explained that in order for an assignment of a cause of action to be effective, the assignee must have a sufficient proprietary right or a genuine commercial interest. If such an interest existed and the assignment was valid (which was not in dispute in this case) the Court of Appeal considered that the authorities in fact show that the correct approach is to assume, firstly, that there had been no assignment and, secondly, that the land had not been transferred to assignee. In other words, whilst it is indeed true that the overall loss for which T could be liable is capped at that which could have been suffered by S, the assignor, it makes no difference that the loss was never in fact suffered by S. It is sufficient that, if S had remained the owner of the land it would have suffered the loss.
When considering the future application of this judgment, it is important to note that the soil report in issue contained no prohibition on assignment and no issue arose on the effectiveness of the legal assignment itself under section 136 Law of Property Act 1925.

Technotrade Limited v Larkstore Ltd [2006] EWCA Civ 1079

6.2 Commercial agents

In February, the Court of Appeal had to consider the vexed question of how to calculate the amount of compensation to be paid to a commercial agent under regulation 17 of the Commercial Agents (Council Directive) Regulations 1993.

Having reviewed the English case law and having rejected as unhelpful and non-binding the decisions of other EU courts, Lord Justice Moore-Bick observed that the most that could be gained from current decisions was that there is no clear agreement on the principles governing the assessment of compensation under the regulation. He therefore focussed on the precise wording of the directive and concluded that its intention was to provide full compensation to an agent for any damage that he has actually suffered, rather than, as some decisions had indicated, to provide a right to receive a payment that if fair and reasonable having regard to all the circumstances of the case.

Lord Justice Moore-Bick concluded that it was inappropriate for the English courts to follow the approach adopted by the French courts which determine compensation by reference to two years' gross commission, subject to adjustment in light of the particular circumstances of the case. Instead, he considered that the task of the English court was to assess the value of the business to the agent as at the date of termination (taking into account factors such as unamortized start up costs, incurred on the advice of the principal).

Whilst he accepted that the ordinary rules of mitigation and avoidable loss should not be applied when assessing compensation, he also made it clear that this did not mean that the court must shut its eyes to what was likely to happen in the future. The fact, for instance, that an agency was terminated only shortly before it would, in any event, have expired by effluxion of time, must inevitably have a bearing on its value at the date of termination. In cases of this nature, rather than value goodwill at its open market value of virtually zero, the goodwill should be valued upon the basis that if the agency had run its natural course the goodwill would have passed to and have been absorbed by the principal's business.

Graham Lonsdale v Howard & Hallam Ltd [2006] EWCA Civ 63

6.3 Concurrent liability in tort

The Court of Appeal confirmed in June that, in certain circumstances, a sub-contractor can be liable in tort to the ultimate customer despite the existence of the contractual arrangements.

To identify whether your contractual arrangements are at risk you must consider, firstly, whether the sub-contractor assumes a responsibility towards the customer and, secondly, whether there is anything in the contract which is inconsistent with that responsibility giving rise to a tortious liability.
Bear in mind that the types of responsibility which might be caught by this are not limited to providing advice. They might, for instance, include installing an IT system or configuring security arrangements. Indeed, any undertaking which is performed by a supplier who has specialist skill or knowledge and who is in direct contact with the customer could potentially give rise to a tortious liability unless the contractual arrangements make it abundantly clear that this is not what is intended by the parties.

*Riyad Bank v Ahli United Bank* [2006] EWCA Civ 780

6.4 Consumers, Estate Agents and Redress Bill

The Consumers, Estate Agents and Redress Bill, introduced on 16 November 2006, proposes to strengthen consumer protection, representation and redress and provide consumers with value for money. The aim of the new legislation is to provide consumers with a more powerful voice and follows a consultation which took place in the first quarter of this year. The Bill includes proposals for the formation of a new consumer body called the National Consumer Council formed which will be a consolidation of Postwatch, Energywatch and the former National Consumer Council. It is intended that this will prove to be a more effective and powerful organization that will liaise with government, regulators and industry. Measures for improving service for consumers from estate agents include the requirement for estate agents to become members of an approved independent ombudsman scheme and more powers for the Office of Fair Trading to inspect an estate agent's files and its fitness to practice. The proposals also make provisions for new redress schemes for postal and energy services.

6.5 Damages

6.5.1 Damages for non-pecuniary loss are frequently too remote to recover

In June, the High Court was entertained by a somewhat unusual and largely unsuccessful claim by a Virgin passenger for losses allegedly arising as a result of Virgin staff's admitted and unwarranted refusal to allow him to board his scheduled plane departure from Nigeria to Gatwick. During the 12 days for which this continued, Mr Wiseman allegedly suffered damages totalling £20,000.

The losses which Mr Wiseman was able to recover included reasonable accommodation and restaurant costs, together with taxi fares to and from the airport and postage and telephone costs incurred between the intended and actual date of departure. These totalled approximately £2,000.

On the other hand, the expenses which his fiancée incurred in London and/or which his "entourage" incurred in Nigeria were considered too remote, particularly as those who incurred the expenses were not party to the contract. Also too remote was the alleged mental trauma which Mr Wiseman suffered as a result of a robbery which occurred during the period of his enforced stay in Nigeria. This was an unforeseen supervening event, not caused by the breach of contract.

Mr Wiseman was also unable in the circumstances to claim damages for injury to feelings as non-pecuniary loss of this nature can only be recovered in exceptional cases. Nor was he able as a matter of principle to claim damages for "loss of society" consequent upon his fiancée terminating their engagement allegedly as a result of his no-show in London (and, in any event, he did not manage to persuade the court that
his enforced stay in Nigeria caused this). Damages for "mental trauma" were also irrecoverable as there was no evidence of any associated physical inconvenience or discomfort.

*Raphael Wiseman v Virgin Atlantic Airways Ltd* [2006] EWHC 1566 (QB)

6.5.2 Damages are compensatory and should not confer a windfall

The Court of Appeal in June confirmed that a benefit which a party gains as a result of the other party's breach must be taken into account in assessing the damages due to him for loss of profit (in much the same way as such damages would be reduced by any savings made by the "innocent" party mitigating its loss).

*R & M Stansfield Enterprises Ltd v AXA Insurance UK Plc* [2006] EWCA Civ 881

6.6 Distance selling

In September 2006, the Department of Trade and Industry and the Office of Fair Trading issued joint guidance for businesses on the Consumer Protection (Distance Selling) Regulations 2000. The legislation protects consumers when buying goods or services at a distance where they are unable to first inspect them. The new guidance explains what information must be provided to enable consumers to make an informed choice, the type of service provision to which the regulations apply and the type of contracts to which the regulations do not apply.


6.7 Doorstep selling

The Consumers, Estate Agents and Redress Bill (see paragraph 6.4) includes an extension to the Consumer Protection (Cancellation of Contracts Concluded Away from Business Premises) Regulations 1987 to allow a cooling off period for goods and services and cancellation rights following a solicited visit. The current legislation provides consumers with a seven-day cooling off period following the purchase of goods or services costing more than £35 from an unsolicited visit. The proposal to include this extension in the Consumers, Estate Agents and Redress Bill follows a public consultation on doorstep selling and cold calling which the government responded to on 7 September 2006. The recommendations will include the requirement for cancellation notices to be included prominently and clearly in contracts, clearer pricing and a willingness to provide written quotes. The last two proposals were recommended to be introduced by voluntary industry self-regulation.
6.8 Entire agreement clauses

6.8.1 Admissibility in evidence of pre-contract negotiations

A typical entire agreement clause may provide as follows:

"This Agreement together with any other document expressed to being operated herein constitutes the entire contract between the parties and supersedes all prior representations, agreements, negotiations or understandings whether oral or written."

The Court of Appeal this year considered it arguable (though was not required to rule on the point) that an entire agreement clause of this nature may not be sufficient to prevent the court from referring to pre-contract materials when seeking to ascertain the parties' intended meaning for words or phrases used in the contract (in this case, the relevant phrase being "preferred supplier status").

Lord Justice Mummery considered that as the phrase "preferred supplier status" (i) had not been defined in the agreement, (ii) had not be judicially considered elsewhere, (iii) had no obvious natural or ordinary meaning and (iv) had a range of possible meanings as illustrated by the parties' pleadings, it would be "necessary to explore the factual hinterland of the agreement in order see whether illumination of the meaning of the expression could be found".

The law in this area is not settled. What the Court of Appeal was in effect suggesting in this judgment was that the court should be permitted to examined evidence of pre-contract negotiations where (i) the words actually used in the contract are fairly capable of having more than one meaning and (ii) it is alleged that the parties have in effect negotiated on an agreed basis that the words bore only one of two possible meanings.

This is to be contrasted with the situation in which one party is in effect trying to persuade the court that one interpretation of the contract is in all circumstances to be preferred to the other. In the latter case, the legal position is and should remain that evidence of pre-contractual negotiations should not be admissible.

*The Rugby Group Ltd v Proforce Recruit Ltd [2006] EWCA Civ 69*

6.8.2 Importance of ensuring that all relevant terms are incorporated

An option agreement granted the defendant the right to require the claimant to build two oil tankers. Upon the defendant exercising the option, two separate shipbuilding contracts came automatically into effect. The original option agreement had included a provision whereby the defendant would be obliged to grant priority delivery to the oil tankers built by the claimant. However, the subsequent shipbuilding contracts made no mention of the priority rights granted by the option agreement and both contained entire agreement clauses, as well as specific dates for delivery and payment.
In the event, the defendant took delivery of two different tankers built by a third party in priority to the claimant's tankers which allegedly caused the claimant to suffer losses totally $20m (although it is not entirely clear from the judgment what exactly these losses comprised and/or how they were to be calculated).

Mr Justice Gloucester could see no basis for overriding the clear meaning and effect of the entire agreement clauses, particularly given that the shipbuilding contracts otherwise provided comprehensively for the rights and obligations of the parties in relation to the two vessels.

The moral of the story - entire agreement clauses are fundamental to the structure of the agreement and should never be treated purely as "boilerplate".

*Ravennavi Spa v New Century Shipbuilding [2006] EWHC 733 (Comm)*

6.9 European Commission review of consumer directives

The European Commission has been conducting a review of the eight consumer directives (Doorstep Selling/Distance Selling, Unfair Contract Terms, Timeshare, Package Travel, Unit Prices, Injunctions - Stop Now Orders, Sale of Goods and Associated Guarantees) with the intention of updating and simplifying consumer law and looking at how it is implemented across the EU. The Department of Trade and Industry commissioned an independent academic study into the possible improvements which was published in September 2005 and a consultation on the results concluded in March 2006. The European Commission will shortly be publishing a green paper following the conclusion of the review.

6.10 Guarantees

6.10.1 Variations which accelerate contractual liability could render guarantee void

A guarantor will be discharged from liability where the principal debtor has subsequently undertaken a binding contractual obligation to pay early, since this would amount to a material variation of the terms of the debt guaranteed.

Mr Justice Clarke made it clear that if a guarantor guaranteed a debt which was payable within a specified time he would no longer be liable if either:

- the creditor advanced money or supplied goods on terms that the money was repayable or the price was payable immediately; or
- the creditor and his debtor agreed a variation of the contract whereby the debtor was bound to pay earlier, unless such agreement was, on the facts, obviously incapable of prejudicing the surety.
The judge made it clear that this would not, however, effect an early repayment or partial repayment, provided that it was made wholly voluntarily. A debtor who was entitled to 55 days' credit was not bound to wait until all 55 days had elapsed. He could, if he chose to do so, pay before then. The guarantor was not released because he did so, even if the early payment was made at the creditor's request. Such a payment was not inconsistent with the contract guaranteed and involved no variation of it. This was to be contrasted with the situation above where a debtor, post guarantee, undertakes a binding obligation to pay a contract early.

ST Microelectronics NV v Condor Insurance Ltd [2006] EWHC 977 (Comm)

6.10.2 Third party enforces guarantee in deed

The claimant sold his business to the second defendant with deferred consideration of £1.2m payable by four six-monthly instalments. The payment of the instalments was guaranteed by the first defendant. The terms of the instalments and of the guarantee were contained in a deed signed by both defendants, but to which the claimant was not party.

The court held the first defendant liable under the guarantee notwithstanding that the claimant was not party to the deed and in full knowledge that the first defendant alleged that the guarantee had been procured by the deceit of the second defendant in collusion with the claimant. The court considered that it was the clear intention of the parties as evidenced by the deed that the claimant should obtain the benefit of the guarantee and that in giving the guarantee the first defendant had automatically assumed the risk of deceit as well as any other default by the second defendant. For this reason, it would also not be appropriate to require the claimant to claim under the Contract (Rights against Third Parties) Act 1999, since, by section 3(2) of that Act, the first defendant would then be able to invoke any defence it might have against the second defendant. To provide relief to a guarantor simply for deceit by the debtor would be inconsistent with the inherent nature of the guarantee.

Moody & Miller v Condor Insurance & MGM Group [2006] EWHC 100 (Ch)

6.11 Interpretation

6.11.1 Meaning in one particular agreement of "other financial institution"

Members of a syndicated loan agreement could, by the contract, transfer their rights to a "bank or other financial institution". The issue which arose was whether this expression could include an investment company.

The Court of Appeal considered that the expression "other financial institution" as used in the context of the loan agreement need not be a bank or even analogous to a bank. The phrase could, in the context of this agreement, include any legally recognised form or being which carried on its business in accordance with the laws of its place of creation and whose business concerned commercial finance, whether or not its business included the lending of money.

The Argo Fund Ltd v Essar Steel Ltd [2006] EWCA Civ 241
6.11.2 Admissibility in evidence of post-contract conduct

The long-accepted rule established by the Court of Appeal in 1970 in *Whitworth Street Estates Ltd v Miller* is that evidence of post-contract conduct cannot be admitted in order to assist the court in ascertaining the meaning of a contract made between the parties. In July, the Court of Appeal had cause to clarify that this rule in fact applied only in the case of written contracts - not oral contracts.

The case involved a dispute between a builder and his client over which of the works were additional to and which fell within the terms of the original contract. The contract had not been reduced to writing although there were various estimates, breakdowns, costing and interim invoices - many of which were prepared after the contract had been established and the works had begun.

The court at first instance refused to admit evidence of the post-contract conduct and documents and instead decided the case primarily on the basis of its preference for the evidence of the builder over that of the client. The Court of Appeal, however, made it clear that this was the wrong approach. In the words of Mr Justice Smith:

"In my judgment it is clear that the principle set out in Miller’s case does not apply to an oral contract. Determining the terms of an oral contract is a question of fact. Establishing the facts will, usually, as here, depend upon the recollections of the parties and other witnesses. The accuracy of those recollections may be tested and elucidated by things said and done by the parties or witnesses after the agreement has been concluded. Receiving evidence of such words or actions does not mean that the judge is losing sight of his task of deciding what the parties agreed at the time of the contract. It is simply helping him to decide whose recollection is right."

As the trial judge had refused to admit evidence of post-contract conduct which, in all likelihood, would have had a material bearing on the outcome, the case has had to be referred for rehearing by another judge with a strong recommendation that it be settled before yet further legal costs are incurred.

*Brian Royle Maggs (T/A BM Builders) v (1) Guy Anthony Stayner Marsh (2) Marsh Jewellery Co Ltd* [2006] EWCA Civ 1058

6.11.3 Interpretation cannot ignore the words used

During negotiations for a facilities management agreement ("Agreement") the parties agreed in a letter marked "subject to contract" that the contemplated services would be provided immediately whilst negotiations continued over the final terms of the Agreement. The letter stated that the services would be provided "under the terms of the contract" - a reference to the draft Agreement which had been provided during the tender process.

Although the High Court determined that "under the terms of the contract" only in fact referred to such of the terms as were necessary to define the terms upon which the services were to be provided in the interim, the Court of Appeal considered this interpretation to be too restrictive. They made it clear that the court did not have a licence to rewrite the words chosen by the parties just because they produced a result that was unexpected, unreasonable or not commercially very wise.
At the time of writing, the full judgment of the Court of Appeal is not available and the full reasoning is not entirely clear from the case summaries.

Somerfield Stores Ltd v Skanska Rashleigh Westerfoil Ltd [2006] CA (Civ) 22 November 2006

6.12 Limitation of liability

6.12.1 Exclusion of liability for loss or damage "of any kind whatsoever"

A bill of lading relating to the shipment of frozen chicken pieces provided that the carrier should not be responsible for "loss or damage to or in connection with the Goods of any kind whatsoever (including deterioration, delay or loss of market) howsoever caused, whether by unseaworthiness or unfitness of the vessel... or by faults, errors or negligence or otherwise howsoever".

When most of the chicken defrosted in transit, the holder of the bill of lading claimed damages for breach of bailment and sought to avoid the operation of the exclusion clause on the basis that it was repugnant to the contract since it gave the carrier complete freedom whether or not to render any performance at all, and hence impunity for all and any breaches of contract.

The court disagreed and determined that the words did not in fact operate to relieve the carrier of liability for any and every breach – it did not cover, for example, damage caused by dishonesty or an outright refusal to ship the cargo to the port of discharge. Furthermore, the allocation of most risks to the holder of the bill of lading was not inconsistent with the purpose of a commercial contract of carriage where the bearer of the risk was able to insure himself against it.

Note that it was not necessary to apply the guidelines in the Unfair Contract Terms Act 1977 in order to assess the reasonableness of the exclusion clause as this was an international supply of goods and hence exempt from the same.

Mitsubishi Corporation v. Eastwind Transport [2006] 1 All ER Comm 328

6.12.2 Liability cap at 5% of contract price upheld despite almost total failure in performance

In May 2006, the Court of Appeal left undisturbed an earlier finding of Judge Coulson QC in which he upheld a contractual cap on liability at 5% of the original contract price despite the argument he was presented with that enforcing this cap would effectively mean that the party in breach would thereby benefit substantially from its own breach.

The claim was for £18m in damages for breach of a contract originally priced at £9m. The judgment addressed the construction of clauses limiting Haden's liability effectively to £800,000. The cap was upheld as it constituted part of the overall allocation of risk between the parties:

"Such "cap" clauses, which are a common feature of commercial contracts, reflect an agreement between the parties that, in the event of a breach, the wrongdoer's liability will be fixed at a pre-set maximum level. In one sense, of course, the wrong-doer who
seeks to rely on such a clause is seeking to take advantage of his own wrong, because the cap clause in question can only be triggered by his breach of contract in the first place. It would, however, be absurd to suggest that, if the cap clause was clear, the wrong-doer could not rely on such a provision to limit his liability, because that is exactly what the parties have agreed that he can do.”

The case is interesting as there had been almost total failure to perform. The paint-spraying system which had been contracted for had been delivered but was so defective that it in fact cost more to rectify than the total contract place. Yet the cap on liability was upheld. The doctrine of fundamental breach was not considered applicable as the parties had clearly provided for what should happen in the event of the breach. If the parties had wished for a different outcome in the event of a fundamental failure to perform, they should have made this clear in the contract. Contracts cannot be construed by reference to post-contract events.

Decoma UK Limited (formerly known as Conix UK Limited) v Haden Drysys International Limited [2006] EWCA Civ 723

6.13 Liquidated damages/penalties

6.13.1 For there to be penalty, there must first be a breach

The issue was whether the standard terms and conditions of an employment agency included a provision which was in the nature of a penalty and therefore unenforceable by the agency against its client.

The terms and conditions stipulated that in order to qualify for a refund when an engagement of an employee introduced by the agency ended within its first 12 weeks, the client must first have (i) paid its fee within seven days of the invoice and (ii) notified the agency within seven days of the end of the engagement. If the client had failed to do either of these on time, it would not qualify for the refund. The client argued that this constituted a penalty because:

- it was triggered by its having failed to pay on time;
- it thereby lost a substantial benefit - the refund;
- there was no connection between the value of the refund and the loss potentially flowing from the late payment/notification; and
- the contract already provided for a remedy by the imposition of interest for late payments.

Mr Justice Chadwick disagreed. The clause was a pre-condition, not a penalty. It did not, itself either impose any charge, deprive the client of any benefit which it would otherwise have been entitled to, defeat the right to refund when it arose or defeat any other right to refund. Rather, it defined the circumstances in which the right to refund arose in the first place.
The rule against penalties only applied where a contract penalises a party for *breaching* an agreement by requiring it to compensate the other party in excess of the loss which would ordinarily have been suffered as a result of such breach. If there is no breach, there can be no penalty.


6.13.2 Providing for a forfeit as a deterrence against breach of a settlement agreement is likely to be penal

Liquidated damages must be a genuine pre-estimate of the likely loss or they are liable to be avoided as a penalty. This principle was illustrated in March in the context of a settlement agreement.

Mr Zhang had commenced proceedings for losses suffered as a real-time internet trader resulting from alleged errors by CMC. The proceedings were settled on terms which were clearly intended to prevent Mr Zhang from continuing to represent a drain on management time and resources.

The settlement letter stated that CMC would pay $40,000 in full and final settlement on condition, inter alia, that Mr Zhang stopped harassing CMC’s employees and made no derogatory or unfavourable communications relating to CMC. The settlement letter also provided that any breach of the settlement terms by Mr Zhang would render him liable to CMC for a sum equal to the settlement sum plus legal costs plus damages for loss of business.

In breach of the conditions in the settlement letter, Mr Zhang continued to make demands and claims, causing CMC to seek injunctive relief and repayment of the settlement sum. Although it was not denied that Mr Zhang was in breach of the terms of the settlement, the Court of Appeal refused to require him to repay the settlement sum on the basis that this provision constituted a penalty.

Firstly, the repayment of the settlement sum was triggered by breaches of the settlement agreement which had no bearing on the advantage secured for CMC by the settlement agreement - that of compromising the extant proceedings. Secondly and significantly, the settlement sum was expressed to be repayable upon *any* breach - however trivial. As such, it could not possibly constitute a genuine pre-estimate of the loss which might have flown from the breach and was, therefore, void as a penalty. The predominant purpose of the clause was deterrence, not compensation and the clause was therefore void.

*CMC Group & Others v. Zhang* [2006] EWCA Civ 408
6.14 Material breach

This year saw one of the few commercial cases in which the meaning of "material breach" has been considered in any detail. In the view of the court, Celtech's failure to pay three consecutive monthly instalments (during year seven of a 15 year contract) constituted, in the circumstances of the case, a material breach even though time was not of the essence under the contract, the contract provided for interest to be payable on late payments and all of the other instalments due during the first six years of the contract had been paid on time.

The clause in issue gave Dalkia the right to terminate the agreement with immediate effect in the event of Celtech "being in material breach of its obligations to pay the Charges". It was considered highly relevant that, at the time Dalkia exercised its right under this clause and terminated the agreement, Celtech was fighting to stave off insolvency. The reason why payment was not forthcoming was not because of some mishap, mistake or misunderstanding. Celtech failed to pay because it did not then have the money to do so.

Furthermore, the amounts involved were neither trivial nor minimal. Celtech owed a total of £332,000 out of a total payable of about £14m. Of this, £105,000 had been outstanding for more than 70 days and a further £105,000 for more than 40 days.

Mr Justice Christopher Clarke made it clear that the right to terminate should not be exercisable where the breach was "minimal or inconsequential" or, even if not minimal or inconsequential, if the breach was "accidental or inadvertent".

Interestingly, although Mr Justice Clarke considered that Dalkia was correct to terminate the contract for material breach, Dalkia would not have acted correctly if it had purported to terminate for repudiatory breach since (i) no condition had been breached - time not having been made of the essence, (ii) Celtech had not indicated that it intended to perform the rest of the contract in such a manner as would deprive Dalkia of substantially the whole of the benefit of the contract; and (iii) Celtech did not evidence an intention never to pay. It simply said that it could not presently pay. In this case, repudiatory breach was certainly not synonymous with material breach.

*Dalkia Utilities Services Plc v Celtech International Limited* [2006] EWHC 63 (Comm)

6.15 Misrepresentation

In the first instance decision in 2005, Richard Siberry QC, sitting as deputy judge of the High Court made it clear that "nothing in this judgment should be taken as an encouragement to investors to ignore terms and conditions applicable to their investment". In April 2006, the Court of Appeal proved him right and determined that the investor had not in fact been induced by any statement, misleading or otherwise, made by the third party who introduced the investment to him.
Although, as is true of all allegations of misrepresentation, the case turns largely on its facts, the judgment of the Court of Appeal has some generic application. It makes it clear that experienced investors cannot simply assume that an investment will match with pre-contract descriptions of the same made by third parties, particularly where the contractual documents not only contain an accurate description of the terms and nature of the product but also clear warnings and statements of the risks involved. Once the contractual documents are signed, the investor runs the risk of being legally estopped from denying his knowledge of their terms and conditions.

On the facts, the experienced investor received information about an investment from a third party with whom he had a close relationship and in whom he placed trust and reliance on matters financial. The information was described by the first instance judge as "rough and ready" and was provided before contractual documents had been seen. The contractual documents which were later seen and signed by the investor not only recorded the actual nature of the investment in clear terms but also contained accurate and clear warnings about the nature and extent of the associated risks. In the words of Lord Justice Moore-Bick "the true facts were not buried in a mass of small print."

The investor lost nearly all of his $250,000 investment and sought damages against the third party for misrepresentation. The Court of Appeal did not hesitate in deciding that the investor did not in fact rely upon the early information given by the third party, but instead upon his own - erroneous - assumption that the contractual terms would reflect the information which he had been given. Hence, even though the nature of the investment may have been misrepresented by the third party, it was not this which induced the investor to invest and there was, therefore, no actionable misrepresentation.

(1) Peekay Intermark Ltd (2) Harish Pawani v Australia and New Zealand Banking Group Ltd [2006] EWCA Civ 386

6.16 Repudiation

6.16.1 By derogation from grant

A franchisee operated a mobile tyre fitting service. A dispute arose as to the extent to which the franchisor was able to enforce the expansion of its own central website business and brand over that of the local business and brand of the franchisee. The contract made little or inadequate provision for the business referred from the central website (which was only in its infancy at the time the contracts were signed) and the parties had failed to negotiate any variations or amendments to deal with this emerging business.

When the franchisee refused to promote the central brand at the expense of its own local brand - on the basis that the local brand not only produced the bulk of its business but was also profitable, whereas the website referral business prescribed prices that were not economically attractive - the franchisor purported to terminate the agreement.

The Court of Appeal held that the franchisor had in fact acted in repudiatory breach, firstly, by wrongly deducting monies from business referred from the website and, secondly, by attempting to derogate from the rights originally granted, especially since those rights were granted on an "exclusive" basis in the territory of Kent. The court considered that the franchisor's rights in the agreement to require the franchisee
to operate in accordance with its instructions had to be seen as subject to a limitation that it would not be exercised so as to impede substantially the exercise of the franchisee's right to operate and promote the business under its own trade name. Although the principle of no derogation from grant had been developed in the context of real estate, there was no reason why it should not apply to commercial agreements.

(1) Jeffery Stone (2) Lynn Ashwell v Fleet Mobile Tyres Limited [2006] EWCA Civ 1209

6.16.2 Right to repudiate easily waived

The importance of effective communication during difficult contractual situations was illustrated in a decision of the High Court in July. The facts of the case were extensive and many findings were made, with the most significant findings turning upon the parties' failure to communicate their positions effectively, resulting in one party loosing its right to bring the agreement to an end.

The agreement in question was in the form of a memorandum of understanding which did not include a "no waiver" clause (which is a clause making it clear that a failure to exercise a right will not result in that right being waived). One party was, in the view of the court, in repudiatory breach of the agreement (having failed to provide the interim funding which it had agreed to pay). The other party, however, permitted this situation to continue and added the outstanding payments, together with interest, to a running account, with a view to reaching an amicable resolution at some point in the future. The High Court considered this to be fatal.

In order to consider an agreement at an end by reason of repudiatory breach, the "innocent" party must communicate this to the "guilty" party. Where there is no such communication and, as in the case, the "innocent" party acts in a way that suggests that it is prepared to continue with the contract notwithstanding the repudiation, the innocent party will soon loose his right to treat the contract as repudiated as it will be deemed to have waived its rights.

Munib Masri v Consolidated Contractors International UK Ltd & Anor [2006] EWHC 1931 (Comm)

6.17 Services Directive

On 29 May 2006, agreement was reached by member states on the Services Directive. The UK is expected to benefit significantly from the directive with the potential benefit estimated at £5bn a year. The purpose of the directive is to remove barriers to trade and reduce red tape for service industries across member states. It is hoped that the directive will boost small service providers in areas such as construction, retail, management consultancy, advertising, estate agency and leisure as well as architects, plumbers, bakers and electricians. It is hoped that the Services Directive could be adopted by member states early in 2007, though it could easily be a further three years before the full benefits are seen.
6.18 Subject to contract

Where parties have agreed written terms which are expressly marked "subject to contract" and the agreement is subsequently signed by the parties without removing the phrase "subject to contract", the agreed terms may nevertheless be binding as an implied contract if the parties subsequently do those things that the written agreement contemplated that each party should do for the benefit of the other.

*The Rugby Group Ltd v Proforce Recruit Ltd* [2005] EWHC 70 (QB) (appealed on other grounds).


March 2006 saw the closure of the consultation exercise for the implementation of the Unfair Commercial Practices Directive ("UCPD") which must be in force in the UK by 12 December 2007. The UCPD, which was adopted on 12 May 2005, will affect all businesses ("traders") which supply or market goods or services to "consumers" and is designed to protect consumers by combating aggressive high pressure selling tactics.

The directive is extremely definition heavy and the precise manner of its incorporation into English law is not yet known, particularly as it will impact on a host of existing legislation and regulation including the Trade Descriptions Act 1968 and the Consumer Protection Act 1987. What is clear is that the directive is to be implemented with "maximum harmonization", which means that there is very little room for deviation from the prescribed text.

The definition of a commercial practice in the UCPD is very wide, as are the types of practice which could be considered as unfair. Practices which are misleading or aggressive (as those terms are defined in the UCPD) will be automatically unfair, together with 31 identified types of commercial practice which will be considered unfair "in all circumstances". These, rather worryingly, include practices such as presenting rights given to consumers in law as a distinctive feature of the trader's office - which could cause considerable difficulties for a wide range of companies which currently promote their "warranties" even though these warranties do not in fact extend rights already available to consumers and, in many, instances, are in fact less extensive than those rights.

One of the main focuses of the consultation was on the range of remedies and sanctions which would be available in the event that a trader pursued an unfair practice. The UCPD requires member states to ensure that there are adequate and effective means to enforce compliance and the government was consulting as to whether to give consumers the right to bring an action for breach of statutory duty and, if so, upon what remedies might be appropriate.

6.20 Unfair Contract Terms Act 1977: reasonableness

In July, the High Court had cause to consider the reasonableness of terms in a supplier's standard terms and conditions which excluded the statutory terms of satisfactory quality and fitness for purpose and effectively deprived the customer of any remedy in the event that the products proved defective (save where they failed to conform with the supplier's specification).
In considering the reasonableness of the exclusions, the judge applied the guidelines found in the 1977 Act (including the parties' respective bargaining power, the supplier's ability to insure, the cost of likely damage and the customer's knowledge of the terms). The judge noted that the reasonableness test was to be applied "having regard to the circumstances which were or ought reasonably to have been known of contemplated when the contract was made" - ie in light of potential rather than actual circumstances. He was expressly mindful of the authorities which make it clear that the court should be slow to interfere with the allocation of risk as revealed by the contracts agreed between commercial entities of equal bargaining power.

In finding that the exclusions of liability were in the circumstances unfair, the judge took account of the fact that:

- the supplier was aware at the time the contracts were made of the use to which the customer intended to put the product and of the fact that this use required consistent quality and fitness for purpose;
- the risk fell entirely on the customer, notwithstanding, firstly, that the Sale of Goods Act 1979 contemplates that the supplier will bear this risk and, secondly, that the supplier can more easily insure itself against losses which might follow from defects in quality or fitness for purpose;
- the contracts in this case were presented on a "take it or leave it" basis and that the number of alternative suppliers was very limited. There was no real negotiation, particularly on risk and the standard terms and conditions were not themselves the product of negotiation between supplier and customer;
- the supplier was a large organisation in terms of assets and expertise and could spread the cost of insurance over a wide customer base, whereas the customer was limited by comparison; and
- the loss which the customer had suffered was foreseeable and extensive and the supplier had in fact settled some of the claims without relying on the exclusions.

In the event, although the judge considered that the exclusion clauses were unfair in the circumstances, this did not enable the customer to recover as the judge found, as a matter of fact, that the products were neither unsatisfactory nor unfit for purpose. We understand that the case is proceeding to appeal, which could provide an excellent opportunity for guidance from the Court of Appeal upon the application of the reasonableness test in similar circumstances. Further details will be supplied in due course if the case proceeds as anticipated.

*Balmoral Group Ltd v (1) Borealis (UK) Ltd (2) Borealis AS (3) Borealis A/S [2006] EWHC 1900 (Comm)*

**6.21 Unfair contract terms: reforms**

In July 2006 the government formally responded to the Joint Report and Unfair Contract Terms Bill which were originally published by the Law Commission and Scottish Law Commission in February 2005. The government has accepted in principle the recommendations in the Joint Report including the proposal to consolidate the existing...
provisions of the Unfair Contract Terms Act 1977 and the Unfair Terms in Consumer Contracts Regulations 1999 (which are the source currently of overlap and confusion, due to the different approach and terminology adopted). The draft Unfair Contract Terms Bill which was attached to the Joint Report is now subject to a regulatory impact assessment.

The reforms proposed are not as whole-scale as had been feared at one stage, with the regime for large commercial enterprises being left largely - though not wholly - intact. In the business to business context, the current proposals are that clauses which are automatically unfair now would remain so, un-negotiated exclusions of or limitations on liability would still be vulnerable to challenge and the burden of proof would remain upon the party seeking to rely upon the clause, although negotiated exclusions of or limitations to the implied terms of conformity with description and/or quality or fitness for purpose would no longer be vulnerable to challenge.

A new "fair and reasonable" test would be introduced which would take into account the transparency of the term as well as the "substance and effect" and "all the circumstances existing" at the time of the contract. Another change would be the introduction of a new category of "small business" (those having nine or fewer employees with exceptions for size of contract, financial services and those "associated" with larger businesses). Small businesses would be able to challenge the fairness and reasonableness of any standard term other than a "core term" unless that term had been changed in its favour following negotiation.

In the international business to business context, it is proposed that imports would be caught by the regime (although exports would remain exempt) and controls would be tightened to prevent parties from avoiding the impact of the regime simply by choosing a foreign law where contracts were otherwise wholly connected with the UK.

In the consumer context it is proposed that all terms (not just exclusion or limitation clauses) other than "core terms" (price, quantity etc) would be open to challenge on grounds of fairness and reasonableness, irrespective of whether the term had been specifically negotiated. International supplies would to consumers would no longer be exempt and English law will apply to protect the consumer even where foreign law was chosen, provided the consumer was living in the UK at the time of the contract and took all relevant steps necessary to conclude the contract in the UK.

For unfair contract terms developments relating to land, see paragraph 42.9.

6.22 Uniform customs and practice for documentary credits ("UCP") 600

The UCP rules are the internationally accepted governing rules for letters of credit. The most recent UCP rules were known as UCP 500 which had been in force since 1994. However, on 25 October 2006, the International Chamber of Commerce Banking Commission ("ICC") unanimously approved the new UCP rules, to be known as UCP 600, which will come into effect on 1 July 2007. This was the culmination of several years of worldwide consultation with numerous interested stakeholders and with DLA Piper playing its part by having a representative on the ICC Consultation Group for the revision of UCP 500 and the DLA Piper London office hosting the final ICC UK member meeting to approve the proposed UCP 600.
The revised rules incorporate a number of changes including:

- a new section of definitions and interpretations to clarify the meaning of ambiguous terms;
- a period of five banking days for examining and determining compliance of documents with the documentary credit, replacing the term "a reasonable time, not to exceed seven banking days" for such examination and determination;
- new provisions allowing for the discounting of deferred payment credits;
- the ability to accept an insurance document that contains an exclusion clause;
- a new provision about beneficiary and applicant addresses;
- redrafted articles for the identification of carriers and agents;

The approval of the new UCP rules comes at a time when the use of documentary credits in international trade and commodity finance, particularly by multinational corporations, is in decline. Documentary credits are increasingly being replaced by open account terms supported by automated trade services, except in the mid corporate market, where the effect of the new UCP rules will be felt.

6.23 Recent developments in emerging markets

When trading or financing trade in emerging markets, it is important to ensure that the legal structures used address the risks met in particular jurisdictions. Understanding the worth of security in emerging markets, where laws are still developing, and where enforcement of the law may be slow or unpredictable, is important to gauge risk of loss, ensure correct pricing and maximum recovery. In Sub-Saharan Africa for example, many jurisdictions present serious concerns with regard to the certainty and speed with which a bank can realise security held over commodities. A structure which gives a bank a proprietary interest in the commodities is advantageous in jurisdictions such as Mozambique, where insolvency laws are in desperate need of reform, or Kenya, where a debenture over a customer's assets can result in a stamp duty charge of 0.2% of the amount secured.

Trade finance in emerging markets is constantly evolving and there have been a number of legal developments, in particular in warehouse financing in some such markets, this year. Certain Sub-Saharan jurisdictions, such as Uganda, Tanzania and Zambia have recently introduced new laws to enhance the value of warehouse receipts in international trade, thereby increasing the opportunity by banks or finance providers to take further security.

In Uganda, the Warehouse Receipts System Bill ("WRS Bill") was passed by Parliament in Uganda in April 2006 and awaits Presidential assent. The WRS Bill recognises warehouse receipts as documents of title, which means that they will shortly be capable of being used as a pledge of underlying commodities, and provides for the regulation of warehouses and warehouse operators.

In Tanzania, trials of the Warehouse Receipt Systems for the coffee and cotton industries have been operating with some success since 2000/2001. Broader uptake is certain to be encouraged by the Tanzania Warehouse Act No. 10 of 2005 ("WRA") which was given
Presidential assent in June 2005. The Act, together with the accompanying regulations (2006), provides a regulatory framework in Mainland Tanzania for warehouse receipts, licensing procedures and other related matters.

Section 4 of the WRA established the Tanzania Warehouse Licensing Board ("Board") which has been tasked a variety of functions including grading warehouses, licensing and inspecting operations, as well as with the establishment of market mechanisms to ensure the increasing involvement of commodities in the warehouse receipt system, possibly including the establishment of a commodities exchange. In addition to maintaining insurance against fire and theft, warehouse operators are required to provide a bond annually to the Board equal to 10% of the value of the goods stored which may be called upon by any person injured by breach of the warehouse operator's obligations under the WRA. The WRA encourages the use of licensed warehouse inspectors by denying any remedy under the act to those who do not do so. The WRA also introduced a presumption that, unless stated otherwise, warehouse receipts are negotiable.

In Zambia, warehouse receipts are regulated by the Zambian Agricultural Commodities Agency Limited ("ZACA"), which is owned by various industry stakeholders. ZACA certifies warehouse operators dealing in maize, wheat and soya beans. ZACA adopted regulations in 2001 ("Regulations") setting out the minimum standards which warehouses and warehouse operators must meet in order to be certified by ZACA. The Regulations require that a certified warehouse operator maintains a minimum net worth of 10% of the value of stock which it is certified to store and in any event shall not be less than US$ 50,000. A certified warehouse operator is also required to file with ZACA a copy of a performance bond or undertaking that is not less than 10% of the value of stock that it is certified to store (and may vary with the financial standing of the applicant). The Regulations also contain requirements as to insurance. Provided certain conditions are met, warehouse receipts can be issued under the Regulations in an electronic form. Although there has been considerable local, small scale uptake of the system, it seems further legislative reform is needed to stimulate growth.

Such legal developments will facilitate international trade in these jurisdictions by facilitating security-backed transactions, nevertheless it is important to understand that the value of security, including warehouse receipts, is dependent on the legal and institutional structure of the relevant jurisdiction, and the practice on the ground.

### 6.24 Developments in factoring and invoice discounting

Factoring, or invoice discounting, has traditionally been a form of mid-level finance whereby a company supplying goods or services on credit would sell its invoices or receivables to a factoring company at a discount. The essential difference between factoring and invoice discounting is that factoring involves the transfer of the responsibility for collection management by the supplier company. Recently, however, factoring has evolved into a more complex cross-border market which has attracted sophisticated investors such as hedge funds. Finance structures involving the factoring of cross-border receivables presents certain jurisdictional legal risks on which it is essential to take legal advice.

Another recent development in the factoring market is "reverse factoring", a process by which a factoring company purchases receivables from high-credit quality buyers such as multinationals instead of its traditional mid-level low-credit quality suppliers. This process injects liquidity into the supply chains of multinationals by leveraging the multinationals' creditworthiness, but has raised a number of legal and regulatory issues, particularly in the
United States, as reverse factoring shares many characteristics with debt finance. The Securities Exchange Commission ("SEC") has voiced concerns about reverse factoring in two separate speeches over the past few years, and there is uncertainty as to whether such receivables can remain on the buyer's balance sheet as a trade payable or if they become bank debt.

Such developments will inject new life into the factoring markets, but it is important to keep abreast of legal and regulatory developments, in particular with new or cross-border factoring products.

7. COMPANY (GENERAL)

See also COMPANY (LISTED), section 8, CORPORATE GOVERNANCE, section 14, FINANCIAL REPORTING, section 19, and MERGERS AND ACQUISITIONS/CORPORATE ACTIVITY, section 35.

7.1 Companies Act 2006

7.1.1 Overview

The Companies Act 2006 ("2006 Act") received royal assent on 8 November. It has had a long gestation period - seven years in fact - and represents the largest reform of company law for over 20 years.

The 2006 Act is the longest in Parliamentary history with 1,300 sections covering 700 pages (http://www.opsi.gov.uk/acts/acts2006/ukpga_20060046_en.pdf). It:

- codifies some existing common law principles (such as directors' duties);
- implements the EU's Takeovers and Transparency Obligations Directives;
- introduces some new provisions both for private and public companies; and
- otherwise amends or restates most of the Companies Act 1985 ("1985 Act"), some sections with minor and some with substantive amendments.

This section highlights a number of the important changes to company law that the 2006 Act will introduce.

7.1.2 Implementation

From 1 January 2007, new provisions implementing the First Company Law Amendment Directive will be enacted. These will require a company to include certain corporate details on all business letters and order forms and on its website. The provisions relating to the Transparency Obligations Directives and to company communications (to shareholders and others), including electronic communications, are due to come into force from 20 January 2007. The provisions to implement the Takeovers Directive were to be in force from 6 April 2007, but the first commencement order did not include the appropriate commencement provisions. See http://www.opsi.gov.uk/si/si2006/uksi_20063428_en.pdf for the commencement order and http://www.opsi.gov.uk/si/em2006/uksiem_20063428_en.pdf for explanatory notes (also see paragraph 35.1). The government intends to consult in
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spring 2007 on the timetable for implementation of the remainder, the numerous regulations required to supplement various elements of the 2006 Act and on transitional provisions to regulate how the 2006 Act will apply to existing companies. The 2006 Act and ancillary regulations are expected to be fully in force by October 2008.

7.1.3 Impact on directors

Codification of duties - the 2006 Act replaces and codifies the principal common law and equitable directors' duties, but it is not an exhaustive statement of their duties. The seven codified duties are as follows:

- **to act within their powers** - ie within the terms of the company's articles and decisions made by shareholders;

- **to promote the success of the company** - although directors must continue to act in a way that benefits shareholders as a whole (as now), there is a list of non-exhaustive factors which directors will need to have regard to. These are the long term consequences of decisions, the interests of employees, the need to foster the company's business relationships with suppliers, customers and others, the impact on the community and environment, the desire to maintain a reputation for high standards of business conduct and the need to act fairly between members;

- **to exercise independent judgment** - directors should not fetter their discretion to act, other than pursuant to an agreement entered into by the company or other than in a way authorised by the company's articles;

- **to exercise reasonable care, skill and diligence** - this (as currently) must be exercised to the standard expected of someone with both the general knowledge, skill and experience reasonably expected of a person carrying out the functions of that director (objective) and the actual knowledge, skill and experience of that director (subjective);

- **duty to avoid conflicts of interest** - directors must avoid situations where they have or may have an interest which conflicts or may conflict with the interests of the company. Methods for authorising such conflicts, either by board or shareholder approval, are to be introduced. For private companies authorisation will be the default position (whereas currently shareholder permission is required by default);

- not to accept benefits from third parties; and

- **to declare an interest in a proposed transaction with the company** - there will be carve outs for matters that are not likely to give rise to a conflict of interest, matters of which the other directors are already aware and for service contracts that have been or will be considered by the directors. (Note there will be an additional statutory obligation to declare interests in existing transactions.)

Whilst these duties replace the existing law, it will remain relevant as the 2006 Act states it is to be used to interpret and apply the new codified duties.
The statutory duties are cumulative, and will (as now) be owed by a director to the company and thus it is the company which must enforce those duties rather than shareholders (unless they are able to bring a derivative action - see "Claims against directors" below). The 2006 Act preserves the existing civil consequences for breach of directors' duties. Other than the duty to exercise reasonable care, skill and diligence (which, as now, is not a fiduciary duty), the duties are enforceable as fiduciary duties and the consequences of breach may include damages, restoration of company property, accounting for profits made and rescission of a contract.

The codification of directors' general duties was one of the most hotly debated areas of the 2006 Act. Whilst the aim of codification was to make directors' duties more accessible and easier to understand, unfortunately we do not believe that this has been achieved.

Declaration of interests in existing contracts - as well as disclosing interests in proposed arrangements, directors will (as now) be required to disclose interests in existing contracts with the company. The disclosure requirements will be expanded so that not only details of the nature of the interest have to be disclosed but also the extent of that interest and any subsequent changes to it. As disclosure will not be required where disclosure has already been made prior to entry into the arrangement under the codified directors' duty, this will be of most relevance on the appointment of a new director or on any subsequent change in his interests previously disclosed.

Ratification of breaches - shareholders' ability to ratify any director's conduct that amounts to negligence, default, breach of duty or breach of trust will be placed on a statutory footing (but, unlike now, interested shareholder-directors will be prevented from participating in the ratification resolution).

Indemnification of directors - the existing restrictions on companies indemnifying directors against certain liabilities are to be relaxed to permit indemnities by group companies to directors of corporate trustees of occupational pension schemes in certain circumstances.

Claims against directors - currently, shareholders only have limited rights to be able to pursue claims for directors' misfeasance on behalf of a company (known as derivative actions). The 2006 Act will give all shareholders a statutory right to commence legal proceedings against directors on behalf of the company for negligence, breach of duty or breach of trust, leading to concerns that directors will face increasing personal claims and hence liability. However, to prevent unmeritorious claims, shareholders will require the consent of the court to proceed with a claim. In deciding whether to give such consent, the court will have to consider, amongst other things, whether the claimant is acting in good faith, whether continuing the claim would promote the success of the company, whether or not the company's shareholders would be likely to ratify the matter, other available causes of action and the views of independent shareholders.
**Shareholders' approval for arrangements with directors** - the provisions of the 1985 Act which deal with transactions between a company and its directors and their connected persons (such as substantial property transactions, service contracts, payments for loss of office and loans and related transactions) have been rewritten in the 2006 Act and some changes implemented. For example, the prohibition on loans and similar transactions (which is quite commonly breached by many smaller companies) is to be replaced with a requirement for shareholders' approval; service contracts for two years or more (as opposed to the current five years) will require shareholders’ approval; more transactions with those connected with directors will require approval (as connected persons are to be widened to include, for example, live-in partners, parents and adult children).

**Corporate directors** - whilst it will remain possible for one company to be a director of another, at least one member of each company's board must be a natural person. Hence, companies that currently only have corporate directors will need to appoint an individual as an additional or replacement director.

**Age restrictions** - the current age restriction of 70 for directors of public companies and their subsidiaries will be abolished. A new minimum age of 16 will be introduced for all directors.

**Directors' home addresses** - all directors will have the option of providing Companies House with an address for service, which will in future enable their home addresses to be kept on a separate non-public register to which access will be restricted. However, home addresses will not be automatically removed from historical records.

**Directors' interests in shares** - directors will no longer be required to disclose interests in the company's shares and, consequently, the company will not be obliged to maintain a register of directors' interests.

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**Changes for all companies**

The following key provisions in the 2006 Act affect both private and public companies:

**Modernisation of company formation** - a number of changes will be made to the company formation procedure to facilitate web incorporation. In addition, one person will be permitted to form any sort of company (not just a private company as now).

**Constitution** - a company's articles will become its main constitutional document (with an existing company's memorandum being treated as part of its articles). There will be a radically simplified set of model articles for private companies to reflect the way that the majority of small companies operate, and new model articles for public companies similar to the current Table A (to view the current Department of Trade and Industry ("DTI") drafts, for private companies, see [http://www.dti.gov.uk/files/file25412.pdf](http://www.dti.gov.uk/files/file25412.pdf) and, for public companies, see [http://www.dti.gov.uk/files/file29935.pdf](http://www.dti.gov.uk/files/file29935.pdf)). Existing companies will be able to adopt the new model articles, in whole or in part, if they wish.
Corporate capacity - the objects of a company formed under the 2006 Act will be unlimited unless its articles specifically limit them. Existing companies may wish to alter their articles to benefit from the flexibility this relaxation will offer.

Execution of documents - execution formalities are to be revised. Currently documents can be executed by a company by either (a) affixing its common seal or (b) the signature of two directors or one director and the secretary. Under the 2006 Act, execution by a single director in the presence of a witness will be permitted. The right for companies to appoint attorneys has been clarified.

Share capital, class rights and share premium - the requirement for an authorised share capital will be removed. Power to subdivide/consolidate shares or to purchase own shares will no longer be required in the articles, but a company can expressly restrict a company's ability to do so in its articles if it wishes. Transitional provisions will need to regulate how existing authorised share capitals and powers in a company's articles are to be treated.

A new procedure will enable companies to redenominate their share capital from one currency to another without the need for a court approved reduction of capital (to address the current problem of fractions of shares arising).

The 2006 Act simplifies the procedure by which companies may issue redeemable shares. For private companies only, authorisation of an allotment of redeemable shares will no longer be required in the articles. The terms of redemption need not be stated in the articles - shareholders may delegate (either in the articles or by special resolution) to directors the precise terms on which the redeemable shares are to be offered (which must be set prior to allotment). Also, payment will no longer be required on redemption if the company and the holder agree.

Any change of capital (whether to issued share capital, share rights or nominal values) will require a new "statement of capital" to be filed at Companies House, reflecting the company's up to date capital position.

The definition of what amounts to payment up of shares in cash will be extended, which will impact on the need to obtain a disapplication of statutory pre-emption rights and, for public companies, the need to obtain independent valuations of non-cash consideration. Where shares are allotted for non-cash consideration, the contract for such allotment will no longer be required to be filed at Companies House (removing existing problems in relation to the confidentiality of such contractual terms).

The provisions relating to class rights are also to be replaced and simplified: unless the articles provide otherwise, class rights may be varied with a 75% majority.

The 2006 Act will further restrict the uses of the share premium account: other than on a reduction of capital, it will only be available for writing off issue expenses and commissions and to pay up bonus shares.
**Distributions in kind** - the 2006 Act clarifies the current uncertainty surrounding whether a transfer of a non-cash asset by a company to a shareholder amounts to a distribution. If the company concerned has distributable profits, then:

- there will be no distribution if the consideration for the asset exceeds its book value; or
- if the consideration for the asset is less than its book value, there will be a distribution of the amount equal to the shortfall (for which it will require sufficient distributable profits).

**Shareholder meetings** - shareholder meetings will be able to be held more quickly - special resolutions will require only 14 days’ notice unless proposed at an AGM. The rights of proxies are to be enhanced to ensure that a member is not disadvantaged by not attending in person. Many procedural provisions relating to meetings of the type currently found in Table A are included in the 2006 Act.

**Pre-emption rights on allotment** - the statutory pre-emption rights in section 89 of the 1985 Act will remain, but the 2006 Act contains a power to reduce the period for which pre-emptive offers must be open for from 21 to 14 days. If exercised, this might reduce underwriting costs on listed company issues.

The ability to exclude statutory pre-emption rights on allotment is being tightened up. Currently a private company may exclude them completely by its constitution - this will only be permitted under the 2006 Act where the relevant private company will only have one class of share after the proposed allotment.

**Shareholder communications** - the 2006 Act introduces some changes to facilitate greater use of electronic communications by companies with their shareholders, which will be effective from January 2007: see, further, paragraph 7.2.

**Auditors’ liability** - after extensive lobbying from the accounting profession, the 2006 Act will permit auditors to limit their liability for claims by the company for negligence, default, breach of duty or breach of trust in relation to the audit for a particular financial year with prior annual shareholders’ approval. However, any limit agreed may be subsequently increased by the court to such amount as is fair and reasonable in all the circumstances of the case, having regard to the auditors’ responsibilities, its contractual obligations and the standards expected of it.

A new criminal offence will be introduced for auditors who knowingly or recklessly give an incorrect audit opinion. This may lead to slower sign off of accounts, an increase in qualified audit reports and greater audit costs as auditors take a more cautious approach.

**7.1.5 Private companies**

Consistent with the government’s aim to simplify company administration and operation for smaller companies, a number of the provisions in the 2006 Act only apply to private companies:

**Company secretaries** - a private company will no longer require a company secretary, but may appoint one if it wishes.
Abolition of unanimity for shareholders' written resolutions - written resolutions may be passed by either a simple majority or by 75% of all the eligible votes for ordinary and special resolutions respectively.

Members' right to circulate a written resolution - as the written resolution procedure is expected to become the common decision making process, members together holding 5% of the voting rights (or lower if the articles specify) will be able to require a written resolution to be circulated for approval.

Abolition of AGMs - private companies will no longer be required to hold an AGM but can opt to do so if they wish through their articles.

Short notice to meetings - where private companies do convene meetings, consent to short notice can be given by the holders of 90% in nominal value of the shares carrying the right to attend and vote (who also constitute a majority in number of the members). This can be increased up to the current requirement of 95% by a company's articles.

Allotment of shares - where a private company will only have one class of shares after any proposed allotment, the directors will have unlimited authority to allot shares (unless restricted by its articles).

Abolition of financial assistance - the 2006 Act includes the long heralded abolition of the prohibition on financial assistance by a private company for the purchase of its own shares or those of its private holding company and the related "whitewash" exemption procedure in sections 155 to 158 of the 1985 Act. (Note the existing restriction on financial assistance by public companies and by private companies in relation to an acquisition of shares in a public company will remain.)

The abolition of this prohibition and the related whitewash procedure raised concerns that this could result in a more restrictive regime for private companies, the argument being that the current statutory regime supplanted the old common law maintenance of capital rules, but its abolition would effectively reinstate them (a somewhat grey area of law). To address this concern, the government has promised to introduce a saving provision by secondary legislation to the effect that the removal of the prohibition on private companies giving financial assistance for the purchase of its own shares will not prevent a private company entering into transactions which could lawfully be entered into now (ie under the whitewash procedure).

Assuming the saving provision achieves the desired effect, these changes should considerably simplify the financing of acquisitions, group reorganisations and take privates (but it is not yet known what comfort banks and financial institutions may require: see paragraph 3.3 ). Consideration will, however, still need to be given to other issues, such as directors duties, insolvency legislation and the like.

New reduction of share capital procedure - a new procedure (requiring a directors' statement of solvency and a special resolution) will enable private companies to reduce their share capital without the need for a court order.

Accounts filing period - to ensure more timely provision of information to shareholders, the period for filing accounts will be reduced from 10 to nine months after the year end.
7.1.6 Public and listed companies

With the aim of securing greater shareholder involvement, a number of new requirements will be introduced for public companies, some of which will apply only to official list companies (but not to AIM companies).

**Business review** - following criticism of the Chancellor's decision to abolish the more stringent operating and financial review, the 2006 Act imposes additional requirements for the business reviews in the report and accounts of official list companies. It also makes other changes to business reviews generally. See, further, paragraph 19.6.

**AGM and accounts** - public companies will be required to hold an AGM and file accounts more quickly - both within six months of the end of the financial year (although stricter timeframes will apply to those companies on the official list under the Transparency Obligations Directive: see, further, paragraph 8.3).

Official list companies will additionally be required to:

- publish their annual report and accounts on their websites;
- disclose the results of polled votes taken at general meetings on their websites;
- give certain minority shareholders the right to:
  - require an independent scrutiny of any polled vote (with any resulting scrutineer's report to be published on the company's website); and
  - require a company to publish on its website statements setting out matters relating to the report and accounts which members propose to raise at the AGM.

**Political donations and expenditure** - a number of simplifications and clarifications are to be made to the existing provisions requiring shareholders' approval of political donations and expenditure. As a number of the grey areas of expenditure (such as expenditure relating to trade unions other than donations to their political funds) will no longer be caught by the legislation, this may lead to a reduction in the number of companies seeking such approvals.

**Enfranchising indirect investors** - particularly in publicly traded companies, it is now commonplace for shares to be held in an intermediary's name, so the ultimate investor does not have direct shareholder rights. To address this, nominee shareholders of official list companies will be able to nominate people whose shares they hold to receive copies of company communications and annual reports and accounts.

All companies will also be able to include provisions in their articles to enable the registered holder to identify someone else as being able to exercise additional rights.

**Voting disclosures by institutions** - the 2006 Act gives the government power to introduce regulations in the future which would force institutions to disclose how they...
have voted. The government has stated that it will only introduce such regulations after full consultation and if a voluntary disclosure regime does not work.

**Transparency Obligations Directive** - this imposes obligations on official list companies in relation to financial reporting, disclosure of information on major acquisitions or disposals of its shares and the dissemination of information about it to its shareholders and the public generally. See paragraph 8.3 for further details.

**Takeovers** - the 2006 Act contains provisions dealing with the EU Takeovers Directive and amendments to the "minority sweep up" provisions to address a number of practical problems arising on their operation. See paragraph 35.1 for further details.

### 7.2 Company communications

#### 7.2.1 Overview

The 2006 Act contains new provisions governing communications, including electronic communications, between a company and its shareholders. For officially listed companies, the FSA's Disclosure and Transparency Rules ("DTR") (which will, together with the 2006 Act, implement the Transparency Obligations Directive) will also contain provisions which apply to electronic communications by such companies to their shareholders. Whilst the timetable for the implementation of the majority of the 2006 Act's provisions has not yet been finalised, the provisions of the 2006 Act relating to company communications will be fast tracked and will come into force on 20 January 2007. The driving force behind this earlier implementation is the significant cost savings that the provisions could generate for businesses. The DTR (including the provisions relating to electronic communications by officially listed companies) will also be implemented with effect from 20 January 2007.

#### 7.2.2 How do the new provisions differ from the current law?

Under the current law a company is permitted to communicate electronically only with those shareholders who have expressly agreed to such form of communication (ie they are required to opt-in to the current electronic communications regime). This requirement for positive action on the part of shareholders has meant that take up rates for electronic communications have historically been relatively low.

The 2006 Act and the DTR address this problem by, in certain circumstances, switching the default position. They will permit a company to use certain types of electronic communication with a shareholder unless the shareholder specifically objects to receiving communications in such manner (ie a shareholder will be required to "opt-out" of the new regime), shifting the power to move to electronic communications from shareholders to the company.

#### 7.2.3 Which communications will be covered by the new provisions?

*All companies (other than officially listed companies)*

Subject to the fulfilment of certain requirements of the 2006 Act (see paragraph 7.2.4), any communications that are authorised or required to be sent to shareholders
by the 2006 Act or the 1985 Act (pending the coming into force of all such provisions of the 2006 Act)¹ may be sent electronically. This will include:

- the annual report and accounts;
- notices of general meetings; and
- proxy forms.

In addition, a UK AIM company will be permitted to send documents required to be sent to shareholders under the AIM rules electronically, provided that it complies with the requirements of the 2006 Act relating to company communications.

Officially listed companies

The DTR will permit officially listed companies to send any communications to its shareholders by electronic means, provided certain requirements are fulfilled (see paragraph 7.2.4). In addition to the communications covered by the 2006 Act/Act (eg the annual report and accounts, notices of general meetings and proxy forms) this will allow a number of other shareholder communications to be sent electronically by such companies, including:

- class 1 circulars;
- prospectuses; and
- defence documents issued by the company in connection with a takeover bid.

This is, however, subject to an overriding requirement to treat all shareholders equally regardless of their place of residence. This requirement may, in practice, prevent officially listed companies using electronic communications where they are prevented by overseas securities laws from sending or making available documents to shareholders resident in certain jurisdictions (typically the USA, Canada and Australia).

7.2.4 The new provisions

Communications by email or fax

In general, the 2006 Act and the DTR do not change the current law relating to email and fax communications - the prior express agreement of a shareholder will still be required.

¹ See further paragraph 7.2.6.
Communications by means of a website

Express agreement - under the 2006 Act and the DTR, a company may communicate via a website with any person with his/her prior express agreement.

Deemed agreement - both the 2006 Act and the DTR also contain provisions which provide that in certain circumstances shareholders will be deemed to have given their consent to website communications - it is here that the real power of the new provisions lies. Official list, AIM and PLUS (formerly OFEX) companies will no doubt wish to make use of these provisions to maximise their ability to communicate with shareholders by website (for example, in relation to AGMs, report and accounts etc) and obtain the anticipated cost savings.

A company which is not an officially listed company (eg AIM or PLUS companies or private companies) will be permitted to default to website communications with its shareholders provided that (i) a resolution of the shareholders has been passed or its articles contain appropriate provision allowing it, and (ii) it has asked the relevant shareholder to agree to communications in this way (explaining what the consequences of failure to respond would be) and such shareholder has not objected within 28 days of the company's request.

For a UK officially listed company to be able to default to website communications with its shareholders, the same requirements as those set out above must be fulfilled, except that appropriate provision in its articles will not be sufficient - a resolution of the shareholders must be passed.

By requiring shareholders to take positive steps to refuse website communications (rather than, as is the case under the current law, to request website communications) it is anticipated that many more companies will benefit from the significant cost savings that web based communications will generate.

Notification requirements - where website communication is used, a company will have to notify the intended recipient(s) (in hard copy or via email or fax if permitted) that the relevant information has been placed on the website, give details of the website and instructions on how to access the information.

7.2.5 Right to hard copy version

The 2006 Act and the DTR preserve the right for shareholders to require information to be sent to them in hard copy form where they have received the information from the company electronically.
7.2.6 How will the new provisions affect existing companies?

The Companies Act 2006 (Commencement No. 1, Transitional Provisions and Savings Order) 2006 ("Commencement Order") which was published on 22 December 2006 contains a number of transitional provisions which deal with the application of those provisions of the 2006 Act relating to company communications to the existing provisions of the 1985 Act and to a company's existing communication procedures. Where the 1985 Act provides for documents or information to be sent or supplied, such provisions must be interpreted in accordance with the communication provisions contained in the 2006 Act.\footnote{For example, section 238(1) of the 1985 Act provides for a copy of a company's annual report and accounts to be sent to, amongst others, members of the company. When read in conjunction with the communication provisions of the 2006 Act, such documents may, subject to the fulfillment of certain requirements (see further paragraph 7.2.4), be sent in hard copy form, in electronic form (eg email or fax) or via a website.} The Commencement Order also provides that, where a shareholder has, before 20 January 2007, given its express consent to the receipt of copies of a company's annual report and accounts, summary financial statement or AGM notices electronically, this will satisfy the requirement for express consent under the new provisions of the 2006 Act. The Transparency Obligations Directive (Disclosure and Transparency Rules) Instrument 2006 which was also published on 22 December 2006 contains a similar transitional provision which provides, amongst other things, that a UK officially listed company can also rely on any existing authority for the purposes of the DTR electronic communication provisions.

7.2.7 Practicalities of implementing electronic and website communications

There are a number of steps which a company can take to prepare for the impending changes, including:

- where relevant, liaising with the company's registrars to understand the processes and procedures that they intend to adopt to cater for the new provisions;

- considering, where relevant, in conjunction with the company's registrars, which method or methods of electronic communications the company is prepared to offer. A company will need to ensure that it has appropriate resources and facilities in place to handle all the methods offered efficiently and may therefore wish to limit the options available;

- where website communications are to be offered, considering whether the company's website needs to be improved, in particular, the financial reports section;

- reviewing existing practices regarding shareholder communications and considering (where relevant, in conjunction with the company's registrars) the form and timing of any communication to a company's current shareholders requesting their consent to electronic communications;

- the process and timing for requesting consent to electronic communications from subsequent new members;
whether a shareholders resolution or change to the articles to permit electronic communications will be necessary at the next AGM; and

- the process (where relevant, in conjunction with the registrars) for recording actual or (where relevant) deemed consent to electronic communications and any subsequent revocation of that consent.

7.3 Substantial property transactions

In (1) NBH Limited, (2) NBH Group Limited v (1) Kevin Peter Hoare, (2) Richard George Hazell and (3) Karin Magarete Hardman [2006] EWHC 73(Ch), the court considered whether informal unanimous shareholder consent (under the principle in Re: Duomatic Limited (1969) Ch 365) was sufficient to satisfy the requirement for shareholder approval of a substantial property transaction with a director or those connected with him under section 320 of the Act.

Mr Hoare was a director and sole shareholder of a company ("Topco"). He was also a director in one of its wholly owned subsidiaries. A trust company (with which Mr Hoare was connected) was used as a vehicle by Mr Hoare to acquire certain assets comprising a package of landfill sites. As part of a series of investment transactions involving venture capitalists ("VCs") and the Topco group, the assets were subsequently bought by Topco from the trust company for less than market value. The parties fell out and when the assets were sold on, insufficient money was recovered by the VCs on their investment who sought to recover their losses. It was argued that as formal prior shareholder approval under section 320 had not been obtained, Mr Hoare (as director) was liable under section 322 to pay the whole of the gain that he had indirectly made from the transaction (ie the difference between what the trust company had paid for the assets and what it sold them for). The court held that Mr Hoare's informal approval of the transaction prior to it taking place was sufficient to satisfy the requirement for approval under section 320, despite the absence of a formal resolution, as he was the sole shareholder (as well as being a director). It was irrelevant that the VCs had acquired shares in Topco at the same time as the assets were purchased. Hence, there was no liability for breach of section 320.

7.4 Financial assistance

The case comprised a claim in respect of unpaid sums due under a post-acquisition credit agreement which were guaranteed. A preliminary issue arose as a result of the purchaser's prior acquisition of target. The share purchase agreement referred to target's indebtedness to its parent (ie the vendor), which the purchaser guaranteed as principal debtor. As security for the guarantee, the purchaser charged a number of shares in target to target's parent company.

Several months later, target applied for a loan and entered into a credit agreement with a third party creditor to borrow £15m. That credit agreement stated that the loan "was for the purpose of repaying target's indebtedness and providing working capital". The loan was supported by a security agreement under which target granted the creditor a fixed and floating charge over its assets. Mr Sutton (who had formed the purchasing company to buy target) guaranteed target's liabilities to the creditor under the security agreement. Target used £9m of the loan to repay its outstanding debt to the vendor (ie its historic parent), the balance of £6m being for working capital/unspecified corporate funds.

As often in these cases, only some of the payments under the credit agreement were made, and the creditor demanded the balance, appointing administrative receivers over target's assets. The preliminary issue was, therefore, whether either or both of the credit and security agreements were valid and enforceable, or void and illegal, as a result of section 151 of the Act. The creditor also demanded payment by Mr Sutton under the guarantee. Target argued that (i) the charge granted to its historic parent was financial assistance "directly or indirectly for the purpose of acquisition" (as it discharged target's obligation to repay the balance of the debt to its parent and therefore lowered the consideration paid for its shares, and (ii) that the purchaser's guarantee was a liability incurred "for the purpose of" the share acquisition (ie unlawful financial assistance), because the £9m borrowed by target was used to repay money due to the vendor under the compromise deed, discharging the guarantee.

On the facts, the court found that there was no financial assistance given by target to the purchaser as a third party for the purpose of acquiring its shares within the meaning of section 151. The credit agreement and security agreement entered into by target were designed to replace target's existing indebtedness and benefit the purchaser. The creditor had no knowledge that its moneys were being used for replacement of securities that were financial assistance. In this case, the purchaser was supporting target, and not the other way around. The charge granted by target was part of a genuine repackaging of target's liabilities to its parent (without which it would be insolvent). The guarantee therefore made commercial sense, in supporting target's obligations to its historic parent. Finally, the court found that as a matter of common sense, it must be acceptable for a company to assist in restructuring its own indebtedness by providing security in instances where it is lawful for it to repay that indebtedness for genuine commercial reasons.

It is not surprising for the judge finding against target who was in effect trying to rely on its own alleged unlawful conduct to wriggle out of a debt. Obiter, he stated that had the credit agreement and the security agreement been held to be invalid, in view of the definition of "secured liabilities" in the security agreement, the creditor would have been entitled to recover in any event the sum of £6m that was advanced totally unconnected with the

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3 To be specific, target's unsecured debt to its parent amounted to £30m (repayable on demand). The consideration for the acquisition was the sum of £1 plus the assumption of debt and liabilities by the purchaser. Under the compromise agreement (1) target agreed to repay in instalments £15m in part satisfaction of the debt to its parent (ie made up of £6m of inter-company loans and £9m at a later date), (2) parent was granted a fixed charge over target's property, and (3) parent released target from the £15m balance owed.
supposed unlawfulness (ie for working capital). Mr Sutton would have been similarly so
liable on his guarantee. Legal commentators have commented that the judge's reasoning on
financial assistance is debatable, as it suggests that, if repayment of a debt is lawful, then
securing its repayment is also lawful.

7.5 Unlawful dividends

In *It's A Wrap (UK) Limited (in liquidation) v (1) Barbara Gula (née Barbara Jean Rogers)
and (2) Anthony Gula* [2006] EWCA Civ 544, the Court of Appeal considered the
circumstances in which a shareholder was liable to repay unlawful dividends received.

Two shareholders who were also directors had received unlawful dividends, which the
liquidator of the company subsequently sought to reclaim. The recipients claimed they had
been advised it was normal tax-efficient practice to withdraw a "salary" by making dividends,
which they put through the company's accounts on that basis. At first instance, ignorance of
the law appeared to be a "defence". However, on appeal, it was found that a shareholder was
liable to repay a dividend he had received if he knew or could have been aware that it had
been paid in circumstances which amounted to a contravention of the Act; it was irrelevant
whether or not he knew of the relevant provisions of the Act.

7.6 Unlawful loans to directors

In *Neville and another v Krikorian and others* [2006] EWCA Civ 943, the court considered
the provisions of sections 330 and 341 of the Act. These prohibit a company from making
loans to its directors and specify that, where the prohibition is breached, the director to whom
the loan has been made or their "connected persons" and any director who authorised the
transaction are (under section 341(2)(b)) jointly and severally liable to indemnify the
company for any loss suffered as a result of the unlawful loan. If a co-director is charged on a
joint and several basis to indemnify the company for the loss suffered, he is not liable if he
can show that at the time of the loan, he did not know of the relevant circumstances
constituting the breach (section 341(5)).

Here, a director who was aware that his company was making loans through a loan account to
another director (his son), was held to be jointly and severally liable with that director to
repay all monies loaned from the time that he became aware of the loans. In this case, the
wording of the originating application of the administrator meant that one director (the father)
did not fully appreciate that the claim against him was based on joint and several liability.
Also of relevance was the fact that the parties squabbled over the authenticity of a board
minute approving the accounts (which showed the loans). The court found that under
section 382(4) of the Act, provenance of a minute was proof of its content and a director
could not escape liability for the accounts that were prepared, signed and delivered by the
board of which he was a member. On the evidence, it was clear that the father had
contravened section 341, as he had authorised the lending by the company to his son as
codirector after the date of the minute, and was consequently liable to indemnify the
company for the loss resulting from the loan. Not only did the father know of the practice of
making loans, he took no steps to stop it or cause the company to call in outstanding amounts
due. Likewise, the son would have been similarly liable to indemnify the company for the
loans made to his father, but he had no assets.
7.7 European Co-Operative Societies

The European Co-Operative Society Regulations 2006 (2006/2078) and the related European Co-Operative Society (Involvement of Employees) Regulations 2006 (SI 2006/2059) came into force on 18 August 2006 (giving effect to two EC directives). They enable the creation of a new form of European co-operative society (known as an "SCE") which is able to operate across the European Economic Area on the basis of registration in only one member state. The regulations, amongst other things:

7.7.1 designate the Financial Services Authority ("FSA") as the competent authority to regulate SCEs with registered office in the UK;

7.7.2 permit bodies with head offices outside the EC to participate in the formation of an SCE, subject to certain conditions;

7.7.3 specify the process for an SCE to register with the FSA;

7.7.4 prescribing the information and documents a co-operative must provide if it wishes to form an SCE by merger or conversion; and

7.7.5 provide for the structure and proceedings of SCEs and the extent and manner of employee involvement in them.

As with the Societas Europaea (European companies) introduced in 2004, SCEs are likely to be rare entities within the UK due to the requirement for considerable employee involvement.

8. COMPANY (LISTED)

See also COMPANY (GENERAL), section 7, CORPORATE GOVERNANCE, section 14, FINANCIAL REPORTING, section 19 and MERGERS AND ACQUISITIONS/ CORPORATE ACTIVITY, section 35.

8.1 Shareholders’ Rights Directive

8.1.1 At an EU level

On 11 January 2006, the EC published its proposal for a directive - known as the Shareholders' Rights Directive (COM/2005/0685) - on (i) the exercise of voting rights by shareholders on an EU wide basis, and (ii) the organisation of general meetings of listed companies whose registered offices are based in the EU. In particular, it seeks to ensure that shareholders owning shares in companies registered and listed in other member states may vote without difficulty. The process of voting at general meetings is also to be streamlined. The publication of the proposed directive followed on from responses received to two public consultations undertaken by the EC (in September 2004 and May 2005), from which the EC report that there was generally support for the introduction of minimum standards at an EU level. In the UK, the directive will affect official list companies, but not AIM or PLUS companies.
The provisional implementation deadline for the directive is currently 31 December 2007, and its key features propose the following:

- that general meetings should be convened with at least one month's notice (ie 30 days). In the UK, the notice period is currently 21 days for AGMs and EGMs proposing special resolutions and 14 days for EGMs proposing ordinary resolutions.\(^4\) This proposal therefore fails to recognise the important distinction in the UK between AGMs and EGMs. Whilst the rule may be suited to an AGM, it doubles the notice period currently in place for many EGMs and (some would argue) fails to take account of business reality. For example, it will increase the timetable for acquisitions/disposals requiring shareholder approval (such as a Class 1 transaction);

- to replace shareblocking\(^5\) with a "record date" system. Under this regime, on a date prior to the meeting, shareholders are validated for voting at that meeting. Whilst a standard record date is not proposed in the directive, the date must *not be earlier* than 30 calendar days before the meeting. Member states will not be permitted to impose excessive shareholder identification requirements. In the UK, the voting process already utilises a record date system which, for most publicly traded companies, cannot be more than two days before the meeting in question\(^6\);

- that all shareholders owning a certain amount of shares (ie including non-residents) should have the right to ask questions and add items to a general meeting’s agenda. The maximum threshold proposed being the lower of 5% of the issued share capital of the company (or a nominal value of €10m). In the UK, an EGM is called for a specific matter normally, so it seems slightly inappropriate to allow any item to be added to an EGM agenda;

- that every shareholder should have the right to appoint any person or legal entity as a proxy, although member states will have the option to restrict the right of proxy holders to exercise voting rights at their discretion, where the proxy holder is in a situation giving rise to a conflict of interest; and

- that information should be available to all shareholders not more than 15 calendar days following the general meeting which the listed company must publish on its website.

At the initial consultation stage, it was proposed that the directive include provisions to (i) create transparency of stocklending agreements, and also to (ii) confer a legal entitlement on the ultimate shareholder or account holder to direct how votes are cast. These have been dropped from the text of the proposed directive.

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\(^4\) Note under the Companies Act 2006 ("2006 Act") - once in force - special resolutions will require only 14 days' notice in the UK (unless proposed at an AGM).

\(^5\) This is the process whereby on a specific date prior to a company meeting, shareholders are required to notify the company of their identity and intention to vote. After that date, the shares cannot be traded. This affects the ability of markets to operate.

\(^6\) The Department of Trade and Industry considers that Regulation 41 of the Uncertificated Securities Regulations 2001, under which issuers may set a record date not more than 48 hours before the time fixed for the meeting for shares held in uncertificated form, provides a balance.
On 24 July 2006, the European Corporate Governance Forum ("ECGF")\(^\text{7}\) published a recommendation on the proposed directive \[\text{http://ec.europa.eu/internal_market/company/docs/ecgforum/recomm_en.pdf}\]. The ECGF flagged that one of its stated objectives is solving the problems relating to cross-border voting. Currently, the environment in which investors hold their shares within the EU is through "securities accounts intermediaries", who are required to facilitate the exercise of their clients voting. In cross-border situations, there can be any number of chains of intermediaries existing between the company and shareholder, and all intermediaries in the chain will need to contribute by either passing on voting instructions down the line, or by facilitating their client's appointment of proxies. The proposed directive does not address this problem. In a memorandum (attached to the recommendation) a possible solution was set out in the form of an amendment to the directive. In essence, the ECGF proposes that an intermediary, on request from a client on whose behalf it holds shares, should either (i) exercise voting rights attached to the securities in accordance with instructions received, or (ii) issue a proxy to the client (or a third party) to exercise those voting rights. The EC had not responded as at 31 December 2006.

8.1.2 At a UK level

On 26 October 2006, the DTI published a "Proposal for a Directive on the exercise of voting rights by shareholders: A consultative document" (\[\text{http://www.dti.gov.uk/files/file34829.pdf}\]). Respondents' views will form part of the government's ongoing negotiations at an EU level. Some of the key matters on which the DTI seeks comments include:

- whether the directive should be limited to apply to companies whose shares are traded on a regulated market only (ie officially listed companies) or whether it should also cover AIM and PLUS companies;

- whether a 30 day notice period for all meetings is appropriate and, if not, what should be the minimum notice period and whether it would be possible to call some meetings on shorter notice. It also seeks views on whether the scope of the information and method of delivery of notice to shareholders;

- whether shareholders should have the right to add items to the agenda of and table draft resolutions at general meetings, or whether this should be restricted. Also, whether the proposed thresholds for exercising these rights are at an appropriate level (as a reminder, the maximum threshold being the lower of 5% of the share capital or a nominal value of €10m);

- whether there should be a maximum 30 day record date period for admission to general meetings, and if the directive should prescribe any other parameter for the setting of record dates;

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\(^{7}\) The ECGF was set up in October 2004 and is chaired by the EC. It meets two to three times a year and comprises representatives of the member states, European regulators (such as the Committee of European Regulators), issuers and investors. It encourages co-ordination and convergence of best practice through its meetings, with a view to enhancing corporate governance codes and advising the EC.
• whether it is necessarily appropriate to regulate the asking and answering of questions at company meetings (as proposed by the directive);

• whether the system of proxy voting is sufficiently liberal (as proposed by the directive) or if some restrictions are inappropriate;

• whether the directive strikes the right balance between ease of appointment of policyholders and investor security in relation to the appointment of proxy holders;

• whether the ability to vote by post is necessary and whether it should be made mandatory either for member states to permit it, or for companies to offer it to their shareholders;

• in respect of voting on instructions, whether the directive covers the right ground to achieve its aim of ensuring that rights conferred by the directive can be effectively exercised in cases where shares are held through intermediaries (ie whether there should be more measures on the passing of instructions between intermediaries in the voting chain); and

• whether companies should be required to count and publish voting results on their websites in the level of detail required by the directive.

The consultation closes on 19 January 2007. It is proposed to replace the relevant provisions of the Companies Act 1985 with the provisions of Part 14 of the 2006 Act. Also relevant will be the new provisions on the exercise of shareholders rights (including the exercise of such rights by “indirect investors”), which are to be introduced as Part 9. At an EU level, the draft work programme for meetings of the European Council indicated that it was due to reach political agreement on a final position on the directive on 4 December 2006 (although this was not confirmed as at 31 December 2006). The European Parliament’s first reading is provisionally scheduled for 13 February 2007.

8.2 2nd Company Law Directive

On 25 September 2006, a directive (2006/68/EC) amending the 2nd Company Law Directive (77/91/EEC) regarding the formation of public companies and the maintenance and alteration of their capital was published in the Official Journal. The amending directive came into force on 15 October 2006, and must be implemented by member states on or before 15 April 2008. In brief, the directive:

8.2.1 will affect only public companies and deals with aspects of formation and maintenance/alteration of their share capital. Accordingly, member states (including the UK) will be able to permit public companies to allot shares for non-cash consideration without requiring them to obtain a special expert valuation (as currently required under section 103 of the 1985 Act) in cases in which there is a clear point of reference for the valuation of the non-cash consideration;

8.2.2 will allow public companies to acquire their own shares up to the limit of their distributable reserves, as specifically authorised in general meeting (in terms of the number of the shares to be acquired and other terms and conditions of the
acquisition), with the period for which such an acquisition being authorised at a general meeting being increased (as set by each member state - but not being a period of more than five years);

8.2.3 will permit member states to allow public companies to grant financial assistance with a view to the acquisition of their shares by third parties up to the limit of their distributable reserves (subject to certain safeguards - to include the acquisition being undertaken at “fair market conditions” and so as not to diminish net assets); and

8.2.4 will allow creditors to resort, under certain conditions, to judicial or administrative proceedings where their claims are at stake as a consequence of a reduction of capital in a public company.

The 2006 Act did not include any provisions in respect of the directive. The DTI will consult on the implementation of the directive's provisions during 2007.


8.3 Transparency Obligations Directive ("TOD")

8.3.1 Background

TOD is designed to enhance transparency on EU capital markets by establishing minimum requirements on periodic financial reporting and on major shareholding notifications and communications with shareholders and the public generally. It affects companies whose shares are admitted to trading on a regulated market (ie official list companies in the UK, but not AIM or PLUS companies). The directive must be implemented by member states on or before 20 January 2007, and is therefore imminent.

In September 2006, HM Treasury announced that only those companies whose financial year begins on or after 20 January 2007 will have to follow the financial reporting requirements of TOD.

8.3.2 Content

At the heart of TOD are rules governing periodic reporting - covering production of annual and half-yearly financial reports, as well as quarterly management statements. The main provisions of TOD are:

- the annual financial report must be published within four months after the end of the financial year;
- the half-yearly financial report covers the first six months of the financial year and must be published within two months of the end of that period;
- interim management statements must be published between 10 weeks after the beginning and six weeks before the end of each half of the financial year, and consist of a description of key material events and transactions and an account of the company's financial position;

• an acquisition or disposal of shares by a shareholder to which voting rights are attached which cross specified thresholds must be notified to the company. The company in turn, is required to disclose the information to the market. The major shareholder notification thresholds set out in the directive are 5%, 10%, 15%, 20%, 25%, 30%, 50% and 75% of the company's voting rights (ie greater than the initial 3% and subsequent 1% thresholds thereafter that currently operate in the UK);

• companies are obliged to give shareholders information concerning dividends, share issues and meetings, and are also required to permit proxy voting. Companies may communicate information to their shareholders by electronic means, but only if certain conditions (including, in certain circumstances, obtaining the approval of the shareholders in general meeting) are satisfied; and

• companies must ensure that regulated information is available across the EU. Draft EU implementing legislation makes the point that the information should, to the extent possible, be made available across all member states simultaneously.

8.3.3 Implementation in the UK

TOD is being implemented in the UK through the 2006 Act and by the introduction of new FSA Transparency Rules (to be incorporated into the Disclosure Rules sourcebook, to be renamed the Disclosure and Transparency Rules - see also paragraph 7.2.1). Some changes will also be made to the Listing Rules (in respect of financial reporting). The final rules appeared in the form of the Transparency Obligations Directive (Disclosure and Transparency Rules) Instrument 2006, which was published on 21 December 2006. This will implement (bar amendments to the Handbook Glossary which came into force immediately) the Transparency Rules with effect from 20 January 2007.

Most of the new rules will apply only to officially listed companies (eg the rules on financial reporting and communication of information). An important exception to this are the rules on major shareholding notifications - these will also apply to UK AIM and PLUS companies. Some of the more interesting aspects of the UK implementation process are as follows:

• quarterly interim management statements: the concept of reporting on a quarterly basis is one with which most UK officially listed companies are not familiar, although it appears that the type of reporting required is more akin to a trading statement than a full-blown quarterly report. However, the FSA is reluctant to provide specific or detailed guidance;

• responsibility statements: both annual and half yearly reports must contain a responsibility statement by all "persons responsible" within the company (most likely the directors), to include a statement that the relevant accounts give a true and fair view of the position of the company;

• thresholds for shareholder notifications of major shareholdings: whilst the directive sets the notification thresholds at 5% intervals, the current UK regime sets the initial threshold at 3% and requires notifications at 1% intervals thereafter. The FSA is to retain the UK's existing thresholds for UK official list,
AIM and PLUS companies (overseas listed companies will be subject to the directive's thresholds);

- preliminary results: officially listed companies will no longer be required to publish preliminary statements of their annual results. The FSA has stated that it expects many companies to continue to produce preliminary statements on a voluntary basis and existing content requirements are to be retained for those that do; and

- liability for periodic reports: in response to concerns that the implementation of TOD could increase the liability of companies and their directors for inaccuracies in financial reports, a new statutory liability regime has been put in place (under FSMA, as amended by the 2006 Act) in order to clarify this issue. This regime applies to financial reports produced in compliance with TOD and also preliminary results (to the extent they contain information that would appear in such a report). In essence it provides that the company alone (not its directors, though they may be liable to the company) will be liable to shareholders who have suffered loss as a result of inaccuracies in or omissions from financial reports.

8.4 Market abuse: EU review of the Market Abuse Directive

The Market Abuse Directive (2003/6/EC) ("MAD") was put in place to achieve harmonisation of the legal environment for all EU financial markets and has been implemented in the UK since 1 July 2005. MAD essentially defines what behaviour is considered as market abuse (namely, insider trading and market manipulation). On 2 November 2006, the Committee of European Securities Regulations published a consultation document setting out draft guidance on:

- what constitutes "inside information" (a non-exhaustive list of examples is given);

- when is it legitimate to delay the disclosure of inside information. The draft guidance is largely confined to providing indicative examples of the two circumstances covered in MAD (article 3(1)) ("negotiations in course" and "decisions taken which need approval of another body");

- when are client orders inside information; and

- insider lists in multiple jurisdictions - proposing a mutual recognition by them whereby a competent authority (eg the FSA in the UK) would accept an insider list maintained by rules of another member state.

The consultation will close on 2 February 2007.

(Please see http://www.cesr-eu.org/index.php?page=home_details&id=173)

8.5 Market abuse: FSA issues market abuse methodology paper

On 17 March 2006, the FSA published an occasional paper outlining a methodology for measuring market abuse in the UK. The paper adopted a methodology looking at the extent to which share prices move ahead of regulatory announcements. Two types of announcement
were examined in order to compile the methodology (i) those relating to trading performance of FTSE 350 listed companies, and (ii) those relating to takeover bids. The FSA reported that the analysis of the FTSE 350 announcements covered a period before FSMA came into effect, and a later period when FSMA was in force, but when the FSA had not yet taken enforcement action against market abuse. Interestingly, the FSA report that no change in the level of market cleanliness in relation to these announcements was found. The FSA considers that use of the methodology as outlined in the paper will enable it to measure its success in tackling market abuse. The FSA is currently working on the repeat analysis but informs us that it is not yet possible to say when it will be published.

8.6 AIM: clamp down on "cash shells"

In April 2005, the London Stock Exchange ("LSE") announced a crack down on "cash shells" who had not invested their funds within the time limits permitted under the AIM Rules. The LSE has continued to be concerned throughout 2006 that a large number of "cash shells" have continued to lie dormant, failing to use the money raised on admission to AIM, and merely using funds to make payments to the board and other advisers. On 17 March 2006, the LSE issued AIM notice 17 "Reminder of Investing Company Rules" reminding "investing companies", as they are now called, of AIM rule 8 and associated guidance. (These essentially require that, if an investing company was admitted to AIM before 1 April 2005 and raised less than £3m at admission, it had until 1 April 2006 either to (i) make an acquisition or a reverse takeover, or (ii) satisfy the LSE that it had substantially implemented its investing strategy.)

The LSE stated that failure to carry out either of these requirements would result in share suspension of affected "investing companies" from 7.00am on 3 April 2006. If the AIM company continued to be unable to satisfy the above within six months of suspension, the shares would be cancelled (as per AIM rule 41). Companies that resulted in having their shares suspended would be required to put out a trading update notice setting out their current position.

The Notice resulted in the suspension of 37 companies from trading on AIM, with those who remained unable to comply with AIM rule 8 having their securities cancelled from trading at 7.00am on 3 October 2006, being six months from the date of initial suspension (as per rule 41).

8.7 AIM: IFRS to become mandatory

On 21 December 2005, the LSE formally confirmed (in AIM notice 15) its intention to revise the AIM Rules in relation to the use of IFRS by AIM companies and provided an initial explanation as to how the mandatory introduction of IFRS for AIM companies will be implemented, including a timetable.

Following on from this, on 22 August 2006, the LSE published AIM notice 22 "Confirmation of Permissible Accounting Standards" (http://www.londonstockexchange.com/NR/rdsnlyres/56C039AC-3EB3-4A1E-A94E-A269D2383E8D/0/AIMNotice22PDF50Kb.pdf), giving (inter alia) a more detailed confirmation of the mandating of IFRS for AIM companies incorporated in the EEA. Specifically, it confirmed that AIM companies (if they are parent companies and produce consolidated accounts) will be required to produce financial information in accordance with IFRS for accounting periods commencing on or after 1 January 2007. This applies both on admission and on a continuing basis to half year/full accounts. This notice stated that EEA AIM companies that are not parent companies may use either IFRS or
applicable national accounting standards. The LSE allowed AIM companies whose
accounting periods started before 1 January 2007 to comply with the current rules. This
mainly affected UK companies who wished to continue using UK GAAP until the required
time. Transitional provisions are set out in the guidance to AIM rules 18 and 19 and
schedule 2 of the AIM Rules.\(^8\)

AIM notice 22 also confirmed the following accounting related issues:

8.7.1 in respect of other GAAPs, that both Canadian GAAP and Australian IFRS, in
addition to IFRS and US GAAP, would be treated as acceptable accounting standards
for the disclosure of financial information. There will no longer be a requirement on
admission that financial information prepared under these standards needs to be
reconciled against IASs, UK or US GAAP. (Paragraph 4 of the Notice discussed in
more detail the changes that have been made to the AIM Rules as a result.) These
Rules came into force immediately;

8.7.2 in respect of Isle of Man and Channel Island companies, that both the Isle of Man and
Channel Islands will be treated as EEA countries for the purposes of AIM Rule
accounting standard requirements; and

8.7.3 in respect of IASs for companies from non-EEA countries, that with the exception of
Japanese GAAP, on admission and when preparing both half-yearly and annual
reports, a non-EEA incorporated company may use one of the following accounting
standards (without reconciliation to IAS): IAS, US GAAP, Canadian GAAP or
Australian IFRS.

Finally, on 31 August 2006, the LSE clarified its position on acceptable accounting standards
in relation to the EC's proposals to postpone the date for the determination of "accounting
equivalence" of local GAAPs with IFRS to 2009. The LSE has said that it will monitor these
proposals and review the standards acceptable to AIM as they develop at an EU level\(^9\).

8.8 AIM: third party trading platforms

On 6 April 2006, the LSE issued a consultation paper in the form of AIM notice 18 "AIM
Rules - Proposed changes to the AIM Rules in respect of Third Party Trading Platforms"
(http://www.londonstockexchange.com/NR/rdonlyres/8504309B-1FAB-43C3-8F12-
1932EC50AD9E/0/AIMNotice18FINALwithschedule.pdf). The Notice proposed changes
to the AIM Rules where securities of an AIM company are registered on a third party trading
platform with the express agreement of the company. The key proposals put forward in the
Notice were:

8.8.1 principles of disclosure (AIM rule 10): that an AIM company must not delay in
notifying information required under the AIM Rules as a result of its obligations to
the operator of a third party platform. Any delay would in all likelihood be a breach

\(^8\) Rules 18 and 19 require that accounting standard changes should only be made with prior approval of AIM Regulation. This is
to ensure that companies do not swap between standards on a frequent basis.

\(^9\) On 5 December 2006, the Final regulation was published in the Official Journal to amend the Prospectus Regulation to grant
third country issuers a two year extension of the transitional period to 1 January 2009. It entered into force three days after
publication.
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of the AIM Rules (and rule 42 sanctions would apply). The LSE proposed to provide additional guidance in relation to AIM Rule 10 to ensure that the AIM Rules take priority over the equivalent obligations that the AIM company owes the operator of the third party trading platform;

8.8.2 ongoing eligibility requirements (AIM rule 37): that an AIM company who has expressly agreed that its AIM securities may be admitted to a third party trading platform must immediately notify the LSE, and also of any later changes in status. It was also proposed that it must provide the LSE (without delay) with a written summary of all regulatory communications with the operator of the platform in relation to the AIM securities traded on it; and

8.8.3 nominated adviser’s ("Nomads") (AIM rule 39): that in respect of every AIM client company that has expressly agreed that its AIM securities be admitted to a third party trading platform, the Nomad must inform the LSE without delay of any unusual trading activity on that platform of which it becomes aware (eg unusual price movements, material increase in volume traded etc). The LSE also proposed to extend Nomads' general obligations under AIM rule 39 to be available at all times to include instances where it is liaising with the LSE.

Following on from the consultation, the LSE published AIM notice 20 on 4 July 2006. The LSE decided at that time to consider the requirement for new rules on the principles of disclosure in the context of a broader review of AIM's regulations that was then in the process of being undertaken in conjunction with market participants. In the meantime, the LSE emphasised that AIM companies should comply with the following general principles in relation to disclosure: information required by the market must be notified to the market no later than it is published elsewhere. Secondly, it emphasised the need to inform the market of new developments.

See also paragraphs 8.9 and 8.10.

8.9 AIM: Nomads under scrutiny

In 2006, the LSE reviewed of the role of the Nomad. The LSE was concerned that some Nomads were taking fees for bringing their clients to market but were failing to supervise their subsequent activities. On 2 October 2006, the LSE published AIM notice 24 "AIM Rules for Nominated Advisers and Other Proposed Rules amendments - Consultation" (http://www.londonstockexchange.com/NR/rdonlyres/3E04EB09-8032-4B40-8C97-E6E4FE834DE9/0/AIMNotice24Final.pdf) which included a proposal to introduce a new rule book to be known as the AIM Rules for Nominated Advisers (essentially a consolidation of existing obligations on Nomads currently found in the AIM Rules and the Nominated Adviser Eligibility Criteria) setting out the responsibilities the LSE expects Nomads to fulfil and the obligations they owe to the LSE.

Important proposals in the new rule book include:

8.9.1 codification of good market practice: a new set of responsibilities intended to reflect current good market practice. In particular, the LSE flags that the rules aim to (i) outline the due diligence a Nomad should generally perform before giving the LSE its declaration that a company is "appropriate" for AIM, and (ii) describes how a Nomad should discharge its duty to act with due care and skill. For each of these responsibilities, a set of high level principles has been established under which
features a non-exhaustive list of activities which a Nomad should generally be expected to undertake;

8.9.2 what is expected of a Nomad: the broad principles of rule 39 of the current AIM Rules are incorporated but are set out in greater detail. For example, it is clarified that it is imperative for a Nomad to contact the LSE immediately if he has concerns about the appropriateness of an AIM company post admission;

8.9.3 power of direction: a new rule is to be included to give the LSE ability to direct the actions of Nomads in exceptional circumstances to keep the reputation of AIM intact;

8.9.4 annual returns: it will be a new requirement for Nomads to submit an annual return to the LSE. This will provide information on the work Nomads perform, in their capacity as a Nomad, and will include details of "relevant transactions" completed in the period covered, and the "qualified executives" employed. It is anticipated that the first returns will be issued by early 2007 in respect of the calendar year 2006; and

8.9.5 interim application: the LSE make it clear that their requirements included in the new Rules are designed to reflect current good market practice. Compliance visits are expected to take place by the LSE during the course of 2007.

Responses to the consultation were requested by 1 December 2006.

8.10 AIM: disciplinary procedures/amended rules

Also included in AIM notice 24 (see paragraph 8.9) were consultation proposals to (i) change the AIM Rules which will require enhanced disclosure of information by a named company on its website, and (ii) amend the AIM Disciplinary Procedures and Appeals Handbook to outline more detail of the rationale behind the LSE's disciplinary process, giving a clearer understanding of its approach to dealing with breaches of the AIM Rules.

8.10.1 AIM Rules amendments: enhanced disclosure

Proposed amendments include:

- AIM companies' website: each AIM company will be required to maintain a website on which key company information must be disclosed and kept up to date. Information will also have to be included in a prospective AIM company's pre-admission announcement. New AIM companies will have a six month period to comply with this new rule, commencing from the date it comes into effect;

- wording on the front of admission documents: this will be altered to set out the responsibilities of Nomads under the AIM Rules and the new Rules for Nominated Advisers; and

- other miscellaneous changes: these include (i) a new requirement in rule 17 to notify the market where there have been changes to the directors' details that may have been disclosed in the admission document or subsequently as required in schedule 2 (g)(iii)-(viii) inclusive, (ii) the removal of the requirement for interims to be audited in the supplement to schedule 1, paragraph (l) (which applies to quoted applicants), and (3) additional detailed guidance to rule 14 on the process for announcing a reverse take-over.
8.10.2 Disciplinary Procedures and Appeals Handbook amendments

Proposed changes include:

- introducing the concept of a "warning notice". This will be issued to an AIM company or a Nomad when the LSE concludes an investigation but does not believe the breach of the AIM Rules is sufficient to justify a fine, censure or serious sanction. The warning will form part of a compliance record which would be taken into account on future breaches; and

- an increase to the cap on fines which can be levied by the AIM Executive Panel from £25,000 per breach to £50,000 per breach.

Responses to the consultation were requested by 1 December 2006.

8.11 AIM: shareholder notification requirements

On 30 November 2006, the LSE published AIM notice 25 "Changes to the disclosure of significant shareholders" (http://www.londonstockexchange.com/NR/rdonlyres/37156CEB-E10C-4551-A2B0-E6BE3AB38047/0/AIMNotice25.pdf). The Notice outlined changes to the way in which most AIM companies will need to disclose significant shareholdings as a result of the implementation of the Transparency Obligations Directive (see paragraph 8.3). It noted that:

8.11.1 the rules on the acquisition or disposal of major shareholdings in chapter 5 of the new Disclosure and Transparency Rules sourcebook ("DTR") will (broadly) apply to AIM companies (1) which are incorporated under the Act, or (2) which are incorporated and have their principal place of business in Great Britain. All other AIM companies must continue to follow AIM rule 17; and

8.11.2 the principles of disclosure in chapter 5 of the DTR are broadly similar to those in the AIM Rules, but the detailed provisions are different.

The Notice also reminded AIM companies within the scope of the DTR that they had to comply with the relevant transitional provisions, including to make public:

8.11.3 by no later than 31 December 2006, the total number of voting rights in respect of each class of share in issue and admitted to trading on AIM (or another UK prescribed market or a regulated market) and to distinguish the number of voting rights attaching to any shares held by the company in treasury; and

8.11.4 any changes to those totals which occur after that date but before 20 January 2007.

The LSE stated that it plans to publish a further AIM Notice confirming the consequential changes to the AIM Rules required to take account of the DTR once the final rules have been published by the FSA (which was on 21 December 2006 - see paragraph 8.3).

8.12 FSA: new power of veto

On 13 September 2006, the government (http://www.hm-treasury.gov.uk/newsroom_and_speeches/press/2006/press_62_06.cfm) announced plans for legislation to ensure that the LSE can remain under UK regulation. The Investment Exchanges and Clearing Houses Bill...
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please see [http://www.publications.parliament.uk/pa/cm200607/cmbills/004/07004-i-i.html](http://www.publications.parliament.uk/pa/cm200607/cmbills/004/07004-i-i.html), and for further information please see related explanatory notes ([http://www.publications.parliament.uk/pa/cm200607/cmbills/004/en/07004x--.htm](http://www.publications.parliament.uk/pa/cm200607/cmbills/004/en/07004x--.htm)) were subsequently published on 16 November 2006. The bill received royal assent on 19 December 2006 and came into force on 20 December 2006. The explanatory notes state that the new Act will:

8.12.1 enable the FSA to prevent UK recognised investment exchanges and clearing houses from making changes to their regulatory provisions which are disproportionate to the end they are intended to achieve or which do not pursue a reasonable regulatory objective;

8.12.2 apply the restriction on disproportionate regulatory provisions to persons applying to the FSA for recognition as an investment exchange or clearing house; and

8.12.3 make provision for the necessary processes to enable the FSA to carry out this role, such as the notification to the FSA of proposed changes, the ability of the FSA to ask to examine proposals and, if called in, for proposals to be able to make representations to the FSA, and for the FSA to be able to make rules or directions.

The new Act is intended to meet concerns that UK recognised bodies might introduce regulatory provisions which impose an excessive regulatory burden on companies whose shares are admitted to the market, or on their members or others who use those markets. Part 18 of FSMA provides for the recognition of UK investment exchanges and clearing houses which meet the recognition requirements set out in FSMA. The FSA, however, has no power under existing legislation to prevent a recognised body from changing its rules or guidance, provided it continues to meet the recognition requirements. The recognition requirements for UK recognised bodies are currently framed in terms of the objectives to be achieved or the minimum standards which must be met. The scheme provided for in the new act allows the FSA to veto excessive provisions without a body's recognition status being affected.

8.13 OFEX: change of name

From 23 October 2006, "OFEX" became known as "PLUS". OFEX companies are therefore now quoted on the PLUS market and referred to as "PLUS - quoted companies". These securities can be identified via the "PLUS - quoted" marker attached to the company name. The consequences of these changes are as follows:

8.13.1 OFEX as a name ceased to exist on 23 October 2006. The name of the operating subsidiary, OFEX plc has changed to PLUS Market plc. The holding company name, PLUS Markets Group plc, remains unchanged;

8.13.2 new trading rules for the unified PLUS Market take effect, and can be viewed on [http://www.plusmarketsgroup.com/](http://www.plusmarketsgroup.com/);

8.13.3 securities on the PLUS Market are now classified using the following market segment codes:

- PLUS - quoted securities (PLPR): securities which are quoted on the PLUS primary market;
8.14 Paperless share transfers

In April 2006, the Institute of Chartered Secretaries and Administrators issued a consultation paper setting out its proposals to mandatorily remove the requirement for paper share certificates and stock transfer forms (http://www.icsa.org.uk/index.php?option=com_content&task=view&id=481&Itemid=39&PHPSESSID=13fddab66e204d4a6a66a275ae69b3a0). Some forms of share ownership are already dematerialised (eg through CREST) which means a physical share certificate is not required. This proposed a mandatory electronic transfer system (which is adopted in many countries already) for all securities admitted to the Official List, AIM, PLUS (formerly OFEX) and ShareMark, with voluntary application to private companies. If introduced:

- share certificates would be replaced by share statements;
- each shareholding would have a shareholder reference number;
- share certificates would cease to be legal evidence of share ownership;
- each time shares were sold, or new ones acquired, a new statement would be issued showing the current holding, even if the balance was reduced to zero; and
- it could avoid the complications and expense of having to run two systems (as currently in the UK, where a company commonly has some share in an electronic system such as CREST and some paper based).

9. COMPETITION

See also INTERNATIONAL TRADE, section 31.

9.1 Introduction

Competition law has been pursued with increasing vigour during 2006 both at the EU and the UK level. There have been no momentous changes of the magnitude which we have seen in recent years, such as the new UK mergers regime in 2003 and modernisation of the enforcement of articles 81 and 82 in 2004. But the competition authorities are wielding their new powers with increasing confidence, and indeed with increased budgets.

9.2 European Commission

9.2.1 Article 81: cartels and other horizontal agreements

The main priority of the European Commission has, once more, been the suppression of secret price-fixing and market-sharing cartels. Five infringement decisions were made in cartel cases in 2006. These were in commodity sectors long recognised as susceptible to cartelisation - Bleaching chemicals, Acrylic glass, Road bitumen,
Copper fittings and Synthetic rubber. Fines totalled over €1.8bn, and included a fine of €519m for the parties to the synthetic rubber cartel.

Various themes can be detected in these decisions:

- In all of them a whistleblower within the cartel alerted the Commission to its existence and cooperated in the investigation against the other members. Each whistleblower received 100% immunity from a fine. In order to encourage further whistleblowing the Commission has started to publish the fine which would have been imposed in the absence of such cooperation.

- The Commission has increased fines where a party has obstructed the investigation, for example by refusing entry on a dawn raid or providing misleading information.

- Recidivism has been a significant factor in increasing fines, as has instigation or leadership of the cartel.

- In its press release the Commission has drawn attention to the possibility of aggrieved customers or competitors claiming damages in national courts based upon the infringement decision.

Other article 81 cases relating to horizontal agreements include International Confederation of Societies of Authors and Composers, where the Commission has issued a statement of objections in relation to the standard contract of the confederation so far as it affects the exploitation of new forms of music copyright - internet, satellite transmission and cable retransmission. This investigation is one of several in recent years affecting supra-national collecting societies.

Several cartel decisions from earlier years have been reviewed by the Court of First Instance ("CFI") or, on further appeal, the European Court of Justice ("ECJ"):

- In Brouwerij Haacht v Commission, an appeal in the Belgian beer decision, the CFI held that the Commission, in assessing the fine, did not need to specify the market with the same accuracy as used for market definition in, for example, merger cases.

- In Midland and Archer Daniels Midland Ingredients v Commission, an appeal in the Amino Acids case, the ECJ rejected (yet again) the argument that the Commission could not increase the tariff for fines, this time on the grounds that the parties had no legitimate expectation that it would not do so.

- The ECJ decision in SGL v Commission, arising from the Graphite Electrodes case, considered the principle of self-incrimination in the situation where the Commission demands the production of documents, holding that the privilege against self-incrimination is not available in relation to documents as distinct from answers to questions. The opinion of the Advocate-General in this case concluded that a party fined for a cartel in the EU cannot seek a reduction because it has also been fined for a cartel in the USA or elsewhere outside the EU (it would be different if the fine had been imposed by a member state).
• The Advocate-General’s opinion in *Salzgitter Mannesmann v Commission* discusses the extent to which information given in confidence can be used to establish an infringement, concluding that such evidence should not be used as the sole basis for an infringement decision; it remains to be seen whether the ECJ will adopt this opinion.

• In *Asnef-Equifax* the ECJ considered again whether the exchange of confidential information could infringe article 81(1). Its conclusion was that the exchange of information could undermine the uncertainty essential for effective competition in a market, but that the answer in any particular case depended on the structure of the market (e.g., the degree of concentration) and the nature of the information. Where, as in the case which it was considering, the exchange was conducted with a view to reducing credit risks, an exemption under article 81(3) might be available.

• In *Meca-Medina v Commission* the ECJ recognised an extended application of the exemption provided by article 81(3) in a case relating to professional rules about the use of drugs in sport, going beyond the economic efficiencies set out in its 2004 guidelines.

Various procedural points were also considered on appeal:

• In *Oberreichische Postsparkasse v Commission* the Commission had disclosed a non-confidential version of the statements of objections to the Freiheitliche Partei Österreichs (FPO), which had complained to the Commission. Two of the banks challenged the disclosure on the grounds that the FPO, as a political party in Austria, had no legitimate interest in making a complaint and that the FPO had no rights in the proceedings, which had commenced its investigation before the FPO complaint. The CFI confirmed that any applicant who has shown a legitimate interest is entitled to receive a non-confidential version of the statement of objections. In certain circumstances, the Commission may also send such a version to a third party showing sufficient interest. The FPO constituted an applicant with a legitimate interest, as a final customer of the banks who had shown that it had sustained or was likely to sustain harm to its economic interests. It was irrelevant that it made its complaint after the Commission had started its investigation.

• In *Vincenzo Manfredi v Lloyd Adriatico Assicurazioni* the ECJ considered questions relating to the recovery of damages by victims of anti-competitive agreements. Such an agreement is void and so has no effect as between contracting parties and cannot be invoked against third parties. But any individual can rely on article 81 before a national court in claiming damages where there is a causal link between his loss and the agreement. The rules governing such actions are to be set by national law, but they must not be less favourable than those governing similar domestic law actions (the principle of equivalence) and must not make the exercise of rights conferred by EC law impossible or excessively difficult (the principle of effectiveness).

The ECJ also considered limitation periods, the award of punitive damages and unjust enrichment.
Changes in the block exemptions in the transport sector have taken place or been announced. There is a new Commission block exemption for air traffic, relating to passenger tariffs and slot allocation. The Council block exemption for liner conferences will be repealed as from October 2008. This means that operators will no longer be able to fix prices. But it may be possible for them to exchange information about capacity, subject to guidelines which will be issued. The Commission block exemption for liner shipping consortia has been extended until 2015.

The Commission has issued new guidelines for fines in antitrust cases, placing emphasis on deterrence and recidivism. A new leniency notice has also been published.

9.2.2 Article 81: vertical agreements

Vertical agreements are regulated with a lighter touch than horizontal agreements. But, as usual, 2006 saw a number of cases involving motor vehicle distribution. Peugeot was fined €49.5m or operating a bonus system which deterred distributors from exporting to other countries. An appeal by General Motors against a fine for a similar bonus system was rejected by the ECJ. In each case the bonus system amounted to an indirect ban on exports, and so offended not only article 81(1) but also the rules in the EC Treaty on the free movement of goods. General Motors and BMW agreed to alter their distribution to comply with the 2002 Block Exemption for Motor Vehicles, so far as it applied to multi-brand dealerships, and the Commission closed its files. Volkswagen succeeded in an appeal before the ECJ, which reversed the finding by the Commission that an anti-competitive agreement had been reached between Volkswagen and its dealers, based case on circulars sent by Volkswagen to the dealers. In Vulcan Silkeborg A/S v Skandinavisk the ECJ ruled on the interpretation of the termination provisions under the Block Exemption as they applied to the restructuring by Audi of its network. A similar issue was decided by the ECJ in Brünsteiner and Autohaus Hilgert v BMW.

The other sector in which rulings relating to vertical agreements can be expected is pharmaceuticals. In GlaxoSmithKline v Commission the ECJ annulled the decision of the Commission that a price uplift for purchasers in Spain who exported the products to the UK infringed article 81(1) and should not be exempted under article 81(3), because the Commission had not dealt properly with the issues arising under article 81(3). The Commission recognised, as it has in earlier cases, that the pharmaceuticals market has special characteristics deriving from national regulation and purchasing by national health authorities.

9.2.3 Article 82: abuse of a dominant position

The Microsoft saga continues. A fine of €280.5m was imposed on Microsoft for failing to comply with the Commission's decision of March 2004. A dispute between Microsoft and the Commission about the provision of information necessary for the implementation of earlier remedies is still not finally resolved.

Exclusivity agreements, quantity commitments and loyalty discounts resulted in a fine of €24m for Tomra, which is dominant in the supply of machines for the collection of used drink containers.
The question of the definition of an undertaking was considered by the ECJ, which held that the public health service in Spain was not an undertaking for the purposes of the competition rules and accordingly could not be guilty of abusing a dominant position (Fenin v Commission).

The consultation on the Commission's Discussion paper on the application of article 82 of the Treaty to exclusionary abuses was followed by publication of the comments received in March 2006.

9.3 EC Merger Regulation

This year has been marked by disputes between the Commission and member states in relation to the exclusivity which the Merger Regulation gives to the Commission over mergers which meet the turnover and other criteria in the regulation. In certain circumstances a national authority may apply its own competition legislation, but under article 21 these circumstances are normally confined to three "recognised interests" - public security, plurality of the media and prudential rules, which must each be applied in a manner which is proportionate and non-discriminatory. A member state wishing to apply any other criterion must communicate it to the Commission and obtain approval for doing so. In three cases the member state governments sought to use article 21 as a means of protecting a major national company from being taken over by a company in another member state.

- The Spanish energy regulator, CNE, has, according to the Commission, subjected a bid by the German energy supplier E.ON for Endesa, a Spanish energy supplier, to conditions breaching article 21 of the Merger Regulation. E.ON was bidding against another Spanish supplier, Gaz Natural. The conditions, which include the divestment of important assets, do not fall within the recognised interests and were adopted without prior communication to the Commission, which had already cleared the acquisition under the Merger Regulation. The CNE also subjected the acquisition to conditions said to be contrary to the rules on free movement of capital and freedom of establishment in articles 43 and 56 of the Treaty. The Commission has initiated infringement proceedings against Spain under article 226 of the Treaty.

- The Commission also reached the preliminary conclusion that Italy had violated article 21 because of unjustified obstacles placed in the way of the acquisition by Abertis of Spain of Autostrade, an Italian competitor in the management of toll motorways. Again the acquisition qualified for examination under the Merger Regulation and was cleared by the Commission. A binding opinion delivered by two government ministers and a decision of the authority responsible for granting motorway concessions rejecting authorisation for the merger are considered by the Commission potentially incompatible with article 21. The concern of the ministers and of the authority was that the merged entity might be unable to make the investment needed and to comply with the requisite standards.

- The Commission also reached the preliminary conclusion that Poland had violated article 21 by instructing the Italian bank Unicredit to divest its shares in the Polish bank BPH as a condition of acquiring its parent, the German bank Bayerische Hypo-und Vereinsbank, despite the fact that the Commission had already cleared the acquisition. The Polish Treasury claimed that under the terms of an earlier privatisation agreement Unicredit was prohibited for ten years from acquiring any other bank active in Poland, a provision intended to protect competition. This ground is not a recognised interest within article 21, and it had not been communicated to the Commission in advance. The Treasury also threatened to revoke the privatisation. The Commission in response opened infringement
proceedings on the grounds that the prohibition in the privatisation agreement was itself incompatible with the rules on freedom of establishment and free movement of capital.

The number of mergers notified, 338, was a record. But only nine cases were referred for full investigation under phase II of the Merger Regulation. There were three unconditional clearances, five conditional clearances and no prohibitions. Two cases were referred to member states for investigation by their competition authorities. One of these was Aggregate Industries/Foster Yeoman, part of which was referred to the UK on the grounds that the transaction affected competition in the supply of aggregates, asphalt and road surfacing services - distinct UK markets, some of which were local and so did not constitute a substantial part of the Common Market. The Commission also considered that the OFT was best placed to assess the case, partly because of the expertise which it had obtained in a recent investigation.

The CFI gave five judgments in merger appeals. In Schneider Electric v Commission it considered an appeal by Schneider arising out of the second investigation of its acquisition of Legrand. The CFI concluded that a decision to initiate phase II proceedings constituted a preparatory measure for a full investigation of a merger and final decision whether it should be permitted. The fact that opening phase II proceedings prolonged the investigation and required the parties to co-operate with the Commission was a result of the procedural framework of the Merger Regulation and did not amount to a decision which affected the legal position of the parties within article 230(4) of the EC Treaty. So it was not possible for Legrand to challenge the decision.

The Spanish energy market was again the subject of dispute. In Endesa v Commission the CFI rejected Endesa's appeal against the rejection of its complaint to the Commission that Gaz Natural had failed to notify its proposed acquisition of Endesa. The question at issue was whether the merger satisfied the turnover thresholds in the regulation, and this itself raised questions as to the form of Endesa's accounts and the adjustments which should be made to them for the purposes of deciding jurisdiction. (This case had led the Commission in 2005 to claim that the two-thirds rule, giving a member state jurisdiction over a merger where all the parties were active mainly within that state, might need to be revised with a view to giving the Commission jurisdiction over more mergers in the energy market.)

9.4 UK

9.4.1 Chapter I of the Competition Act 1998

The appeals by parties in the "hub and spoke" cartel cases, Replica Football Kits and Toys and Games were rejected by the Court of Appeal, which upheld the judgments of the Competition Appeal Tribunal ("CAT") on both liability and penalty. Applications for leave to appeal to the House of Lords are now pending. The OFT, upheld substantially by the CAT, had found the parties to its two investigations to have infringed the chapter I prohibition by a concerted practice consisting of the exchange of information about prices. It was argued that CAT's ruling had given rise to commercial uncertainty as to the freedom of manufacturers and their principal customers to discuss matters properly of common interest, including actual or likely retail prices, profit margins and wholesale prices or terms of sale. The Court of Appeal rejected this argument, holding that, provided such discussions were conducted on a bilateral basis and were limited to matters such as possible retail prices, profit margins and wholesale prices or terms of sale, there should be no risk of infringement. Discussions about possible prices, or about historic prices, could tend...
towards discussion of future prices and agreement as to what they should be. Parties to such discussions needed to be aware of that risk and to avoid it (Argos and Littlewoods v OFT, JJB Sports v OFT).

The OFT withdrew its decision that the Mastercard multilateral agreement on interchange fees infringed article 81 and the chapter I prohibition in the face of a claim made by Mastercard in the CAT that the defence put forward by the OFT to Mastercard's appeal diverged materially from the reasoning in its decision. The CAT then refused to deal with the substantive question whether the agreement infringed article 81 or the chapter I prohibition (MasterCard UK v OFT).

The OFT's discretion to close its file on a complaint was extended by the judgment of the CAT in Casting Book v OFT. The CAT concluded that the OFT had closed its file for reasons which were genuinely independent of, and without having reached any conclusion as to, the merits of the case. The investigation was still at an early stage, the OFT considered that the limited resources available to it could be more usefully deployed elsewhere and new information suggested that the value of the products affected by the alleged infringement was lower than originally thought.

9.4.2 Market inquiries

Following a market study, the OFT published a report European state aid control, providing guidance on the appraisal of subsidies carried out by government departments and agencies. Another study, UK Airports, proposed that the BAA airports in south-east England and Scotland be the subject of a market investigation reference to the Competition Commission ("CC"); it also recommended the deregulation of Manchester Airport. Payment protection insurance may also be referred to the CC following a study instigated by a super-complaint made by the National Association of Citizens Advice Bureaux.

The CC reported on market investigation references into Domestic bulk liquefied petroleum gas (last investigated in 1981) and Store cards. Following the Store cards report the CC made an order remedying defects which it had identified, in particular transparency as to APR, the tying of ancillary services and payment by direct debit. The CC is also consulting on remedies in Home Credit, Classified Directory Advertising Services and Northern Ireland Personal Banking. The OFT, following a challenge by the Association of Convenience Stores in the CAT, reversed its earlier decision and made a market investigation reference of the groceries market. The CC has until May 2008 to report.

9.4.3 Private enforcement

Healthcare at Home is seeking damages from Genzyme following the decision of the OFT that Genzyme had infringed the chapter II prohibition by imposing an unlawful margin squeeze. The CAT awarded Healthcare at Home £2m as an interim payment in relation to its loss of actual margin (Healthcare at Home v Genzyme).
9.4.4 Mergers

Merger activity has been high. The CC began ten investigations, and a further 15 references were averted by the parties offering the OFT undertakings (usually but not always structural) remediying the significant lessening of competition (SLC) anticipated.

A significant number of mergers were completed either before the OFT commenced its investigation or before it made any reference. The OFT's practice, though not formally announced, is now to seek undertakings from the parties to completed mergers that they will not further integrate the businesses concerned. If a reference is made, these are adopted by the CC, which will probably then replace them with more stringent undertakings or (in the absence of undertakings) an order under section 81 of the Enterprise Act 2002.

In Stericycle v Competition Commission the parties to a completed merger appealed to the CAT against an order of the CC requiring the acquirer to create separate management teams for the two businesses and to appoint both a monitoring trustee and a hold-separate manager. The order of the CC also restricted the flow of confidential information between the businesses. The order was intended to prevent the parties from taking "pre-emptive" steps which might frustrate the outcome of the CC inquiry - in particular running down a brand and making it less attractive to a purchaser on divestment. The parties contended that the CC had acted beyond its powers, otherwise disproportionately or unreasonably, and in particular that an order could not be made reversing pre-emptive action already taken. The CAT dismissed the appeal, holding that the CC had exercised its powers reasonably and within the margin of appreciation allowed to it. It issued a warning that parties to a merger who had high market shares should anticipate a reference and an order preventing further integration; if they began integration, they did so at their own risk.

Local competition was at issue in two appeals heard by the CAT. Somerfield brought an appeal against the decision of the CC that its acquisition of certain stores from Wm Morrison (themselves divested following the acquisition of Morrison by Safeway) would lead to an SLC in certain areas, and also against the direction specifying that Somerfield must divest the stores acquired rather than those which it already owned and naming competitors from whom, at least initially, it must select the divestees. The appeal eventually proceeded only on the second of these points. Dismissing the appeal, the CAT held that the CC was entitled to seek to restore the status quo ante and to conclude that the acquired stores were more attractive to divestees than the existing stores, subject to Somerfield demonstrating otherwise. It also held that on the evidence the CC was justified in excluding convenience and other discounting stores as potential divestees (Somerfield v Competition Commission).

The acceptance by the OFT of divestment undertakings in lieu of reference from Boots on its acquisition of Unichem was challenged in the CAT by Celesio, a pharmaceutical wholesaler and retailer. The OFT had concluded that the reduction of fascias in a particular area from four to three would not result in SLC at a local level. The CAT rejected the appeal, holding that it was reasonable for the OFT to conclude that the continued presence of at least two independent competitors would be sufficient to prevent an SLC (Celesio v OFT).
The OFT reversed its earlier decision to discontinue the system of offering informal oral advice to parties proposing a merger. It has reintroduced the informal advice procedure (though not the equivalent written procedure, confidential guidance), but added two further conditions. The first is that the parties must demonstrate a genuine intention to proceed with the merger. The second is that they must identify the possible competition concern which might lead to a reference to the CC. The OFT will refuse advice if it would be unable to add to the guidance available from a published precedent.

Merger fees charged by the OFT tripled in April in the first of a two-stage increase.

9.4.5 OFT opinion

The OFT issued a revised, but still draft, opinion, on the distribution of newspapers and magazines. The OFT does not now envisage a block exemption in this market, since conditions in each territory may vary. Instead it will assess each agreement individually on a territory-by-territory basis. The earlier distinction between the distribution of newspapers and of magazines, based on their relative perishability, is no longer considered to be significant. The OFT is also reviewing the Newspaper Code.

9.4.6 Policy

The OFT set out its revised priorities for investigation under the Competition Act 1998. Factors to be considered will include private enforcement, consumer benefit, deterrence, aggravating/mitigating elements, policy considerations, resources available and likelihood of success.

The new policy on priorities followed a structural reorganisation of the OFT, which will affect the way in which cases are dealt with. Instead of being organised by reference to the legislation which it enforces, the OFT will normally allocate cases to teams based upon the market concerned.

The OFT also issued new guidelines on the involvement of third parties in Competition Act cases.

Sir Christopher Bellamy resigned as President of the Competition Appeal Tribunal as from 15 December 2006. His successor has not yet been announced.

10. CONSTRUCTION: SCOTLAND

For CONSTRUCTION: ENGLAND, see section 11.

10.1 New legislation

10.1.1 Building (Scotland) Amendment Regulations 2006

These Regulations amend the Building (Scotland) Regulations 2004 (SSI 2004/406) which set out functional standards for buildings. The principal amendments are in relation to the six schedules to the 2004 regulations which are replaced in their entirety. These amendments arise due to a number of factors: the result of practical experience of the new system; changes to some of the technical requirements; and


10.1.2 Construction Contracts (Scotland) Exclusion Amendment Order 2006

This Order amends the Construction Contracts (Scotland) Exclusion Order 1998 (SI 1998/686). The amendment provides that a body whose accounts are examined and certified by or are open to inspection of the Auditor General for Scotland fulfils one of the conditions to enter into a contract under the private finance initiative. This means that the contract is excluded from the operation of the Housing Grants, Construction and Regeneration Act 1996 Part II.


10.1.3 Construction Design and Management ("CDM") Regulations

Revisions to the CDM Regulations 1994 are expected to come into force in April 2007. The new simplified Regulations revise and bring together the existing CDM Regs 1994 and the Construction (Health Safety & Welfare Regulations) 1996.

Further information can be found at: http://www.hse.gov.uk/construction/cdm.htm

10.1.4 Corporate Manslaughter and Corporate Homicide Bill

This Bill creates a new offence in Scotland called corporate homicide. In England, the equivalent offence is called corporate manslaughter. It is currently progressing through the UK Parliament.

See paragraph 13.7.

For further information, see:
http://www.publications.parliament.uk/pa/cm200506/cmbills/220/06220.i-ii.html

10.1.5 Fire Safety (Scotland) Regulations 2006

These Regulations make provision in connection with the carrying out of assessments to identify risks in respect of harm caused by fire, and the review of those assessments. They also make provision about fire-safety in relevant premises (as defined in the Fire (Scotland) Act 2005).


10.2 Case review

10.2.1 Arbitration notices

In Scrabster Harbour Trust v Mowlem Plc, the Inner House of the Court of Session considered the issue of whether an arbitration notice had to comply strictly with the
provisions of the Scottish Arbitration Code 1999 referred to in the contract between the parties.

The contract provided that 'any reference to arbitration ....shall be conducted in accordance with the Scottish Arbitration Code 1999'. In this case, Mowlem served a notice of arbitration on the Trust. However, the notice failed to comply with the 1999 Code in that it did not propose the name of an arbiter. The Trust argued that the notice was invalid. At first instance, the Outer House rejected this argument. Lord Clark considered that the wording of the contract referred to the carrying on of the arbitration and not its commencement. On appeal, the Inner House rejected the Lord Ordinary's approach. It held that the Code related to the commencement of the arbitration as well as the process. However, despite that, the Inner House refused the appeal considering that the contract between the parties should be interpreted in a business-like way and that it was clear from the wording of the contract that the parties did not intend strict compliance with the Code in order to validly refer a dispute to arbitration. In particular, the court pointed to the fact that the sample notice of arbitration included within the contract did not in itself comply with the Code. The implication of this decision is that strict compliance with the Scottish Arbitration Code is not always absolutely necessary, although, where the Code is referred to, it would clearly be safer to follow its provisions to avoid a legal challenge.

For further information on this decision, see the Scottish Court Service website: [http://www.scotcourts.gov.uk/opinions/2006csih12.html](http://www.scotcourts.gov.uk/opinions/2006csih12.html)

10.2.2 Insolvency, termination and withholding notices

In *Melville Dundas Ltd (In Receivership) v George Wimpey UK Ltd*, the Inner House of the Court of Session considered the issue of the operation of JCT insolvency provisions and section 111 of the Housing Grants, Construction and Regeneration Act 1996.

In this case, Melville Dundas, the contractor, went into receivership without receiving payment from George Wimpey of an interim application. The final date for payment passed in respect of the application without a withholding notice being issued by George Wimpey. Instead, George Wimpey terminated the contract by reason of insolvency under clause 27 (which delayed any further payments to the contractor until the works were complete and the accounts balanced). Melville Dundas raised an action in respect of the interim application and an issue arose as to whether clause 27 of the JCT 1998 trumped the contractor's rights under the Scheme. In the Outer House, Lord Clarke found in favour of Wimpey. On appeal however, the Inner House overturned Lord Clarke's decision and held that the Scheme applied. Wimpey were ordered to make payment. The decision offers much needed clarity in respect of the interaction of clause 27 and section 111.

10.2.3 Storm conditions and construction contracts

In this widely reported 2006 case, a sub-contractor sought a finding from the court that the conditions on site fell within the definition of "storm" within the specified perils clause of the contract. In terms of the sub-contract the sub-contractor was liable to meet the cost of damage except if it was caused by a 'storm' in which case liability would lie with the main contractor. The action was dismissed at first instance and the sub-contractor appealed. The sub-contractor argued that a storm could be constituted by one weather element only and there was no need to consider any particular technical measurement. The main contractor argued that the definition of a storm should: turn on the facts of each case; be based on the opinion of a person of 'ordinary commonsense'; and include the requirement of violent weather which has an effect on the surrounding area. Sheriff Principal Bowen dismissed the appeal. He considered that a storm could be constituted by one element alone but that a link between the damage caused and the weather conditions had to be demonstrated. He considered that a storm required atmospheric violence of an extreme or unusual nature and that this had not be established in this case.

This decision is of significance because there is little authority in Scotland on what constitutes a storm in terms of standard insurance provisions.

*W F Price (Roofing) Ltd v Balfour Beatty Construction Limited*

Further information can be found at: [http://212.20.233.34/opinions/A988_05.html](http://212.20.233.34/opinions/A988_05.html)

10.3 Other developments

10.3.1 Sustainability targets for public bodies

On 24 November 2006, the Scottish Executive announced that 90% of all Scottish public sector construction projects valued above £1m should include at least 10% of materials from recycled or reused content. The Executive is the first public body in the UK to set a level for such construction projects. This new standard is to be implemented over a two year period.

For further information, see the Waste and Resource Action Programme website at: [http://www.wrap.org.uk/construction/constructionProcurement/scottishPublicSector/index.html](http://www.wrap.org.uk/construction/constructionProcurement/scottishPublicSector/index.html)

10.3.2 New SBCC forms

The Scottish Building Contract Committee Limited ("SBCC") has continued to produce its suite of new forms. The new forms incorporate in one document the JCT conditions and the Scottish Building Contracts. The suite of contracts revises and updates the existing forms, amalgamates certain of the forms and introduces new forms, as a simplification and tidying-up process. The suite has recently been extended with the Design and Build and Sub-contract forms.

For further information, see the SBCC’s website at: [http://www.sbcconline.com/news.aspx](http://www.sbcconline.com/news.aspx)
11. CONSTRUCTION: ENGLAND

See also PLANNING, section 39, and REAL ESTATE, section 41. For CONSTRUCTION: SCOTLAND, see section 10.

11.1 New industry standard contracts

For the construction and engineering industries, 2005 was the "year of the industry standard form contract" - with two major bodies, the JCT and the ICE, both launching new forms of contract (the JCT's 2005 suite of contracts and the Third Edition of the NEC). This pattern has continued in 2006.

11.1.1 In the last 12 months, the following JCT 2005 contracts have been published:

- Standard Building Contract with Quantities without contractor's design - SBC/Q/XD;
- Standard Building Contract without Quantities without contractor's design - SBC/XQ/XD;
- Standard Building Contract with Approximate Quantities without contractor's design - SBC/AQ/XD;
- Sub-contracts accompanying the Intermediate Contracts, with options for contractor's design and without contractor's design;
- Prime Cost Building Contract;
- Repair and Maintenance Contract.

11.1.2 The following contracts are due to be published in 2007:

- JCT Constructing Excellence Contract (CE): a new contract commissioned by the Local Government Association which is aimed at the local government sector and, accordingly, drafted to make collaborative working a key feature of the agreement (and based on the "Be" Collaborative Contract);
- Minor Works Building Contract with sub-contractor's design is due in March 2007;
- Management Building Contract;
- Construction Management Contract (due 2008);
- CIC Consultant's Contract: the development of another form of consultant's appointment (due to be published at Easter) comes hot on the heels of the BPF Consultancy Agreement 2005 and accompanying BPF Collateral Warranties. The BPF consultant's appointment was developed by clients in consultation with the industry and intended as a one-size-fits-all agreement. The CIC form is a similar form, intended to be used by all consultants on construction projects. The planning and drafting of this form has been long and detailed, the lists of...
consultants’ services are comprehensive and sophisticated. As with the BPF form, it remains to be tested by the market.

11.1.3 Reform of the "Construction Act"

In 2005, a review of the Housing Grants, Construction and Regeneration Act 1996 began. This Act is the single most important piece of legislation to have been passed affecting the construction and engineering industries, specifically because Part II deals with the ever important issues of payment and dispute resolution (by adjudication).

It was always expected that the review would ultimately result in the implementation of a wide-ranging set of reforms to the Act. These would be aimed at:

- improving payment mechanisms in the construction industry; and
- making Adjudication fairer and more cost-effective for the parties.

An industry wide consultation paper was issued in spring 2005 and the Department of Trade and Industry released its official response to the consultation in January 2006.

Although the initial indication from the DTI was that a 12 week public consultation on the wording of the proposed changes to the Act would be launched in spring 2006, this process was delayed pending the conclusion of discussions between the DTI and the Construction Industry Council as to the detailed wording of the amendments to the Act. The result of this is that the 12 week public consultation on the detailed wording of the changes to the Act will take place early in 2007.

Once the DTI has reported on the findings of the public consultation, a draft Order will be placed before Parliament setting out the proposed amendments.

It is anticipated that the amendments to the Act will, at the earliest, come into force in 2008.

11.2 Health and safety law developments affecting the construction and engineering industries

11.2.1 Construction (Design and Management) Regulations 2007: see paragraph 23.1.

11.2.2 Control of Noise at Work Regulations 2005: see paragraph 23.2.

11.2.3 Control of Asbestos Regulations 2006: see paragraph 23.3.

11.2.4 Regulatory Reform (Fire Safety) Order 2005: see paragraph 23.4.
11.3 Tax law developments affecting the construction and engineering industries

In April 2007, the Construction Industry Scheme will undergo its second major change since it was introduced in the early 1970s. The CIS is a tax deduction scheme which requires certain payments made by "contractors" to their "sub-contractors" in respect of "construction operations" to be made under deduction of tax at source, unless the sub-contractor holds a gross payment certificate.

For further information, see paragraph 45.11.3.

12. CONSUMER CREDIT

12.1 Consumer Credit Act 2006 ("Act")

The Act received royal assent on 30 March 2006 and will be implemented in stages, largely over the next two years. The major changes brought about by the Act will come into force as follows:

<table>
<thead>
<tr>
<th>Key measures</th>
<th>Implementation date (according to the DTI timetable)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Unfair credit relationship provisions</td>
<td>6 April 2007</td>
</tr>
<tr>
<td>2. Extension of the Financial Ombudsman's' powers and duties</td>
<td>6 April 2007</td>
</tr>
<tr>
<td>3. Repeal of automatic unenforceability (s127(3)-(5))</td>
<td>6 April 2007</td>
</tr>
<tr>
<td>4. Change to the definition of &quot;individual&quot; to exclude partnerships of more than three people</td>
<td>6 April 2007</td>
</tr>
<tr>
<td>5. Removal of £25,000 limit</td>
<td>6 April 2008</td>
</tr>
<tr>
<td>6. Obligations to provide further information:</td>
<td>6 April 2008</td>
</tr>
<tr>
<td>• OFT information sheets with arrears letters/default notices</td>
<td>6 April 2008</td>
</tr>
<tr>
<td>• New arrears notices</td>
<td>6 April 2008</td>
</tr>
<tr>
<td>• New statement requirements</td>
<td>6 April 2008</td>
</tr>
<tr>
<td>7. OFT information powers and licensing duties extended</td>
<td>6 April 2008</td>
</tr>
</tbody>
</table>

Much of the detail of the changes will appear in secondary legislation which has been subject to consultation during 2006 and which should be published in the second quarter of 2007.
12.2 Credit card default charges

The Office of Fair Trading ("OFT") investigated charges imposed by credit card companies when customers default, for example by failing to make monthly payments on the due date or by exceeding their credit limit. They concluded that, in general, these charges were too high and likely to be unfair for the purposes of the Unfair Terms in Consumer Contracts Regulations 1999.

In April, the OFT published a statement of their position, announcing that they expected all credit card issuers to review their charges in the light of this statement and make any necessary amendments to their terms and conditions without undue delay.

Towards the end of 2006, however, the market saw a general trend of rising interest rates, partly attributed to the loss of revenue felt by credit card issuers as a result of the mass reduction of the level of default charges.

12.3 Overseas credit card transactions

The OFT successfully fought an appeal against the High Court’s decision in November 2004 which stated that foreign purchases made using a credit card do not attract the consumer protections of section 75 of the CCA. The judgment handed down by the Court of Appeal confirmed the OFT’s view that the application of section 75, which makes credit card issuers jointly and severally liable with suppliers for purchases made using credit cards, should extend to overseas, as well as domestic, purchases.

*Office of Fair Trading v Lloyds TSB Bank plc and others* [2006] EWCA Cir 268

12.4 Consumer credit advertising

Following investigations carried out in 2005, the OFT concluded that many credit advertisements failed to comply with the Consumer Credit (Advertisements) Regulations 2004 ("Advertisements Regulations"). More than 60% of credit adverts in regional newspapers and 68% in popular car magazines failed to comply fully.

During 2006, both local Trading Standards Offices and the OFT have been very active checking advertising material and they have taken action where they feel it does not meet with their rigorous interpretation of the Advertisements Regulations.

12.5 Licensing

Recent figures published by the OFT showed a significant reduction, as compared with 2005, in the number of: licensing actions conducted; applications refused; licenses revoked; minded to refuse notices issued; and warning/advisory letters issued.
12.6 Payment Protection Insurance ("PPI")

On 19 October 2006, the OFT reported their intention to refer the UK PPI market to the Competition Commission, subject to the outcome of a recent consultation period ahead of an expected decision early in the new year. The report came as a result of the findings of their market study launched after a super-complaint from the Citizens Advice Bureau.

The OFT identified the following major failings in the PPI market:

12.6.1 consumers do not shop around for the best PPI deal;

12.6.2 the complex nature of PPI makes comparison between different policies/providers difficult; and

12.6.3 in some cases consumers assumed, were told or were given the impression that taking out PPI would help their application for credit.

See further, paragraph 20.6.3 for information about the FSA review and paragraph 20.6.4 for information about firms fined for failures in connection with selling PPI.

12.7 Other developments

12.7.1 Electronic agreements

The Consumer Credit Act 1974 (Electronic Communications) Order 2004, which came into force 31 December 2004, provided for the entering into of regulated agreements online. Largely due to potential problems of fraud, many lenders did not initially take up this option. The past year has seen an increase in the number of lenders willing to do business in this way, predominantly in the credit card market.

12.7.2 European developments

The proposed Consumer Credit Directive, which aims to develop a single market for consumer credit, has been debated at length over the last few years. To date, the EU Competitiveness Council has been unable to reach any agreement on the proposed directive and the EU Presidency has been forced to forego presenting a compromise text to the EU Council. There remain many differences between the positions taken up by member states in relation to the proposed directive, most notably concerning the harmonization of short-term credit contracts and overdrafts, the scope and nature of information to be provided to consumers at each step prior to the conclusion of a contract and the definition of annual interest rates, in particular the inclusion of taxes and the method of calculation.

Some member states have questioned the added value of the proposed directive over their current consumer credit laws and the UK remains opposed to it.
13. CORPORATE CRIME

13.1 Serious organised crime

13.1.1 Serious Organised Crime Agency ("SOCA")

SOCA became operational on 1 April 2006. The agency was formed from the amalgamation of the National Crime Squad, National Criminal Intelligence Service, the part of HM Revenue and Customs ("HMRC") dealing with drug trafficking and associated criminal finance, and the part of UK Immigration dealing with organised immigration crime.

For the financial year 2006/07, SOCA will receive grant in aid from the Home Office set provisionally at £416m in resource funding and £41m in capital provision. It anticipates employing approximately 4,200 full time equivalent staff during the year.

It is anticipated that 40% of SOCA's resources will be focused on combating drug trafficking, 25% on immigration, 10% on individual and private sector fraud and 15% on other forms of organised crime. The remaining 10% of resources will be focused on helping law enforcement agencies with their work.

The Director General is able to designate SOCA officers as having the powers of a police constable, a customs officer, or an immigration officer.

13.1.2 Serious Organised Crime and Police Act 2005 ("SOCPA")

SOCPA came into force on 1 April 2006.

Part 1 of SOCPA deals with the establishment and the activities of SOCA.

Part 2 deals with investigatory powers of the Director of Public Prosecutions, the Director of Revenue and Customs Prosecutions and the Lord Advocate in relation to offences set out in section 61. These offences include (but are not limited to) money laundering, terrorism, and counterfeiting. They also include VAT offences, false accounting and cheating the public revenue where there is a potential loss of not less than £5,000.

SOCPA is also responsible for creating measures which enable it to enter into arrangements with defendants where lighter sentences will be offered in exchange for co-operation. The intention is to encourage defendants to co-operate with the Crown. Evidence provided from the US certainly supports the notion that providing written deals to defendants pays off. Defendants in the US assist the prosecution in 26% of drug trafficking cases compared to only 1% of drug trafficking cases in Britain. However, these provisions also give the judiciary greater powers in that, when passing sentences, they are entitled to disregard minimum or mandatory sentences specified by other legislation to reflect the level of assistance provided.
A safeguard is in place if defendants fail to deliver on their part of the deal after receiving a commuted sentence; they can be brought back to court and given a heavier sentence. Conversely, those who subsequently co-operate after receiving what would be regarded as a normal sentence can ask for a lesser sentence to be substituted.

With provisions that also permit prosecutors to grant immunity from prosecution altogether or to agree, on the basis of certain conditions, not to use particular evidence against individuals, some solicitors believe that this is a compromise too far. Many solicitors fear that the new provisions could lead to miscarriages of justice, with the temptation for criminals to falsify or edit their evidence with the specific intention of achieving a better deal for themselves.

These provisions also require the establishment of powerful witness protection measures in order to incentivise criminals to co-operate.

Only time will tell whether these provisions and SOCA will be deemed a success. The Home Secretary has specified four criteria with which to judge SOCA’s performance:

- trends in the harm caused by organised crime;
- evidence that organised criminals are finding UK a less attractive place in which to operate;
- improving understanding of organised crime; and
- meeting targets on asset recovery from operations.

13.1.3 Disclosure notices

A disclosure notice may be given to a person by a member of staff at SOCA, an officer of HMRC or a police constable if there are reasonable grounds for suspecting that an offence has been committed, any person has information which relates to a matter relevant to the investigation of that offence and there are reasonable grounds for believing that information provided by the person in compliance with a disclosure notice is likely to be of substantial value to the investigation.

Such a notice requires a person to answer questions or furnish information/produce documents at a time, place or in a manner specified in the notice. Where a disclosure notice has been given, the person issuing it or an authorised person may copy the documents produced, take extracts, and require the person producing the documents to provide an explanation of them.

13.1.4 Search and seizure

A warrant may be issued if the Investigating Authority is satisfied that the documents are on the premises and:

- a person has been required by a disclosure notice to produce documents but has not done so;
• it is not practicable to give a disclosure notice requiring production;

• giving a notice might seriously prejudice the investigation of an offence.

A warrant authorises an appropriate person to enter and search premises, using such force as reasonably necessary and to take possession of any document or take steps necessary for preserving or preventing interference with documents.

13.1.5 Penalties

It is an offence to fail to comply with a disclosure notice or the production of documents without a reasonable excuse. The maximum penalty is a fine and/or 51 week’s imprisonment.

13.2 Revenue and Customs Prosecutions Office

13.2.1 Annual Report

The Revenue and Customs Prosecutions Office ("RCPO") has issued its first Annual Report. The RCPO was launched as a new, specialist and independent prosecuting authority on 18 April 2005. In the Report, the Director of the RCPO, David Green QC, identified the priorities for the first year as the servicing of criminal casework for HMRC and SOCA, the development of RCPO's new relationship with HMRC, and the establishment of RCPO as a new component of the criminal justice system.

The RCPO has issued the following statistics for its first year of operation:

• 1701 cases involving 2269 defendants were completed;

• 81% of defendants were convicted;

• in 76% of prosecutions at least one defendant pleaded guilty;

• 89% of prosecutions resulted in the conviction of at least one defendant;

• 71% of cases were concluded in the Crown Court;

• 65% of defendants in the Crown Court pleaded guilty;

• 29% of cases were concluded in the magistrate's court;

• 76% of defendants in the magistrates court pleaded guilty;

• 411 confiscation orders were obtained;

• £21.5m in criminal assets were recovered; and

• as at 31 March 2006 1017 cases were in progress.
13.2.2 The Director of the RCPO highlighted the following points in the Report:

- the RCPO has worked hard to establish its own identity and reputation within the criminal justice system;

- particular challenges have been posed by the growth in Missing Trader Intra-Community ("MTIC") fraud. This represents a major threat to the public revenue and affects many EU jurisdictions. MTIC prosecutions are long and complex. Historically, over 110 defendants have been convicted resulting in the imposition of substantial terms of imprisonment. The RCPO has obtained confiscation orders totalling £60m. At the time the report was published the RCPO was advising on or prosecuting 25 MTIC cases, and had 150 defendants before the courts at various stages of the trial process;

- the RCPO has faced a growth in organised tax credit fraud involving identity theft. At the time of the report the RCPO was dealing with over 30 such cases;

- the RCPO has played a full role in external bodies, including the Whitehall Prosecutors’ Group, the Criminal Procedure Rule Committee, the Concerted Inter-agency Criminal Finance Action Group and the High Cost Cases Review Board; and

- the RCPO has made strong contributions to significant initiatives on disclosure.

13.2.3 A Written Ministerial Statement dated 19 July 2006 indicates that the powers contained in SOCPA Part 2 (ie serving disclosure notices, compulsory interviews etc) are available to be used by RCPO in respect of tax offences.

13.3 Tax fraud: Civil Investigations Teams

See paragraph 45.4.1.

13.4 Extradition: NatWest Three

The extradition of the "NatWest Three", Giles Darby, David Bermingham and Gary Mulgrew, to the US this year received extensive media coverage in the UK. The three were indicted by a Grand Jury in Houston, Texas on seven counts of wire fraud. They worked for Greenwich NatWest ("GNW"), a structured finance division of NatWest. The indictment describes the scheme to defraud as follows:

Paragraph 10:

"Between approximately February 2000 and August 2000, defendants David Bermingham, Giles Darby, and Gary Mulgrew, and others, devised and executed a scheme to defraud NatWest and GNW and deprive them of money and their right to honest services by recommending to GNW that it sell its interest in Swap Sub for only $1m, when the defendants knew GNW's interest was worth far more, and when the defendants were planning fraudulently to convert the balance of GNW's interest to themselves and others."
Paragraphs 16 and 17:

"It was part of the scheme that on February 22, 2000, having devised a plan to restructure the Swap Sub for their own benefit, defendants Bermingham, Darby and Mulgrew travelled to Houston, Texas to meet with Enron’s CFO and others...Subsequently, the defendants, still purporting to represent GNW’s interests, agreed with Enron’s CFO and Michael Kooper on how to carry out the scheme."

Paragraph 22:

"On or about May 1, 2000, Michael Kooper caused a wire transfer of $7,352,626 in scheme proceeds from Houston to a Southampton K Co. account established by defendant Bermingham at the Bank of Bermuda (Cayman) Limited. Bermingham subsequently divided the proceeds, directed wire transfers of $2.38m to both Mulgrew and Darby, and kept the balance for himself. Meanwhile, Enron’s CFO and Kooper, and others, received a total of approximately $12.3m through Southampton, L.P., representing their share of scheme proceeds."

The Speaker of the UK House of Commons allowed an emergency debate on 12 July 2006 on extradition and the "NatWest Three" after a request by Liberal Democrat MP Nick Clegg. Extradition between the UK and the US is governed by the Extradition Act 2003 and the 1972 Extradition Treaty. In 2003 a new Treaty was signed. At the time of the debate the UK had ratified the 2003 Treaty but the US had not meaning the 1972 Treaty remained active. Under the 1972 Treaty, the requesting party must support its request for extradition with evidence according to the law of the requested party; in short, a prima facie case in the UK and probably cause in the US. However the 2003 Act designates the US as a State that does not have to provide any evidence to support an extradition request, resulting in an imbalance in the arrangements.

13.5 Fraud Act 2006

The Fraud Act 2006 received royal assent on 8 November 2006. It is due to come into force early in 2007.

The Act aims to clarify the current statutory fraud offences contained in a number of statutes, including the Theft Acts of 1968 and 1978, and introduces a new single offence of fraud. The new offence would carry a maximum sentence of 10 years and can be triggered in three ways:

- fraud by false representation eg misuse of a credit card to pay for items;
- fraud by failing to disclose information to another person where there is a legal duty to disclose eg failing to disclose information relating to a heart condition when making an application for life insurance; and
- fraud by abuse of position eg an employee of a software company who uses his position to clone software products with the intention of selling the products on.

It also creates three new offences of:

- possessing, making and supplying articles for use in frauds eg making a device which, when attached to an electricity meter, causes the meter to malfunction;
fraudulent trading by a sole trader ie a person outside the reach of section 458 of the Companies Act 1985 or article 451 of the Companies (Northern Ireland) Order 1986; and

obtaining services dishonestly eg where a person climbs over a wall and watches a football match without paying the entrance fee.

For further information, see the OPSI website:

13.6 Bribery: Transparency International Bribe Payers Index ("BPI")

The BPI was released on 4 October 2006.

It is based on the responses of 11,232 business executives from companies in 125 countries to two questions about the business practices of foreign firms operating in their country, as part of the World Economic Forum's Executive Opinion Survey 2006. To assess the international supply-side of bribery, executives are asked about the propensity of foreign firms that do the most business in their country to pay bribes or to make undocumented extra payments. The survey is anonymous.

The questions on which the BPI is based first ask respondents to identify the country of origin of foreign owned companies doing the most business in their country. Respondents are then asked: "In your experience, to what extent do firms from the countries you have selected make undocumented extra payments or bribes?". This analysis produced four clusters (or groups) of countries. Cluster 1 comprises the countries from which companies are least likely to bribe when doing business abroad, and cluster 4 comprises those that are most likely to bribe, according to the BPI 2006.

- Cluster 1: Switzerland, Sweden, Australia, Austria, Canada, UK, Germany, Netherlands, Belgium, US, Japan.
- Cluster 2: Singapore, Spain, United Arab Emirates, France, Portugal, Mexico.
- Cluster 3: Hong Kong, Israel, Italy, South Korea, Saudi Arabia, Brazil, South Africa, Malaysia.
- Cluster 4: Taiwan, Turkey, Russia, China, India.

These countries are among the leading international or regional exporting countries, whose combined global exports represented 82 percent of the world total in 2005. While most of the countries in the survey are OECD members, membership was not a selection criterion. Thus, OECD countries such as Denmark and Norway are not part of the list, while non-OECD countries like India, Israel, Singapore and South Africa, for instance, were included.

13.7 Corporate Manslaughter and Corporate Homicide Bill

This year the government finally presented before Parliament its long-promised Bill to reform the law of manslaughter as it applies to corporate bodies. The Bill received its third reading in the House of Commons on 4 December 2006, and its second reading in the House of Lords on 20 December 2006.
The purpose of the Bill is to remove a technical legal obstacle to the successful prosecution for manslaughter of companies and other corporate organisations, particularly large corporate organisations, following fatal accidents at work or fatalities involving the public, for example in transport accidents, which are attributable to management failings.

In the case of a body corporate, the current law of manslaughter in England and Wales, or culpable homicide in Scotland, requires proof that a senior official or officials of the corporation who can be said to represent its "controlling” or "directing” mind was or were individually involved in the events leading to the fatality and individually guilty of manslaughter or culpable homicide.

This requirement, known as the "identification principle”, does not present a difficulty in the case of relatively small companies where management at that level is closely involved in directing day-to-day operations, and an individual manager at director-level can be shown to have been individually guilty of gross negligence which caused the death of another person. However, prosecution is much more difficult in the case of large organisations where managers at director-level or equivalent play a much more strategic role.

In the case of such organisations, it can be difficult to identify an individual very senior manager, who was guilty of acts or omissions in an operational context which were causative of the death, but who also is of sufficient seniority to be identified as part of the company's directing or controlling mind.

Furthermore, in line with this approach, the courts, at any rate in England and Wales, have not allowed the prosecution to aggregate diffuse failings within an organisation for the purposes of presenting their case.

The government proposes to deal with these difficulties by creating a new offence, which would apply where the way in which an organisation's activities are managed and organised has caused a person's death and amounts to a gross breach of one of various types of duty owed to the victim under the law of civil negligence. These duties include the duties owed by an employer to its employees, the duties owed by an occupier of premises to visitors and trespassers, duties owed by those carrying out commercial activities and duties owed by those keeping or using plant or vehicles.

It will be necessary to show that the way in which any of the organisation's activities are managed or organised by its senior managers was a substantial element in the breach of duty, and that the relevant breach constituted conduct falling far below what could reasonably be expected of the organisation in the circumstances.

The new offence will apply to corporations, including companies, and bodies directly established under statutory provisions, and a list of government departments and other Crown bodies specified in a schedule to the Bill.

The proposed offence will be called corporate manslaughter in England and Wales, and corporate homicide in Scotland. It will only be triable in the Crown Court, or in the High Court of Justiciary, as the case may be. Proceedings will only be able to be brought in England and Wales with the consent of the Director of Public Prosecutions, and the existing offence of manslaughter by gross negligence will be abolished in relation to corporations.
As the offence will only relate to organisations, it will be punishable by a fine, and there is no provision for imprisonment, but there will be no upper limit to the amount of the fine that can be imposed. The court will also have the power to order steps to be taken to remedy a breach of duty, in a procedure involving consultation by the prosecution with the relevant enforcing authority. Failure to comply with such an order will be a separate offence, punishable by a fine on conviction on indictment.

The present proposals are conservative, in that, in line with the current law, the death must be shown to have been caused by a breach of a civil duty of care which must be a gross breach.

As regards Crown bodies, these are in general to be subject to the legislation, but public policy decisions, the exercise of exclusively public functions, including military and certain policing and law enforcement operations, and statutory inspections (except where carried out as employer or as an occupier of premises), will be excluded from the scope of the legislation. Individual liability is excluded, though individual managers will still be liable, on appropriate facts, to be prosecuted on an individual basis under the general law, for manslaughter, culpable homicide or breaches of health and safety law. The government took on board criticisms that an implicit requirement in an earlier draft of the Bill that the breach of duty should wholly relate to the failings of senior management amounted to a reintroduction of the "identification principle" by the back door. For this reason, under the current proposals it is only necessary to show that the failings of senior management were a substantial element in the breach.

Others have questioned whether the legislation is really necessary, given that the courts already have powers to impose high levels of fines for serious health and safety breaches without it being necessary to prove that the relevant failings caused a death. That issue may also prove to be a potential obstacle to successful prosecutions. In this respect, the observations of the Court of Appeal in the Hatfield case urging prosecutors to think carefully before bringing charges requiring specific proof of causation would appear to be equally applicable in respect of the new offence created by the Bill as they are in respect of the existing offence of manslaughter.

However, it is clear that the current Bill meets a strongly felt desire for an offence which enables companies to be convicted for causing a death. It is also clear that, when it is enacted, regulators and prosecutors will come under strong pressure to make use of it.

13.8 Money laundering and proceeds of crime

See paragraph 20.7.

14. CORPORATE GOVERNANCE

See also COMPANY (LISTED), section 8.

14.1 Revised Combined Code on Corporate Governance ("Combined Code")

By way of background, all officially listed companies are required by the Listing Rules to report on the extent to which they have adhered to or derogated from the provisions of the Combined Code in their annual report and accounts. The last major overhaul of the Combined Code was carried out in 2003, when it was revised to incorporate the Higgs Report on non-executive directors and the Smith Report on audit committees. Having carried out a "call for evidence" in 2005, the Financial Reporting Council ("FRC") reported that there was
little appetite for major change or a complete overhaul. Therefore, only two amendments of note were proposed\(^{10}\). These were (i) to relax existing provisions to allow the chairman to sit on the remuneration committee (where he/she is considered independent), and (ii) to add a new provision requiring companies to include a "vote withheld" box on AGM proxy forms.

The updated version of the amended Combined Code was published by the FRC on 27 June 2006 (http://www.frc.org.uk/documents/pagemanager/frc/Combined_Code_June_2006.pdf). Note the proposal to include a "vote withheld" box on AGM proxy forms was extended to apply to all general meetings (not just AGMs). It was further decided that any announcements of results should make it clear that a "vote withheld" is not a vote in law and is not counted in the calculation of votes. Further minor changes were made to ensure that certain rules complied with the provisions of the new Companies Act 2006 (then the Companies Bill) ("2006 Act").

The 2006 version of the Combined Code applies in respect of accounting periods commencing on or after 1 November 2006.

14.2 Pre-Emption Group: revised Principles on Application of Pre-Emption Rights

Twenty years after the Pre-Emption Guidelines were first published, the Pre-emption Group published a revised Statement of Principles in relation to the application of pre-emption rights in May 2006. Whilst these Principles are of primary importance to officially listed companies, AIM companies are also encouraged to apply them. The revised Principles provide guidance on:

14.2.1 the circumstances in which flexibility might be appropriate in relation to the disapplication of pre-emption rights;

14.2.2 the factors to be taken into account when considering requests for disapplication; and

14.2.3 making use of an agreed authority for a non pre-emptive share issue.

The Principles replace the previous Pre-Emption Guidelines. As amended, they largely reflect what has been market practice for a number of years, namely that, to go outside the thresholds, there should be a good business case and the prior sanction of institutional shareholders should be obtained. The Statement of Principles is available at http://www.pre-emtiongroup.org.uk/principles/index.htm.

\(^{10}\) The FRC issued a consultation paper on 18 January 2006 proposing amendments to the 2003 version of the Combined Code (http://www.frc.org.uk/corporate/combinedcode.lfm).
14.3 International Corporate Governance Network ("ICGN"): draft Principles

On 15 May 2006, the ICGN published for consultation its proposed New Statement of Principles on Institutional Shareholder Responsibilities, following on from the Statement it produced in October 2003. The New Statement incorporates much of the 2003 Statement but adds a new section relating to internal governance among institutional shareholders. The New Statement therefore addresses the responsibilities of institutional shareholders in relation to both their external role as owners of shares and their internal governance procedures. Points to note include the following:

- the Statement highlights the responsibility owed through the ownership and exercise of voting rights, as this can influence the way in which businesses conduct themselves. Where agents are instructed to act on an institutional shareholder's behalf, it is up to the beneficial owner of the shares to ensure that the responsibilities of ownership are fulfilled by that agent;

- institutional shareholders should develop and consistently apply corporate governance policies;

- companies should be informed of negative votes or absenteeism at general meetings and the reasons behind such decisions;

- institutional shareholders' corporate governance policies should include a clear approach for dealing with situations where dialogue with companies is failing; and

- institutional shareholders' voting policies should be published so that companies in which they invest and their underlying shareholders can understand what criteria are used to reach decisions.

See [http://icgn.org/organisation/documents/src/icgnrespdraft2504.pdf](http://icgn.org/organisation/documents/src/icgnrespdraft2504.pdf) for the New Statement of Principles. Comments were requested by 23 June 2006. The Statement is still in draft form. The ICGN indicate they will review developments two years after it has been finalised.

14.4 ICGN: Remuneration Guidelines

On 14 July 2006, the ICGN published its finalised guidance on executive remuneration. The Remuneration Guidelines update existing ICGN policy and are intended to provide a global benchmark for listed companies to achieve a balance between their ability to recruit and potential damage to reputation or morale. The guidelines are geared towards institutional investors who have both fiduciary responsibility and an economic interest in ensuring that executive remuneration or compensation is best aligned with their interests.


14.5 Association of British Insurers ("ABI"): revised guidelines on executive remuneration/share incentive schemes

See paragraph 45.6.3.
15. **DATA PROTECTION**

15.1 UK Information Commissioner recommends the introduction of custodial sentences for breaches of data protection law

In May 2006 the UK's Information Commissioner's Office ("ICO") published a report entitled "What Price Privacy"\(^{11}\) ("Report") which recommends the introduction of custodial sentences of up to two years for those involved in unlawful trade in confidential information. In December 2006 the ICO published a follow-up report entitled "What Price Privacy Now\(^{12}\)", reviewing the progress made six months after the Report.

In the Report the Information Commissioner indicates that studies have revealed a "widespread and organised undercover market in confidential personal information" with the most common method of obtaining this information being "blagging" or people obtaining information by pretending to be someone they are not.

In the Report the Information Commissioner expresses some frustration that of the 22 cases brought by the Information Commissioner between November 2002 and January 2006 in only two cases did the fines imposed amount to more than £5,000, despite the detriment caused to the individuals concerned. Two further successful prosecutions and a further caution, resulting in fines ranging between £3,300 and £4,200 have been brought since publishing the Report.

In response to the Report the Department of Constitutional Affairs published a consultation paper\(^{13}\) on 24 July 2006 seeking views as to whether the proposed sanctions are proportionate and whether they would act as an effective deterrent. The consultation closed on 30 October 2006 and the responses are due to be published early in 2007. In line with the recommendations in the Report, the government is proposing to amend section 60 of the DPA to introduce the sanction of six months imprisonment on summary conviction and two years on conviction on indictment to punish those found guilty of a section 55\(^{14}\) offence.

The Report identifies the "suppliers" as almost invariably being involved in the private investigation industry. However the buyers or "procurers" should also take note of the proposed offences.


\(^{14}\) Subject to exemptions, section 55 of the Data Protection Act 1998 ("DPA") makes it an offence to obtain, disclose or procure the disclosure of personal information knowingly or recklessly without the consent of the data controller. It is also an offence under section 55 to sell or offer to sell personal data which has been obtained without the consent of the data controller. The penalties for offences under section 55 are currently: on summary conviction, a fine not exceeding the statutory maximum (currently £5,000), and on conviction on indictment, an unlimited fine.
15.2 **Passenger name records**

This year has seen some significant further developments in the ongoing debate over the handling of passenger data relating to flights to the US.

By way of background, following the events of 11 September 2001, the US introduced legislation (through the Aviation and Transportation Security Act 2001) requiring all airlines flying to, from or across the US to provide US Customs with access to the passenger information, referred to as the "passenger name records" or "PNR", within their reservation and departure control systems.

On 6 October 2006, the EU Commission agreed that the EU and US had completed negotiations on an Interim Agreement which provides legal certainty and will enable PNR data in the reservation systems of air carriers to continue to be transferred to the US in the same way as under the Existing Agreement.\(^\text{15}\) The Existing Agreement was annulled in May as beyond the competence of the European Community. To all intents and purposes, the Interim Agreement continues the existing practice of the US Administration accessing electronic PNR data from air carriers’ reservation/departure control systems located within the territory of the EU member states. The Interim Agreement will expire (unless superseded earlier) on 31 July 2007.

The EU welcomes the Interim Agreement which will help to prevent and combat serious transnational crime, whilst ensuring an equivalent level of protection of passengers’ personal data in line with European standards on fundamental rights and privacy.

15.3 **Data Retention Directive**

The European Parliament has approved the controversial draft Data Retention Directive\(^\text{16}\). Member states have until August 2007 to adopt the directive as national law, although they have the option to postpone its implementation with respect to Internet data for an additional 18 months.

The directive will require internet service providers ("ISPs") and telecommunication companies to retain communications data for between six months and two years. The exact time periods are to be determined by individual member states. The requirements do not extend to the content of communications and the retained data will only be made available to the appropriate authorities for the investigation of criminal and terrorist offences.

There is some uncertainty as to whether the scope of the directive extends to businesses other than ISPs and telecommunications companies. This uncertainty turns upon how member states will apply important terms such as "publicly available electronic communications services" to the obligations contained in the directive. In some jurisdictions including France and Italy, it is expected that internet access providers including internet cafes, bars, restaurants, hotels, airports, etc, to the extent that they provide electronic communications services such as internet access, would fall within the scope of national implementation of the directive. The position in other jurisdictions, including the UK, is still somewhat unclear and


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some uncertainty remains as to who will be subjected to UK law. The UK is however one jurisdiction where the directive's impact on telecommunications companies and ISPs may not be that great as a voluntary code of practice is currently in place, which requires service providers to retain communications data for 12 months. Authorities in the UK have indicated that they do not envisage these periods being changed by the implementation of the new directive.

15.4 Outsourcing: UK's Information Commissioner's Office guidance

In April 2006 the UK's Information Commissioner's Office ("ICO") published a good practice note ("Guidance") on outsourcing offering guidance to small and medium sized businesses on how to deal with data protection in the context of outsourcing transactions. The Guidance includes some common sense recommendations on good practice which are suitable for inclusion in outsourcing agreements. For example: (i) Making sure that the processor take steps to ensure the reliability of their staff; and (ii) requiring the processor to report any security breaches or other problems. The Guidance also recommends that the customer audits the processor regularly to make sure they are "up to scratch".

Part of the Guidance seems to suggest that, provided appropriate security measures are in place, use of the EC approved model clauses are not required for transfers to processors outside the EEA. However a spokesman from the team at the ICO responsible for drafting this guidance has confirmed that this is not the intention. The Guidance is intended to say that the EC approved model clauses are not required where one of the other conditions of schedule 4 of the Data Protection Act 1998 are satisfied.


15.5 SWIFT transfers: article 29 WP Opinion

On 22 November 2006, financial institutions across Europe will have been shocked to find out that, following the publication of a new article 29 Working Party Opinion ("Opinion"), they may be liable for previously unforeseen breaches of Directive 95/46/EC ("Directive").

The Opinion relates to the activities of the Belgian based Society for Worldwide Interbank Financial Telecommunication ("SWIFT"). SWIFT operates a financial messaging and payment service, including software interface, used by over 8,000 financial institutions based around the globe and can process as many as 12 million transactions a day. These transactions are diverse and relate to some of the most high profile payments, securities, treasury and trade.


http://www.garanteprivacy.it/garante/document?ID=1367590

Implemented in the UK by the Data Protection Act 1998.
Although SWIFT is based in Belgium, it has operating offices throughout the world and a second headquarters in the US. Each time a transaction is facilitated by the SWIFT technology and SWIFTNet FIN technology for international transfers, information in relation to the bank account holder and beneficiary is stored in SWIFT’s system in Belgium. This data is then “mirrored” into a databank in the US and held in both locations for 124 days before deletion. It should be noted that not only names and addresses of individuals are stored, but also their bank account details and documentation.

It will come as no surprise that, following 11 September 2001, the US authorities sought to access much of the information held by SWIFT in order to locate and prevent the funding of large scale terrorism. The Office of Foreign Assets Control of the United States Department of the Treasury ("UST") has issued 64 subpoenas against SWIFT since 2001 and, without the knowledge of the financial institutions, SWIFT negotiated a compliance agreement for the disclosure of data in accordance with these demands. This compliance agreement meant that the “mirrored” data stored in the US would be transferred into a "black box". The information in the "black box" became the property of the US government for the UST to perform searches on.

The details of SWIFT’s agreement with the UST started to enter the public domain in June 2006 and the European Parliament became concerned about a possible conspiracy in Europe including loop holes in domestic law which would allow the central banks (who oversee the activities of SWIFT) to avoid compliance with data protection legislation. On 27 September 2006, the Belgian data protection authority ("DPA") established that SWIFT was in breach of national data protection legislation. In particular, the DPA described SWIFT’s agreement with the UST a "hidden, systematic, massive and long-term violation of the fundamental European principles as regards data protection". As a result of this finding, the article 29 Working Party investigated and subsequently issued the Opinion to the member states of the European Union. The details of this Opinion could place the financial institutions of Europe in a difficult position if they face national DPA prosecution.

The Opinion states that both SWIFT and the various financial institutions are data controllers for the purposes of the Directive and have joint responsibility (albeit SWIFT owed the primary responsibility) to individual data subjects for the protection of their personal information being handled by SWIFT.

As data controllers, neither SWIFT nor the financial institutions had adhered to the data protection principles included in article 6 of the Directive in relation to quality and proportionality. The Working Party is not asserting that SWIFT would have had to breach US law by non-compliance with subpoenas, rather that SWIFT should have disclosed only specific individual data on a case by case basis. This could have been done within the national and European data protection framework with respect to the limitation and compatibility, proportionality and necessity of the personal data processed.

Furthermore, to be legitimate, SWIFT would have had to fulfil one of the article 7 grounds including, for example, being necessary for the legitimate interest pursued by the controller. The Working Party noted that "SWIFT has a legitimate interest in complying with the subpoenas under US law" as it would have incurred sanctions for non-compliance. However, SWIFT had failed to achieve a proper balance between its own interests and those of the

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millions of individuals it stores data about and, therefore, could not rely solely on its own legitimate interests.

Pursuant to articles 10 and 11 of the Directive, it was stated that SWIFT and the financial institutions had failed to provide data subjects with the necessary information about the mirroring of data to the US or the "black box" transfer. SWIFT was also in breach of its notification obligations pursuant to articles 18 to 20.

In relation to articles 25 and 26 SWIFT was clearly acting in contravention of the restrictions on transborder data flows, due to the transfer of data to the US and to other SWIFT branches throughout the world based outside of the European Economic Area. The Working Party concluded that the US did not offer an adequate level of protection for the data in accordance with article 25 and that SWIFT had failed to implement adequate safeguards for the fundamental rights and freedoms of individuals (article 26). Nor could the derogations in article 26 be fulfilled, including the protection of the vital interests of the data subject, which the Working Party deemed to be irrelevant. The Opinion concluded that the public interests derogation was not intended to be as easily invoked and would have to relate to public interests in a particular member state, not a third country such as the US in this case. The Working Party points out that there is an existing international framework available for the fight against terrorism and breaches of the Directive could have been avoided.

The Working Party, by virtue of this Opinion, has issued a warning to the financial institutions in the EU who, as data controllers, owed a legal obligation to make sure that SWIFT was in full compliance with the data protection legislation. The financial institutions should operate a policy of transparency and provide individuals with the correct information about how their personal data is used and where it is located. The lack of transparency in this case was a serious breach of the Directive and the local DPAs have been urged to be vigilant in ensuring that the financial institutions are data protection compliant. It is likely that, following this Opinion, the DPAs will be forced to take enforcement action against their own financial institutions "even in the fight against terrorism and crime fundamental rights must remain guaranteed".

15.6 Radio Frequency Identification: ICO guidance

Two new pieces of guidance concerning the use of Radio Frequency Identification ("RFID") tags were released by the Information Commissioner's Office ("ICO") in September 2006. One set of guidance is aimed at individuals and the other at any business or organisation which may already use or consider using the technology.

RFID tags are currently used in a variety of ways, for example in "prepaid "smartcards" for travel" or keeping track of items such as baggage and products. The potential for the use of RFID tags is likely to be far reaching, with some countries already using the technology to tailor advertising to individuals or to monitor staff in the workplace. This may lead to either the tag itself or a connecting database holding information about the individual.

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22 Opinion 10/2006 on the processing of personal data by the Society for Worldwide Interbank Financial Telecommunication (SWIFT).

Businesses must ensure complete transparency in their use of RFID tags, including telling people how to disarm the RFID tags, as set out in the guidance. Furthermore, the data must not be held longer than necessary.

15.7 Email scanning

In March 2006 the European Article 29 Data Protection Working Party issued an opinion in relation to whether email screening activities will constitute a breach of any relevant European rules or legislation.

The Working Party opinion notes that individuals have a right to send and receive correspondence and to confidentiality in that correspondence, (including emails), which arises from existing legislation including the European Convention for the Protection of Human Rights and Fundamental Freedoms ("ECHR"), Directive 95/46/EC ("Data Protection Directive") and Directive 2002/58/EC ("e-Privacy Directive"). The e-Privacy Directive specifically regulates the processing of personal information in connection with the provision of publicly available electronic communications networks. Article 5 of the e-Privacy Directive protects confidentiality in communications and article 4 requires that providers take "appropriate technical and organisational measures" to safeguard the security of its services.

The Working Party opinion considered three different practices:

15.7.1 Screening emails for virus detection:

The opinion outlines the following measures for email providers to comply with in order to legitimately scan emails for viruses:

- the content of emails and annexes has to be kept secret and must not be disclosed to anyone but the addressee(s);
- if a virus is found, the installed software must offer sufficient guarantees regarding confidentiality;
- if a virus scan is carried out in the form of content scanning, it should be set up automatically and only for this purpose.

15.7.2 Screening emails to filter spam:

The Opinion outlines the following:

- Subscribers must have the opportunity to "opt-in" and "opt-out" of the scanning of their emails for spam, the option of checking emails deemed to be spam and the opportunity to decide what sort of "spam" the system checks for;
- Filtering tools should be developed to let users decide which emails they would like to screen - this technology should be installed at their end terminal.

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DLA Piper UK LLP Legal Review 2006 Scotland 91
15.7.3 Screening emails for the purpose of detecting any predetermined content:

The Working Party has concluded that screening emails for unlawful or other predetermined content is not in compliance with article 5 of the e-Privacy Directive.

The Opinion outlines that email providers are prohibited from filtering or interception without the consent of the users or they must be legally authorised to do so by member state legislation.

16. DEFAMATION, PRIVACY AND CONTEMPT

16.1 Defamation

The undoubted highlight of the year was the House of Lords decision in October in Jameel & Anor v Wall Street Journal [2006] UKHL 44. The main issue in the case centred on the application of the Reynolds qualified privilege defence. Since the Reynolds decision, only three publishing defendants had been successful in using the defence. In both the High Court and the Court of Appeal, the Wall Street Journal had been found liable and damages of £40,000 were awarded to the claimant.

There were notable differences between the Lords in the test to be applied under Reynolds, but each disapproved of the strict application of the Reynolds duty and interest test and the non-exhaustive factors. The Lords considered that the publication has to be judged as a whole and that judges should not interfere unnecessarily with editorial judgment. The Lords overturned the Court of Appeal and found against the claimant. Lord Bingham considered that there should be a retrial but was overruled by the majority.

The Former leader of the Scottish Socialist Party, Tommy Sheridan, won his deeply contested libel trial with the News of the World. The newspaper had alleged that Sheridan was an adulterer who had visited swingers' clubs and taken part in orgies. Despite dismissing his legal team and conducting the remaining part of the trial on his own, the Jury found in his favour and Sheridan was awarded £200,000 in damages. One of the key issues in the case appears to be witnesses of the orgies failing to mention Mr Sheridan's thick body hair. The case looks set to continue as the newspaper has pledged to appeal and investigations are continuing as to whether witnesses may have committed perjury during the trial.

The hypnotist Paul McKenna won his libel trial against the Mirror Group after an article alleged that his PhD was bogus. Damages are to be assessed at a later hearing.

In addition, the UK courts have clarified the liability of ISPs for defamatory content published on their networks: see paragraph 32.3.

16.2 Privacy

The European Court of Human Rights finally gave judgment in the long running privacy claim in Wainwright v United Kingdom (26 September 2006). The House of Lords had rejected the Wainwright's claim in 2003 for invasion of privacy. The Wainwright family had been strip searched during a visit to a relative in prison. The court held that article 3 (inhuman and degrading treatment) had not been breached but found that article 8 (protection of physical and moral integrity) had been breached as the harm being protected against was out of proportion to the manner of the searches. The court also held that the House of Lords
decision was a breach of article 13 as the Wainwright's were denied a remedy in their national court. The Wainwrights were awarded €3,000 each in damages.

The Press Complaints Commission ("PCC") upheld a complaint that the report of a pregnancy prior to the 12 week scan without consent from the individual was a significant breach of the PCC Code of Practice. The Independent had published a report revealing the pregnancy of an actress before she had told her family and friends.

Sir Elton John failed with his injunction attempt to prevent publication of photographs taken outside his London home. The photographs showed that Sir Elton was bald and he claimed that this was an invasion of his privacy. Justice Eady held that the photographs did not convey any private information and distinguished the case with that of Naomi Campbell and Von Hannover where the claimants had been successful.

Finally, at the end of the year, the Court of Appeal revisited the balancing exercise between article 8 and article 10 (freedom of expression) in Ash v McKennitt [2006] EWCA Civ 1714 in a judgment that suggests that the English courts may be shifting towards greater protection for the privacy of even public figures. Doubt was cast on recent Court of Appeal authority suggesting that "role models", voluntary or not, had less expectation of privacy (see A v B plc [2003] QB 195) and instead Von Hannover, which required the existence of "special circumstances" before the exposure of public figure's private life could be justified, was followed.

16.3 Contempt

Following the Da Vinci Code copyright infringement case (see Baigent and Leigh v Random House Group Ltd, paragraph 30.1.3), The Lawyer magazine published the judgment of Justice Smith before the judge had officially delivered it to the court. The judgment had been provided in draft to the parties. Once notified of the error, The Lawyer removed the judgment from its website. In a subsequent hearing, Justice Smith held that, whilst there was an argument that The Lawyer was not in contempt of court, journalists ought to be more aware of the law. It was apparent that The Lawyer did not know there was even a law on contempt of court.

17. EMPLOYMENT

17.1 Collective issues

17.1.1 Trade unions and recognition rights

The statutory trade union recognition procedures have now been in force for five years and over 500 recognition requests have been dealt with. However, during the period 2005 to 2006, the Central Arbitration Committee ("CAC") reported a decline of around 30% in the number of applications it received about trade union recognition, continuing the significant downward trend of the previous year.

This year there has been one application for judicial review of a decision of the CAC, the only means by which the CAC's decision can be challenged.

On an application for judicial review by the National Union of Journalists ("NUJ") the Court of Appeal upheld the decision of the High Court that the CAC had correctly taken the view that it had no power to entertain an application by the NUJ for
recognition by Mirror Group Newspapers. Mirror Group had concluded a recognition agreement with the British Association of Journalists (BAJ), which had at most one member in the Mirror Group workforce. It was recognised that this allowed employers in effect to circumvent the statutory recognition provisions by concluding voluntary recognition agreements with unions with no little or no support within the workforce.

\[ R \text{ (on the application of the National Union of Journalists) v CAC} \]

17.1.2 National information and consultation

The Information and Consultation of Employees Regulations 2004 came into force on 6 April 2005, establishing a new right for employees to request that their employer establish information and consultation procedures within the workplace. During 2006, the regulations have had limited impact. At the time of writing, the CAC had received only seven complaints under the Information and Consultation Regulations.

In one such case, the CAC ruled that where an employee representative requested data for the purpose of determining the number of people employed by the employer's undertaking in the UK, the employer was required to disclose more than simply the total number of employees. The representative was entitled to information regarding the establishments, sites and plants that made up the employer's undertaking and the number of employees employed at each of those sites.

\[ \text{Amicus v Macmillan Publishers} \]

At the time of writing, the CAC had received only six requests to pass on to employers requests from employees for the establishment of information and consultation arrangements. However, 2006 did see the first reported judgment of the EAT on the regulations. The EAT held that where the employer relies on multiple agreements constituting a valid pre-existing agreement, each of the agreements relied on had to comply with the requirements of a valid agreement, namely that it is in writing, has been approved by the employees of the undertaking; and clearly sets out how the employer is to give the information to the employees or their representatives and seek their views on such information. The decision also confirms that it is possible for an agreement to be regarded as approved by the employees of the undertaking if it is approved by trade union representatives.

\[ \text{Moray Council v Stewart} \]

17.2 Contracts of employment

In a constructive dismissal case, where a course of conduct culminating in a last straw on the part of the employer was relied upon as amounting to a fundamental breach of the implied term of trust and confidence it was not necessary for each individual incident which made up the course of conduct, or the last straw, to be a breach of contract. The tribunal had to consider whether the course of conduct cumulatively amounted to such a breach. The conduct which was said to constitute the last straw did not need to be unreasonable or blameworthy; however it did have to contribute something to the breach of the implied term.

\[ \text{Barke v Seetec Business Technology Centre Ltd} \]
In another constructive dismissal case, the EAT held that the last straw principle did not apply where the employee had affirmed an earlier breach of contract and there was only one event occurring after the affirmation for the tribunal to consider.

_Gibson & Partners (t/a Blandford House Surgery) v Hughes_

The High Court held that a non-dealing covenant in a solicitor's contract of employment, restricting her for a period of one year after the end of her employment from acting as a solicitor for any person who had been a client of the firm in the previous year, was reasonable and therefore enforceable by her former employer. However, a clause restricting her from practising as a solicitor within a six mile radius of her former employer's offices was unreasonable, having regard to the population within that area, and was thus unenforceable.

_Allan Janes LLP v Johal_

A hotel manager who was required to sleep-over at the hotel several nights each week to cover emergencies such as fire or flood, and was not paid for the hours spent in the hotel during a sleep-over, brought a breach of contract claim for unpaid wages in respect of the sleep-overs. The EAT held that the work being carried out by the hotel manager was sleeping over in the hotel which was required in order to fulfil the hotel's health and safety and fire obligations. He was therefore entitled to be paid for the sleep-over periods.

_Anderson v Jarvis_

The Court of Appeal held that a provision in a Staff Handbook stating "Those employees with two or more years continuous service are entitled to receive an enhanced redundancy payment from the Company", was "apt" to be incorporated into the employee's contract of employment and was in fact incorporated in this case. The enhanced redundancy provisions were clearly phrased in terms of entitlement. The court noted that provision for redundancy is now a widely accepted feature of an employee's remuneration and as such is particularly apt for incorporation in the contract.

_Keeley v Fosroc International Ltd_

In a case concerning discretionary bonuses, the Court of Appeal confirmed that in exercising its discretion, an employer should not act irrationally or perversely, but emphasised that an employee would have a high hurdle to get over to establish that the employer had acted irrationally or perversely. The court further held that section 3 of the Unfair Contract Terms Act 1977 did not apply to a term of the contract relating to remuneration.

_Commerzbank AG v Keen_

In this case, the Outer House of the Court of Session (the Scottish equivalent of the High Court) considered an employer's claim for damages for breach of contract. The court held that it is not sufficient in such cases for an employer to show that the employee had breached the covenants; it must also show that it suffered loss as a result of that breach. The case is interesting as it is rare for covenant cases to reach a full hearing; most are settled or resolved at the injunction stage.

_Dunedin Independent Plc v Welsh_
In this case, the EAT held that in exceptional circumstances there is an implied right for an employer to temporarily transfer employees to do other work, provided the need for the employee to do such work is plainly justified, the work is suitable, the employee offers no detriment in terms of benefits or status and the change is only temporary. However, the EAT stressed that it would be rare that such an implied right arose.

\textit{Luke v Stoke on Trent City Council}

17.3 Discipline and grievance

The statutory dispute resolution procedures have now been in force for over two years, but the figures contained in the Employment Tribunal Service’s annual report for 2005 to 2006 suggest that the procedures have so far failed to achieve their aim of resolving disputes out of court. The number of cases accepted by the tribunal rose by one third to 115,039 in 2005 to 2006. The DTI has announced a major independent review of the procedures. Recommendations for change are expected to be made in Spring 2007.

17.3.1 Grievance

The employment tribunals and the EAT have continued to take a very relaxed approach to what amounts to a statutory grievance letter. The EAT has emphasised that the purpose of the statutory grievance procedure is to give the parties a chance to settle disputes before entering into litigation.

In this case, the EAT stated that the statutory requirements are minimal; all an employee needs to do is set out his or her complaints in writing. It is not necessary to make it clear that it is a grievance, or to invoke the grievance procedure and there is no requirement that every detail of the complaint be set out. It is sufficient if the employer can understand the general nature of the complaint being made.

\textit{Shergold v Fieldway Medical Centre}

In this case, the EAT further held that a grievance does not have to be made in any unduly legalistic or technical manner and set out the general test that the objective of the procedure can fairly be met if the employers, on a fair reading of the statement and having regard to the particular context in which it is made, can be expected to appreciate that the relevant complaint is being raised.

\textit{Canary Wharf Management Ltd v Edebi}

An employee’s written request for flexible working amounted in the circumstances to the presentation of a grievance for the purposes of the statutory grievance procedure, even though the letter itself did not suggest that it was to be regarded as a grievance. In this case, however, the employee had already had an informal request for flexible working turned down. Had there been no prior request, the result might have been different as it would be difficult to characterise a request to change hours, without more, as a “grievance”, since at that stage the employee has no grounds for complaint.

\textit{Commotion Ltd v Rutty}

The EAT has confirmed that an employee cannot rely on statements made in a questionnaire served on the employers, in this case under the Equal Pay Act, as
constituting a step 1 statement of a grievance. The exception to this seems to be a
questionnaire under the Employment Equality (Age) Regulations 2006, which is not
specifically excluded from constituting a grievance. This would appear to be an
oversight.

*Holc-Gale v Makers UK Ltd*

There have been a number of cases this year concerning the operation of the time
limits for bringing tribunal claims. Under the statutory procedure, if an employee
brings a grievance within the three month time limit which applies to most claims in
the employment tribunal, the time limit for bringing the claim is automatically
extended for a further three months.

In this case the EAT held that where the original time limit for presenting a tribunal
claim is automatically extended by three months in accordance with the statutory
grievance procedures, the extended time limit starts on the day after the day the
original time limit ends. Thus an employee whose normal time limit for bringing an
unfair dismissal claim expired on 19 September 2005 had until 20 December to
present a valid claim.

*Singh t/a Rainbow International v Taylor*

In an interesting case, if one of limited practical application, the Employment Appeal
Tribunal has held that time limits are not extended under the statutory dispute
resolution procedures where an employee brings a discrimination claim against
another employee. However, another EAT decision has cast doubt over whether this
case was correctly decided and the issue awaits clarification.

*Bisset v Martins & Castlehill; London Borough of Lambeth v Corlett*

In another case dealing with the time limits for bringing a claim, the EAT said that a
discrimination claim can be admissible even if the claimant has not submitted a
grievance to the employer within four months of the act complained of. Although the
grievance must be submitted within one month of the expiry of the "original time
limit" for bringing the claim, the phrase "original time limit" does not refer simply to
the standard three month time limit, but to that period plus any extension of time
deemed by the tribunal to be just and equitable.

*Bupa Care Homes (BNH) Ltd v Cann*

In two separate cases decided on the same day, the EAT held that for the purposes of
the extension of time, an employee's grievance is to be treated as having been lodged
within the normal time limit even if it is lodged before the effective date of
termination or other date from which time starts to run.

*HM Prison Service v Barua; London Borough of Lewisham v Colbourne*

17.3.2 Disciplinary and dismissal

Helpful guidance on the information that has to be provided by employers under the
statutory dismissals procedure was provided by the EAT in May this year. The EAT
explained that the employer's obligation is as follows: At the first step the employer
merely has to set out in writing the grounds which lead him to contemplate dismissing the employee, together with an invitation to attend a meeting. At that stage the statement need do no more than state the issue in broad terms. The employee simply needs to be told that he is at risk of dismissal and why. It is at the second step that the employer must inform the employee of the basis for the ground or grounds given in the statement. The basis for the grounds are simply the matters which have led the employer to contemplating dismissing. The employee must be given sufficient detail of the case against him to enable him properly to put his side of the story. In a redundancy context that will involve providing information as to both why the employer considers that there is a redundancy situation and also why the employee is being selected.

*Alexander v Bridgen Enterprises Ltd*

In this case the EAT said that if the words of what is put forward as a step 1 letter are ambiguous, or the tribunal are doubtful as to whether they are sufficient, the tribunal are entitled to look at the whole context, including whether the employee knew what the allegations against him were.

*Draper v Mears Limited*

The EAT has shown itself to be very accommodating on the question of what constitutes a grievance, interpreting the law so as to allow the maximum number of claimants access to the tribunal system. However, there are some indications that the courts will be less accommodating when considering whether an internal disciplinary or dismissal procedure could reasonably be said to be continuing, giving rise to an extension of time for presenting a claim. In this case, the EAT held that a solicitor's letter before action seeking a cash settlement of a potential unfair dismissal claim did not raise an internal appeal. The fact that a letter could be viewed as a letter before action did not preclude it from raising an appeal. However, in order to raise an appeal such a letter would generally have to seek reinstatement or re-engagement.

*Piscitelli v Zilli Fish Ltd*

In this case, however, the EAT upheld the tribunal’s decision that an employee who lodged an appeal against dismissal the day before the expiry of the three month time limit for bringing a claim had reasonably believed that an internal dismissal procedure was continuing.

*Codemasters Software Company v Wong*

In this case, the EAT held that dismissal was not automatically unfair where the employer had followed the statutory procedure in full prior to making the decision to dismiss, but had implemented a suspension without pay prior to completing step 1 of the procedure. The dismissal will only be automatically unfair if the statutory procedure has not been followed in relation to the dismissal itself.

*A to B Travel Limited v Kennedy*

The EAT held in this case that a requirement in a contractual disciplinary procedure for an employee to enclose written grounds of appeal in order to appeal a disciplinary decision failed to comply with step 3 of the standard disciplinary procedure. The case
is a warning for employees that even where the disciplinary procedure goes further than the minimum statutory requirements in some respects, the statutory requirements must nevertheless be complied with.

*Masterfoods v Wilson*

The EAT confirms in this case that there is no free-standing right to bring proceedings for breach of the statutory dispute resolution procedures where there is no underlying statutory claim. The employee had insufficient continuous service to bring an unfair dismissal claim.

*Scott-Davies v Redgate Medical Services*

17.4 Equality

17.4.1 Age discrimination

The long-anticipated Employment Equality (Age) Regulations 2006 came into force on 1 October 2006 prohibiting discrimination in employment on the grounds of age. The regulations have been described by the CBI as "the most significant change in employment law in recent years".

The regulations apply to all workers and job applicants. They follow the usual pattern of prohibiting direct and indirect discrimination, harassment and victimisation. An important point to note, which differs from other discrimination legislation, is that direct, as well as indirect, discrimination is capable of objective justification.

The key provisions are:

- The upper age limit for unfair dismissal and redundancy rights has been removed, meaning that people over 65 will now be able to claim unfair dismissal and statutory redundancy payments.

- A new default retirement age of 65 has been imposed so that employees who are forced to retire before that age will be able to claim age discrimination and unfair dismissal. Employers may be able to impose retirement ages of less than 65 but only if this can be objectively justified, which is likely to be only in exceptional circumstances.

- Employees can request to work beyond retirement age (ie 65 in most cases) and employers have a duty to consider the request, however, they do not need to give reasons for refusal.

- Age limits for statutory sick pay, statutory maternity pay, statutory adoption pay and statutory paternity pay have been removed.

- The regulations contain a questionnaire procedure to assist potential claimants with obtaining information from the employer.

At the time of writing there have been no reported employment cases under the new regulations.
See paragraph 38.2 for information about age discrimination and pension schemes.

The legality of the regulations has been challenged by Heyday, a campaigning organisation linked to Age Concern, which has brought an application for judicial review against the government. Heyday alleges that the regulations do not properly implement the European Directive on age discrimination, because they allow employers to keep mandatory retirement ages of 65 or over. The case has been referred to the ECJ and it is unlikely that a decision will be made for another 12 months at least.

*R (on the application of the Incorporated Trustees of the National Council on Ageing (Age Concern, England)) v Secretary of State for Trade and Industry*

In a German case, the ECJ held that a German law providing fixed-term workers aged 52 and over with fewer legal protections than their younger counterparts was unlawfully discriminatory on the ground of age even though Germany had until 2 December 2006 to implement legislation outlawing age discrimination. The case gives importance guidance on what will amount to objective jurisdiction in the context of age discrimination. The ECJ held that, although the challenged law's purpose of making it easier for older workers to get jobs was legitimate, the means adopted to achieve that aim, ie the application of a blanket exclusion from certain legal protections of workers simply on the grounds of age, were not appropriate and necessary.

*Mangold v Helm*

17.4.2 Disability discrimination: cases

There have been few cases this year dealing with the question of what constitutes a disability for the purposes of the DDA, or what evidence the claimant must provide to establish that they have a disability.

In a Spanish case, the ECJ has confirmed that sickness is not the same as disability. The ECJ's approach to the definition of disability is more restrictive than that of UK law, but as Member States are free to go beyond the requirements of European law, the UK definition of disability is unaffected.

*Chacón Navas v Eurest Colectividades SA*

In this case, it was established that a claimant seeking to establish that he or she suffers with a physical impairment for the purposes of the definition of "disability" does not have to show that there is a physical cause for the symptoms experienced, or that he or she suffers with a particular illness.

*Millar v Inland Revenue Commissioners*

The Court of Appeal has held that the fact that a claimant has been awarded disability living allowance by a Social Security Appeals Tribunal is not conclusive of the question whether he or she is disabled for the purposes of the DDA.

*Hill v Clacton Family Trust Limited*
Since October 2004 it has been possible to bring a claim of direct discrimination under the DDA. An EAT case decided earlier this year demonstrates the importance in such cases of identifying the correct comparator. In this case, the employee (W) was a HIV positive careworker who was dismissed by his employer due to concerns about transmission of the disease. As a starting point, the EAT noted that a comparator is a person whose "relevant circumstances including his abilities" are the same as "or not materially different" to those of the claimant. It then clarified that the word "including" meant that the "relevant circumstances" to be imputed to a comparator are wider than just his or her abilities. In this case the tribunal had correctly assumed that the comparator had the same abilities, skills and experience as W. However, it had failed to impute to the comparator an attribute (whether caused by a medical condition or otherwise) which carried the same risk of causing illness or injury to others as W's condition. W had not been treated less favourably on the ground of his disability.

*High Quality Lifestyles Limited v Watts*

A reference has been made to the ECJ on whether a claimant can claim that she had suffered discrimination by association with her son's disability. The claimant alleges that she has been discriminated against on the basis that she is the principal carer for her disabled son. The DDA does not appear to allow such a claim, but her claim is based on the Equal Treatment Framework Directive. The ECJ will have to consider whether the DDA properly implements the Directive. An appeal to the EAT against the decision to refer the case to the ECJ has been rejected. The outcome of this case could have major implications for the scope of disability discrimination law in the UK.

*Coleman v Attridge Law and anor*

There have been a number of important decisions this year regarding the duty on employers to make reasonable adjustments.

The employer failed in its duty to make reasonable adjustments by not providing an interpreter to a deaf employee at a disciplinary hearing. The Court of Appeal also held that an employer can only discriminate against a disabled employee if he treats him or her differently for a reason, present in his mind, that is related to the employee's disability. This case is considered further in unfair dismissal below.

*OCS Group Limited v Taylor*

There have been conflicting EAT decisions regarding whether the duty to make reasonable adjustments extends to consulting the employee about the adjustments which could be made. In one case, an employer's failure to consult with an employee prior to dismissing him on ill health grounds amounted to a failure to make reasonable adjustments.

*Rothwell v Pelikan Hardcopy Scotland Limited*
In another case, however, the EAT held that the duty to make a reasonable adjustment does not extend to consulting a disabled employee about what adjustment might be made.

**Tarbuck v Sainsbury's Supermarkets Limited**

However, in a case decided at the end of 2006, the EAT said that the judgment in *Tarbuck* should be followed when considering whether there is a duty to make reasonable adjustments. The EAT felt that the trigger point for the duty to arise in the case of an employee on long term sick leave is when the employee indicates that she will be returning to work. In this case, the duty had not been triggered by the time the employee resigned. Further, if adjustments will have no practical effect in mitigating the substantial effect on a disabled person of the atmosphere in which she works, there is unlikely to be a breach of the duty to make reasonable adjustments.

**NCH Scotland v McHugh**

The EAT has held that the Disability Discrimination Act 1995 does not, as a matter of law, preclude the obligation to make reasonable adjustments extending to the creation of a new post for the employee where the employee is unable to carry out that existing job.

**Southampton City College v Randall**

In another "reasonable adjustments" case the Court of Appeal considered the proper scope of the arrangements made by or on behalf of an employer in respect of which the duty to make reasonable adjustments arises and who the disabled person should be compared with in determining whether those arrangements placed him at a substantial disadvantage.

**Smith v Churchill Stairlifts plc**

In this case it was held that the DDA does not impose an absolute obligation on an employer to refrain from dismissing an employee who is absent on grounds of ill health due to disability and that an employer may take into account disability related absence in operating a sickness absence procedure, provided it is justified in the circumstances of the case in doing so. However, that this case does not deal with whether not taking into account some, or all, disability-related absences might be regarded as a reasonable adjustment.

**Royal Liverpool Children's NHS Trust v Dunsby**

In a further welcome case for employers concerning disabled employees and sick leave, the EAT held that an employer was not obliged to amend its sick pay policy to give a disabled employee on disability-related long-term sick leave the right to full pay as part of its duty to make reasonable adjustments.

**O'Hanlon v Commissioners of HM Revenue and Customs**
In this case, the EAT considered the four stage progress required to decide if a duty to make reasonable adjustments existed and had been breached. The tribunal failed to identify what it was about the claimant's job which placed her at a substantial disadvantage, or who she was to be compared with. The claimant was unable to do her job on a full or part time basis, therefore there was nothing that could be done to adjust for her and the duty to make reasonable adjustments did not arise. The EAT held that it is not a failure to make a reasonable adjustment to fail to consider whether alternative work is available.

**London Borough of Barnet v Ferguson**

In this case the EAT considered the time limit for bringing a claim under the DDA and held that the Tribunal did not err in considering it just and equitable to extend the time limit where the claimant suffered from a mental illness and, at the time the claim was originally issued, was unwilling to accept that his condition contributed a disability. The EAT also held that a complaint about the discriminatory manner in which an employee conducted a disciplinary procedure which led to dismissal was a complaint about dismissal. Therefore the statutory grievance procedure did not apply and the submission of a written grievance did not extend the time limit for bringing a claim.

**Jones v Department for Constitutional Affairs**

In a case brought under the DDA but with implications for all discrimination claims, the EAT considered the approach which tribunals should value when considering whether an alleged discriminating act extended over a period (a "continuing act") such that it should be treated for time limit purposes as having been done at the end of the period. The EAT held that the tribunal should look at the substance of the complaint and ask whether the employer was responsible for a continuing state of affairs or ongoing situation where the protected group in question (e.g. disabled persons) are treated less favourably. It is not necessary for there to be evidence of a policy, practice or regime giving rise to the continuing act.

**Pugh v National Assembly for Wales**

17.4.3 Disability Discrimination Act 2005

The remaining provisions of the Disability Discrimination Act 2005, which impose a positive duty on public bodies to promote equality of opportunity, came into force on 4 December 2006.

17.4.4 Equal pay

Equal pay has been one of the most important areas of employment case law in 2006. The number of equal pay complaints submitted to the employment tribunal in 2005-2006 more than doubled, largely due to a number of high-profile multi-party public sector claims.

The UK government estimates that around 36% of UK employees are remunerated according to a pay system based on length of service. Such systems may come under attack as potentially discriminatory not only on grounds of age, but on the grounds that they indirectly discriminate against women. However, in a surprising decision
this year, the ECJ has ruled that employers do not have to provide specific objective justification for using length of service as a criterion to determine pay, even where to do so is indirectly discriminatory against women. The requirement to provide objective justification only arises where the employee raises serious doubts as to the appropriateness of rewarding experience in this way, having regard to the particular job in question.

_Cadman v HSE_

There are currently conflicting authorities at EAT level regarding the approach to defending equal pay claims. The European approach requires that a difference in pay has to be objectively justified whereas the domestic approach is simply to require the employer to be able to account for the difference by reference to a factor which is material but is not the sex of the employee. This is unless the factor relied upon by the employer is one which may itself indirectly discriminate against female employees, in which case the factor has to be objectively justified. In a decision in 2005 the EAT departed from the traditional domestic approach and followed European case law when it held that the genuine material factor defence requires justification by objective criteria in all cases, even where there is no presumption of sex discrimination.

_Sharp v Caledonia Group Services Ltd_

In June this year, however the EAT declined to follow _Sharp_ and re-asserted the traditional domestic approach. _Sharp_ was settled in June and will now not be going to the Court of Appeal, meaning that the uncertainty remains.

_Villalba v Merrill Lynch_

The Court of Session has upheld the EAT's decision that an employer was entitled to make a pro rata reduction in an employee's annual bonus in respect of the period when she was absent from work on maternity leave. The court held that such a reduction did not amount to sex discrimination as section 6(6) of the Sex Discrimination Act 1975 operates to remove claims related to pay from the Act's scope.

_Hoyland v Asda Stores Ltd_

This year also saw the end of one strand of the ongoing part-time workers pension cases. In a case which significantly limits the number of claims which will be able to continue, the House of Lords held that, where there has been a TUPE transfer, the six month time limit under the Equal Pay Act for bringing a claim against a transferor concerning the operation of an equality clause relating to an occupational pension scheme begins to run from the date of the transfer rather than from the end of the employee's employment with the transferee.

_Powerhouse Retail Ltd v Burroughs_
The Court of Appeal held that female ancillary workers employed at a hospital in Newcastle could not compare themselves for equal pay purposes with male ancillary workers employed at another hospital within the same NHS Trust, even though all the workers in question were employed by the Trust. The Trust could not be regarded as a "single source" to which the differences in pay could be attributed, which was responsible for the inequality and which could restore equal treatment. The Trust had not assumed responsibility for the terms and conditions of all the employees.

*Armstrong and ors v Newcastle upon Tyne Hospital Trust*

In one of the long-running multiple party claims against a public body in the North East, the EAT has confirmed that claimants could compare themselves for equal pay purposes with comparators who had been rated at a lower grade under a job evaluation scheme. The EAT further held that where an employer has successfully demonstrated that a difference in pay is due to a genuine material factor which is not the difference in sex, the fact that the employer could have introduced a scheme to equalise the pay of the claimants and the comparators is irrelevant. Further, it is irrelevant that the disparity in pay has continued over a long period provided the genuine material factor continued to apply for the whole of that period.

*Redcar and Cleveland Borough Council v Bainbridge and ors*

17.4.5 Gender reassignment

This year there has been one reported case under the gender reassignment provisions of the Sex Discrimination Act 1975. The case has important implications for discrimination cases generally because of the comments of the Court of Appeal relating to the burden of proof. The Court of Appeal criticised the employers' argument that it was for the claimant to identify particular projects to which she should have been assigned. Once the burden of proof had shifted, it was for the employers to produce a detailed analysis of the projects and proposals to which the claimant was not assigned, and their failure to do so meant that they had not rebutted the case against them.

*EB v BA*

17.4.6 Race discrimination

In a race discrimination claim decided in July this year, the EAT has given further guidance on how tribunals should approach the burden of proof in race and other discrimination cases. The EAT considered whether the employer is entitled to put forward at stage 1 of the two-stage burden of proof test evidence that undermines the claimant's arguments that he or she has a prima facie case of discrimination. The EAT held that there is a distinction between an employer's explanation for allegedly discriminatory treatment and facts put forward by the employer to counter or put in context the claimant's evidence. The tribunal is entitled to consider evidence put forward by the employer at the first stage of the test.

*Laing v Manchester City Council*
The Court of Appeal has reserved the controversial decision of the EAT that a member of the British National Party who was dismissed from a job working with people of Asian origin was able to rely on the principle that a person can succeed with a direct race discrimination claim where he or she has been treated less favourably on the ground of another person's race.

*Redfearn v Serco Ltd t/a West Yorkshire Transport Service*

In this case the EAT considered the scope of the protection of victimisation provisions under the Race Relations Act. The EAT held that if an employee gives information to her employer about a colleague's complaint of discrimination she can be said to have done a protected act for the purposes of a victimisation claim, even though she neither identified any evidence or discrimination nor made any specific allegations of discrimination.

*National Probation Service v Kirby*

In this case, the Court of Appeal considered the operation of the time limit for bringing a race discrimination claim where it is alleged that the discrimination was extending over a period. The claimant made a number of allegations of discrimination in relation to the investigation of and conduct of disciplinary proceedings. The Court held that there does not need to be a discriminatory policy, rule, practice, scheme or regime in order for there to be an act extending over a period. The acts considered may be different in nature but constitute a continuing state of affairs in which discrimination occurs.

*Lyfar v Brighton and Sussex University Hospitals Trust*

17.4.7 Sex discrimination

This year saw the first authoritative judgment to hold that a manager can be liable personally to pay compensation not only for acts of discrimination or harassment which she herself commits, but also for aiding acts of discrimination carried out by other employees.

*Gilbank v Miles*

For the purposes of compensation for sex discrimination, an employee who was constructively dismissed while on maternity leave had to be placed in the position she would have been in had her employer not discriminated against her. In the present case, the employee would have been made redundant shortly after returning from maternity leave and the tribunal found she would have rejected an offer of suitable alternative employment. Consequently, she was only entitled to pay in lieu of notice not redundancy pay.

*Brash-Hall v Getty Images Limited*
An employment agency which failed to undertake a risk assessment in relation to a pregnant woman as requested by a prospective employer with the result that she did not gain employment with that employer discriminated against her on the grounds of sex.

*Brocklebank v Silveira*

A decision of the European Court of Human Rights found that refusal to pay a post-operative male to female transsexual her state pension from age 60, the retirement age for women, on the ground that she had to wait until 65, the then pension age for men, was a violation of her right to respect her private and family life under article 8 of the European Convention on Human Rights. This case is now of mainly historical interest as the Gender Recognition Act 2004 permits a person who has undergone gender reassignment to apply for a certificate which permits the acquired gender to be recognised as the person’s gender for all purposes.

*Grant v United Kingdom*

In one of a number of cases this year dealing with the employment status of ministers of religion, the House of Lords has concluded that an associate minister of the Church of Scotland was an employee of the church and, as such, could bring a claim for sex discrimination.

*Percy v Church of Scotland Board of National Mission*

In a decision which is now of mainly historical importance due to the impact of the new age discrimination regulations, the House of Lords held that the upper age limit barring persons over the "normal retiring age" or the statutory default age of 65 from bringing tribunal claims for unfair dismissal and redundancy payments is not indirectly discriminatory against men.

*Secretary of State for Trade and Industry v Rutherford*

17.4.8 Sexual orientation discrimination

This year there have been very few reported cases under the Equality of Employment (Sexual Orientation) Regulations 2003. There were only fourteen successful cases under the regulations before the employment tribunals in the period 2005-2006.

In this case the tribunal upheld two employees’ complaints of direct discrimination, harassment and automatic unfair dismissal and in relation to one claimant applied an uplift of 50% in relation to all sums awarded, including injury to feelings, in recognition of the employer’s complete failure to follow the statutory dismissal procedures.

*Norris and Robertson v Lambert*

A tribunal held that a gay employee dismissed by his employer after a male colleague alleged that he had performed a lewd sexual act in the work gym was not treated less favourably on the grounds of his sexual orientation. He was dismissed because the employer genuinely and legitimately believed him to be guilty of the alleged misconduct, but the manner of investigation of the allegation did amount to
discrimination. On appeal, the EAT criticised the tribunal for making findings on the basis of a case not put forward by the claimant and the case has been remitted to a tribunal for re-hearing.

*Lewis v HSBC*

17.4.9 Religion or belief discrimination

The number of religion or belief discrimination complaints presented to the employment tribunals continues to grow, albeit slowly. A total of 486 complaints were presented in 2005-2006, but of these only nine were successful.

This year saw the first appellate case under the Equality of Employment (Religion and Belief) Regulations 2003. The EAT considered the correct approach to the application of the burden of proof in religion and belief discrimination cases. The case concerned a claim of direct discrimination arising from dismissal. The EAT held that once the claimant has proved primary facts from which an inference of unlawful discrimination could be drawn, then the burden shifts to the employer to provide an explanation untainted by religious belief. A distinction must be drawn between facts and explanation as the explanation cannot be taken into account at the first stage of the burden of proof test.

*Mohmed v West Coast Trains Limited*

17.4.10 Part-time working

A decision of the House of Lords has broadened the scope for bringing claims under the Part Time Workers Regulations. Part-time work claims are conditional on both the part-time and full-time worker being "engaged in the same or broadly similar work having regard, where relevant, to whether they have a similar level of qualification, skills and experience. The House of Lords held that in determining whether full-time and part-time workers are doing "the same or broadly similar" work, the focus should be on the similarities, not the differences, since it is almost inevitable that there will be some differences. Particular weight should be given to the extent to which their work is exactly the same and to the importance of that work to the enterprise as a whole.

*Matthews v Kent & Medway Towns Fire Authority*

Another part-time workers case this year considered the issue of the entitlement of part-time workers to public holidays. The EAT held that a part-time worker had not been treated less favourably than a full-time worker on the ground that he did not receive time off in lieu of public holidays which fell on days he did not work. The treatment he received was not due to the fact that he worked part time, but due to his employer's policy that employees could only benefit from public holidays which fell on their normal working days. However, it is likely that the effect of this case is limited to its particular facts as the employer operated a call centre which operated seven days a week. Full-time employees working five of those seven days were just as likely to lose out on time off for public holidays as those working part-time.

*McMenemy v Capita Business Services Limited*
17.4.11 Fixed-term working

10 July 2006 was an important date for employers who employ employees on successive fixed-term contracts. The Fixed-Term Employees (Prevention of Less Favourable Treatment) Regulations 2002, which came into force in July 2002, prevent employers placing employees on successive fixed-term contracts without objective justification. If an employee is employed under a fixed-term contract and the contract has been renewed or if an employee was previously employed on another fixed-term contract, he or she will be regarded as a permanent employee as soon as he or she has been continuously employed for four years. Service prior to 10 July 2002 does not count for these purposes. Therefore, the earliest an employee could achieve permanent status was 10 July 2006.

A European case this year considered the directive which led to the introduction of the UK regulations. The ECJ held that the purpose of the directive is to prevent employees hired on a series of fixed term contracts from being deprived of the protection offered to those hired on indefinite contracts. The ECJ held that the Greek implementing legislation, which states that only contracts separated by a period of time of 20 days or less are covered by the directive, runs contrary to this objective. The ECJ also held that the Greek legislation was contrary to the directive in that it prohibited conversion of fixed term public sector contracts into indefinite contracts.

*Adeneler and ors v Ellinikos Organismos Galaktos*

In this case, the EAT held that where an employee on a fixed term contract is dismissed prior to the expiry of the fixed term but on appeal the dismissal is overturned, the appeal does no more than reinstate the original fixed term. If the term has expired, the successful appeal does not extend the fixed term beyond its original expiry date.

*Prakash v Wolverhampton City Council*

17.5 Employment status

There have been a number of cases this year dealing with the important question of employment status.

It is an established principle that mutuality of obligation (the requirement to provide or pay for work on the one hand and the obligation to perform it on the other) is the irreducible minimum of a contract of employment, without which the contract cannot exist. In this case, the EAT reiterated this principle and stated that it is not sufficient for there to be an absence of an obligation on the employer to provide work, there must also be an absence of an obligation on the employee to accept work when it is offered to him. In this case, the proper construction of the contract was that if work was available it must be offered, and that when work was offered the individual had to undertake it unless he had a very good reason not to. Therefore, the individual was an employee.

*Wilson v Circular Distributors Limited*

In another case concerning mutuality of obligation, the Court of Appeal held that the fact that a contract is not of indefinite duration is no bar to mutuality of obligation. A home tutor worked for the local authority for 10 years. The council was not under any contractual...
obligation to offer pupils to her, and she was under no obligation to accept. Once she had agreed to take on the work, however, she was obliged to fulfil her commitment to that pupil and the council was obliged to continue to provide work until the particular engagement ceased. The court held that during each period of work, there was an obligation on the claimant to teach and on the council to pay and that that was all that was legally necessary to support the finding that each individual teaching assignment was a contract of service. It was accepted that the times between each contract were “temporary cessations of work” within the meaning of section 212 of the Employment Rights Act, which meant that the employee's employment was continuous.

**Cornwall County Council v Prater**

However, in another case the EAT effectively circumvented the requirement for mutuality of obligation in circumstances in which the employer was required to offer the claimant 100 days work per year, but the claimant was entitled to decline any assignment offered provided he acted in good faith. The EAT considered that the fact that the claimant did not have an unfettered right to turn down work meant that the mutuality of obligation was present.

**ABC News Intercontinental Inc v Gizbert**

A similar approach has been taken in determining whether an individual is a worker for the purposes, for example, of the Working Time Regulations. The broader definition of worker goes beyond covering an employee working under a contract of service and includes any individual working under any other contract where the individual undertakes to do or perform personally any work or services for another party to the contract (ie a contract for services). The EAT has held that in this case too there must be an irreducible minimum of mutual obligation.

**Younis v Trans Global Projects Limited**

However, in this case a different division of the EAT concluded that in order to demonstrate worker status there is no necessity to show mutuality of obligation. The position remains unclear pending a decision of the Court of Appeal.

**Cotswold Developments Construction Limited v Williams**

In an important case on the employment status of agency workers, the EAT considered the 2005 cases of *Dacas v Brook Street* and *Cable and Wireless v Muscat* and held that the tribunal had been entitled to find that an agency worker supplied to the Council for five years was not employed by the Council, rejecting the suggestion of Lord Justice Sedley in the Court of Appeal in *Dacas* that the passage of time alone could lead to the inference of a contract of employment between an agency worker and the end user. The EAT gave useful guidance as the circumstances in which a tribunal should find an implied contract of employment between the agency and worker and end user.

**James v Greenwich Council**

The EAT further considered the requirements necessary to establish worker status in another case concerning holiday pay. The EAT held that the fact that an individual performs services personally is not sufficient to make that individual a worker. The individual in question had business accounts prepared and submitted to the Inland Revenue, he was free to work for others, he was paid at a rate which included an allowance for overheads and he was not paid if
he did not work. The EAT concluded that the individual was carrying on business on a self-employed basis and was not entitled to holiday pay. The fact that the work was performed by him personally was irrelevant.

*Bacica v Muir*

The EAT held that a tribunal was wrong to conclude that a 50% shareholder and director of a company could not be an employee on the basis that joint control of the company was not consistent with employment status. The fact that an individual acts as an employer does not prevent them being an employee.

*Gladwell v Secretary of State for Trade and Industry*

17.6 Employment tribunals

In March 2006, the Employment Tribunal Service joined the Department for Constitutional Affairs and became part of the new Tribunals Service Agency.

The Employment Tribunal Rules of Procedure 2004, which have been fully in force since last year, continue to generate EAT decisions which emphasise that claims should not be thrown out because of failure to comply with technical requirements due to error.

In this case, the employer's response to a claimant's application to the tribunal was rejected by the tribunal secretary because it had not been presented on the prescribed form. The size of the boxes on the form used meant that the tribunal was unable to scan the form onto its system. The EAT held that the secretary's rejection of the response was a decision which was capable of review and which could also be appealed. However, parties should be discouraged from appealing against a procedural error when that error can be corrected by a review.

*Butlins Skyline v Benyon*

In this case, the EAT allowed a claim to proceed notwithstanding that the claimant's address had not been included in the claim form as required by the 2004 rules. The EAT said that it is important to appreciate that the rules are simply a procedural vehicle to enable important statutory claims to be advanced before a tribunal. The chairman ought to have asked himself whether the omission of the claimant's address was (i) a relevant omission and (ii) a material omission. In this case, as the claimant had included her representative's address, it was neither. In both respects the chairman must have regard to the overriding objective.

*Hamling v Coxlease School Ltd*

The EAT has confirmed that the 2004 rules do not give a tribunal power to set aside a notice of withdrawal of proceedings. The claimant would, however, be free to commence new proceedings arising from the same facts assuming such proceedings could be commenced within the relevant time limits.

*Khan v Heywood and Middleton Primary Care Trust*

The EAT upheld a tribunal's decision to overturn a costs order for £5,500 made against an employer which failed to enter a response to the claimant's application to the tribunal. The
EAT held that the tribunal has power to make an order for costs against or in favour of a respondent who has not put in a response or whose response has not been accepted only in relation to the conduct of any part of the proceedings in which the respondent has been permitted to participate.

Sutton v The Ranch Ltd

There have been a number of important cases this year dealing with the geographical extent of employees' rights under the Employment Rights Act 1996. The long-running case Serco v Lawson finally reached the House of Lords, conjoined with two other cases on the same point. The House of Lords agreed with the Court of Appeal that the standard or normal application of the unfair dismissal rules was to an employee working in Great Britain. However, the House of Lords went on to say that the "employment in Great Britain" test should be treated as a general principle rather than a firm rule. The application of the unfair dismissal rules should now depend upon whether the employee in question was actually working in Great Britain at the time of dismissal, rather than upon what was contemplated when the contract of employment was entered into. Ordinarily the question should simply be whether he is working in Great Britain at the time when he is dismissed.

Serco v Lawson

The House of Lords went on to say that in the case of peripatetic employees, who, owing to the nature of their work, did not perform services in one particular territory, the base of such an employee should be treated as the place of employment.

Crofts and ors v Veta Ltd

In the case of expatriate employees, the House of Lords stated that it would be unusual for an employee who works and is based abroad to come within the scope of British unfair dismissal rights, but that expatriate employees would be protected in certain circumstances. The two examples given were, firstly, an employee posted abroad by a British employer for the purposes of a business carried on in Great Britain - for example, a foreign correspondent on the staff of a British newspaper and, secondly, an expatriate employee of a British employer who is operating within what amounts for practical purposes to an extra-territorial British enclave in a foreign country. There may be other qualifying situations, but in order to come within the scope of the Employment Rights Act employees would need to show "equally strong connections with Great Britain and British employment law".

Botham v Ministry of Defence

Whilst providing some welcome clarification, the House of Lords decision in Serco v Lawson left considerable scope for further litigation on this question. In a case decided after Serco v Lawson, the EAT held that a Scottish employee living in Thailand, employed by a Singaporean subsidiary of a Swedish company, working on an oil rig operated by a Scottish company situated in Far Eastern waters, could not claim unfair dismissal in the UK.

Anderson v Stena Drilling

A decision of the Court of Appeal should mean the end to the practice of employees bringing wrongful dismissal claims in the tribunal then heading off to the High Court to recover the excess damages over the £25,000 the tribunal is permitted to award. The Court of Appeal held that, even where the employee expressly reserves the right to bring further proceedings
in the High Court if successful in the tribunal, the effect of the tribunal's decision on the issue of wrongful dismissal extinguishes the cause of action so that it cannot be re-litigated in the High Court.

_Fraser v HLMAD Limited_

17.7 Family friendly rights

17.7.1 Cases

This year saw the first reported decision of the EAT to consider the right to request flexible working. In this case, the employee's informal request to alter her full-time working hours to a three-day week was rejected by the employers and her formal written application was refused as well. The EAT held that the tribunal must examine the evidence as to the circumstances surrounding the situation to which the application gave rise. In doing so, the tribunal are entitled to enquire into what would have been the effect of granting the application. In this case, the employment tribunal was entitled to find that the evidence did not support the employer's assertion that allowing the claimant to work a three-day week would have had a detrimental effect on performance.

_Commotion Ltd v Rutty_

In this case the EAT held that an employer discriminated against a pregnant woman on the grounds of her sex by moving her to a lower paid job for reasons other than health and safety. A balancing exercise is required, weighing the health and safety reasons for a maternity suspension against the discriminatory effect of restricting the right of a woman to carry out her normal job.

_New Southern Railway Limited v Quinn_

17.7.2 Work and Families Act 2006

The Work and Families Act came into force in October 2006. The Act provides a framework of new rights relating to maternity and adoption leave and pay with much of the detail being provided by regulations.

Under regulations now in force under the Act, with effect for women with an expected week of childbirth on or after 1 April 2007:

- all employed women are entitled to 12 months' maternity leave regardless of length of service;
- the period of maternity pay has been extended from six to nine months (and to 12 months by the end of this Parliament);
- mothers will have to give eight weeks' notice of their return from maternity leave;
- there will be improved contact between mothers and employers including "keeping in touch days" when the employee can attend work without losing leave or pay rights;
statutory maternity pay can begin on the same day as the employee's maternity leave commences, rather than on the following Sunday as is currently the case; and

changes have been made to the administration of statutory maternity pay to make it easier for employers to pay through payroll.

The Act also envisages that:

- from April 2007, the right to request flexible working will be extended to carers of adults; and

- from 2009/2010, fathers will have an entitlement to a maximum of six months' paternity leave, with some paternity pay at the flat rate if the mother returns to work without taking her full maternity pay entitlement.

The DTI has confirmed that the definition of "carer" for the purposes of the extension of the right to request flexible working will be an employee with 26 or more weeks' service who is, or expects to be, caring for someone over the age of 18 who:

- is a spouse or civil partner;

- is a near relative; or

- lives at the same address as the employee.

The regulations regarding extension of the right to request flexible working and paternity leave are not yet in force.

17.8 National Minimum Wage

On 1 October 2006 the following changes were made to the National Minimum Wage:

- the adult rate was increased from £5.05 to £5.35 per hour;

- the youth rate, for workers aged 18 to 21, was increased from £4.25 to £4.45 per hour; and

- the rate for workers aged 16 and 17 was increased from £3.00 to £3.30 per hour.

The EAT has held that an employer who provided accommodation for his workers paid them less than the national minimum age because he had incorrectly included a fortnightly charge for utilities in his calculation of their wages. This charge could not be counted towards the workers' earnings for the purposes of meeting the requirements of the national minimum wage legislation.

*Revenue and Customs Commissioners v Leisure Employment Services Ltd*
The EAT has held that it is necessary to take "on-call" time into account when assessing whether an employee had been paid the national minimum wage. See further reference to this case in the Working Time section below.

MacCartney v Oversley House Management

17.9 Negligence and psychiatric injury

In perhaps the most widely reported case of the year, the High Court awarded an employee £800,000 after she successfully brought a claim against her employers in negligence and under the Protection from Harassment Act 1997, alleging that she had suffered harassment and bullying by her fellow employees for whom the employer was vicariously liable.

Green v DB Group Services (UK) Limited

The Court of Appeal has found that an employer can be liable for an employee's suicide following a serious accident at work, thereby enabling the widow to make a successful claim under the Fatal Accidents Act 1976 for the loss of her financial support. The Court of Appeal held that once an employer was found to be liable for an employee's depression, the question is whether it was the depression which caused the employee to commit suicide. In this case it clearly was, and therefore the employer was also responsible for the suicide. The Court said that it was only necessary to show that the psychiatric harm in the form of depression, and not the suicide itself, was reasonably foreseeable at the time of the accident.

Corr v IBC Vehicles

An employer which imposed a significant workload on an employee, who suffered three breakdowns as a consequence, was found to be liable for the psychiatric harm caused. The High Court found that the psychiatric harm was reasonably foreseeable having regard to the nature and extent of the employee's work and that the employer was in breach of its duty to provide a safe workplace by failing to take steps to cover absent employees.

Garrod v North Devon NHS Primary Care Trust

An employer could not be expected to foresee that an employee who had suffered two episodes of post-natal depression was more vulnerable to depression brought on by work-related stress. Despite this, however, once the employee had complained for several months about her excessive workload, had been found in tears by the employer, and had provided a written account of her problems, the employer's failure to take appropriate steps to prevent psychiatric injury did amount to negligence.

Daw v Intel Corporation Ltd
The Court of Appeal declined to overturn a county court judgment that an employee's psychiatric injury had not been caused by work-related stress and said that, even if it had been, the injury had not been reasonably foreseeable by the employer. The employee had not complained about stress to her line manager or to her GP, the work itself was not stressful, the employee had volunteered to work on her days off and there had been no change in her behaviour or appearance suggesting that she was finding it difficult to cope. Further, the fact that there had been a breach of the Working Time Regulations did not of itself establish a breach of duty; it was only a factor to be considered when looking at the picture as a whole.

*Pakenham-Walsh v Connell Residential (private Unlimited Company) and another*

In a further case which considered the impact of the Working Time Regulations in cases of psychiatric injury, the High Court held that a breach of the duty to ensure that an employee does not exceed a 48 hour working week cannot itself result in damages. This is because there is a specific enforcement regime for the regulations.

*Sayers v Cambridgeshire County Council*

17.10 Termination of employment

17.10.1 Redundancy

Legislation

The DTI has issued new regulations, which make a minor change to the law on collective redundancy consultation, following the ECJ's decision in the case of *Junk v Kuhnel*. Under the Collective Redundancies (Amendment) Regulations 2006, employers must notify the Secretary of State of collective redundancies before giving notice to terminate contracts of employment rather than simply before termination takes effect.

Cases

The EAT has found that while compliance with the information and consultation obligations under section 188 of the Trade Union and Labour Relations (Consolidation) Act 1992 does not have an unlimited shelf life, on the facts of this particular case, the employees' claim that the employer's initial compliance with section 188 in January 2003 could not be relied on by the time the redundancy dismissals actually took place in November 2004, should be dismissed.

*Vauxhall Motors Ltd v TGWU*

An EAT case highlights the fact that employees who move away from the safety of their current role to take on a new challenge might make themselves vulnerable to redundancy if their new venture does not take off. The EAT said that the fact that an employer fails to offer the employee the opportunity to return to their previous role does not necessarily make the dismissal unfair.

*Hachette Filipacchi UK Ltd v Johnson*

The Court of Appeal has overturned the decision made by the EAT to reduce a protective award. It said that the tribunal had correctly applied the guidance in the
case of *Susie Radin Ltd v GMB and others* and its decision to award 20 days pay was not perverse.

**Leicestershire County Council v Unison**

The EAT held that where a protective award is made for failure to collectively consult, only those employees who are the subject of the award may enforce it. Where the claim for the protective award was brought by a recognised trade union, only employees in respect of whom the union was recognised could enforce it. Other employees would have to bring a separate claim either individually or via elected employee representatives. Leave to appeal to the Court of Appeal has been given.

**TGWU v Brauer Coley**

The EAT held that where the employees who were the subject of a protective award remained in employment throughout the protected period (but were subsequently made redundant) the amount of the protective award should not be reduced to take account of the remuneration they received during that period. This case emphasises the punitive nature of the protective award.

**Cranswick County Foods Plc v Beall**

17.10.2 Unfair dismissal

Legislation

The Employment Rights (Increase of Limits) Order 2006 provides that with regard to dismissals post 1 February 2007:

- the maximum compensatory award for unfair dismissal will increase from £58,400 to £60,600; and
- the maximum weekly pay will increase from £290 to £310 (therefore the maximum basic award/statutory redundancy payment will be £9,300).

Cases

The Court of Session has found that an employer had acted unreasonably in taking an expired written warning into account when deciding to dismiss an employee by reason of misconduct. The dismissal was therefore unfair. Even if the warning had not expired the employer may still have acted unreasonably in dismissing the employee as the warning was not a final written warning, thereby failing to convey how seriously the employer viewed the breach or that the consequence of a further breach would be the employee's dismissal.

**Diosynth Ltd v Thomson**

The EAT has considered a case concerning two joiners who were dismissed for using their employer's equipment during their employer's time to work for someone else. They lied about it when confronted and were subsequently dismissed. They complained of unfair dismissal on the basis that previously the employer had not dismissed another employee who had been caught doing the same thing. The EAT
said that it was reasonable for the employer to take into account that the employees in question had lied and continued to do so and only had three years service. The other employee, however, had not lied about his offence and had 30 years good service with the company. The dismissals were not, therefore, unfair.

**Enterprise Liverpool plc v Baress**

The Court of Appeal has held that an employer who had dismissed employees for refusing to sign new contacts containing potentially unenforceable restrictive covenants could rely on "some other substantial reason" as a potentially fair reason for dismissal. However, it said it was then necessary to proceed to the second stage and consider whether the employer had acted reasonably in dismissing the employees. If the covenant is arguably unenforceable, there will be greater need for a tribunal to consider other factors relating to fairness, such as whether the employer gave the employees time and opportunity to consider the covenant and take legal advice.

**Willow Oak Developments Ltd t/a Windsor Recruitment v Silverwood and others**

The Court of Appeal has held that a deaf employee had been fairly dismissed by his employer despite the employer's failure to provide him with an interpreter at a disciplinary hearing. The Court found that he had been given sufficient opportunity to defend allegations of misconduct against him at the subsequent appeal hearing. Employers should note, however, that the disciplinary hearing in this case took place prior to the introduction of the statutory disciplinary and dismissal procedures. These require a disciplinary hearing to be conducted in such a way that both employer and employee can explain their cases. A failure by the employer to facilitate this means that any subsequent dismissal would be automatically unfair. It is not clear whether that unfairness can be subsequently rectified by the appeal held at the third stage of the statutory procedures.

**OCS Group Ltd v Taylor**

In two cases looking at the issue of whether there was a potentially fair reason for dismissal, the EAT has found that even where an employee has been involved in misconduct that could justify a dismissal, a tribunal is entitled to conclude that the misconduct reason put forward for an employee's dismissal is not the true one and that, therefore, an employee had not been dismissed for one of the potentially fair reasons set out in the Employment Rights Act 1996.

**ASLEF v Brady; East Lancs Coachbuilders v Hilton**

The EAT found on the particular facts of this case that, as a matter of public interest, a claimant could not use secretly obtained recordings of the private deliberations of the school governors as evidence in tribunal proceedings. However, the secret recordings of the open parts of the hearings could be used as evidence as it was always intended that written minutes would be made of these in any event. However, it is important to note that the EAT said that in discrimination cases where the private deliberations of a panel contained the only evidence of discrimination, public interest might require that the recordings could be used.

**Chairman and Governors of Amwell View School v Dogherty**

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**Excellence through know-how**
The EAT agreed with the tribunal that a simple assertion by the employer that re-engagement was not practicable because of a breakdown in trust and confidence between the employer and the employee, was not enough to prevent an order of re-engagement being made. The tribunal had weighed up the relevant factors including the practical difficulties of a former employee returning to the workplace and fitting in with colleagues and management and decided that re-engagement should be ordered.

*Johnson Matthey plc v Watters*

The EAT has held that procedural flaws did not render an employee's dismissal unfair where, in the circumstances, she would have been dismissed in any event. Where a tribunal was minded to find that a dismissal was unfair for procedural reasons alone it was open to the employer to show that, on the balance of probabilities, compliance with a fair procedure would have made no difference. The tribunal had to be satisfied that it could fairly and properly determine what would have happened if there had been no procedural flaw. Where the employer could discharge the burden of proving that the procedural failings made no difference to the outcome, and the procedural defects did not infringe the statutory procedures, the dismissal would not be unfair.

*Kelly-Madden v Manor Surgery*

The Court of Appeal has held that in an unfair dismissal case the tribunal may make a "Polkey" deduction on the basis that employment would have terminated fairly in any event even where its assessment of whether employment would have terminated fairly is speculative. However, the reasons for that decision and the factors relied on must be fully stated.

*Scope v Thornett*

The EAT has confirmed that an employer can still fairly dismiss an employee for ill-health capability despite the fact that the employee's illness (in this case stress-related) is attributable to the conduct of the employer. However, the cause of the employee's incapability is a relevant factor for the tribunal to consider when deciding whether the dismissal is fair in all the circumstances.

*Royal Bank of Scotland v McAdie*

17.10.3 Compromise agreements

The Court of Appeal has found that a clause in an agreement requiring the recipient of a settlement sum to repay it in the event of "any breach" was unenforceable as a penalty. It held that the sum due to be repaid was "extravagant and unconscionable" compared with the potential loss arising from the breach.

*CMC Group plc and others v Zhang.* See, further, paragraph 6.13.2.
17.11 Transfer of undertakings

17.11.1 Legislation

On 6 April 2006, the Transfer of Undertakings (Protection of Employment) Regulations 2006 finally came into force. The main provisions of the regulations are:

- a widening of the scope of the regulations to cover cases where services are outsourced, insourced or assigned by a client to a new contractor;
- a new duty on the old (transferor) employer to supply information about the transferring employees to the new (transferee) employer, including details of the identities of the employees and of the rights and liabilities which will transfer;
- special provisions making it easier for insolvent business to be transferred to new employers (see paragraph 43.2);
- provisions which clarify the circumstances under which it is unfair for employers to dismiss employees for reasons connected with a relevant transfer.

17.11.2 Cases

The House of Lords has applied the ruling made by the ECJ last year that a transfer of an undertaking cannot take place over a period of time. It must take place on a specific date, regardless of any agreement between the parties to the contrary. The date of the transfer will be a question of fact in each case.

*Celtec v Astley*

The EAT has held, in what appears to be the first case on this issue, that the punitive principles behind protective awards made in collective redundancy cases also apply when assessing compensation for a failure to consult in connection with a transfer of an undertaking. In contrast to the case-law relating to awards made in collective redundancy situations, however, the EAT said that, in its view, so long as the awards' principal punitive aim is recognised, regard could be given to the actual loss that a claimant has suffered as a result of the failure to consult.

*Sweetin v Coral Racing*

The ECJ has held that the rights and obligations arising from a collective agreement, governing an employee's contract of employment at the time of a transfer, do transfer to the new employer, even if it is not party to the collective agreement. However, the new employer does not have to observe the terms of a collective agreement entered into after the transfer has taken place.

*Werhof v Freeway Traffic Systems GmbH and Co KG*
The EAT upheld the tribunal's finding that the transfer of an undertaking was the sole or principal reason for the dismissal of the employees, notwithstanding that there had been a period of nearly two years between the transfer and the dismissals. It had always been the employer's intention to harmonise terms and conditions and the dismissals were the employer's method of achieving that. The EAT also said that the principle established in the case of *Berriman v Delabole Slate Ltd* (that for the purposes of the ETO defence "changes in the workforce" mean changes in the numbers or job functions of the employees) remained good law.

*London Metropolitan University v Sackur*

17.12 Unlawful deductions

In this case, the EAT held that the time limit for bringing a claim for unlawful deductions from wages ran from the date of payment of the wages containing the shortfall where the claim was for underpayment. The EAT identified three types of unauthorised deductions: a straightforward deduction, a payment alleged to be a shortfall of what is actually due and a complete non-payment. In the case of a complete non-payment, time begins to run when the contractual obligation to make a payment arises. In the other two cases, time begins to run when the payment is made.

*Arora v Rockwell Automations Ltd*

17.13 Vicarious liability

The House of Lords has upheld last year's Court of Appeal's decision and found that an employer can be vicariously liable for harassment caused by an employee in the course of his employment under the Protection from Harassment Act 1997. The House of Lords held that unless a statute expressly or impliedly indicates otherwise, the principle of vicariously liability applies.

*Majrowski v Guy's and St Thomas's NHS Trust*

The principle of vicarious liability was also discussed in the *Green v DB Bank* case above.

17.14 Whistleblowing

The Court of Appeal, declining to follow its earlier decision in *Fadipe v Reed Nursing Personnel*, decided that an employment tribunal does have jurisdiction to hear a complaint by an ex-employee who claims to have suffered a post-employment detriment for having made a protected disclosure. The Court of Appeal decided that the relevant provisions in the Employment Rights Act 1996 protect a worker from victimisation and a worker who blows the whistle should be protected from victimisation whenever that occurs.

*Woodward v Abbey National Plc*
The Court of Appeal, upholding the EAT decision, found that a teacher who had resigned after being given a written warning for hacking into his school's computer system to demonstrate its vulnerability had not been subjected to a detriment or unfairly dismissed contrary to the whistleblowing provisions in the Employment Rights Act 1996. The Court of Appeal held that "disclosure" was a common word and Parliament had not given some special meaning to the word. It therefore agreed with the EAT that the teacher had been disciplined for misconduct and not for making a protected disclosure.

*Bolton School v Evans*

The EAT upheld the tribunal's decision to strike out a whistleblowing claim on the basis that it was misconceived as it had no reasonable prospects of success. The facts did not disclose that the employer was "likely to fail to comply" with any legal obligation under section 43(B)(1)(b). Applying previous case-law the EAT said that the word "likely" meant more than a possibility. The fact that the employer "could" have breached its obligations was not enough to constitute a qualifying disclosure for the purposes of section 43(B).

*Kraus v Penna Plc*

The EAT, overturning the tribunal (which found that the burden of proving that an employee's disclosure was not made in good faith was neutral), has confirmed that the burden of proof lies with the employer.

*Bachnak v Emerging Markets Partnership (Europe) Ltd*

17.15 Working time

The government is consulting on a proposal to increase holiday entitlement from 20 days to 28 days. The Work and Families Act 2006 contains the enabling power for the government to increase holiday entitlement. The proposal is for entitlement to increase by four days from 1 October 2007 and the remaining entitlement to come into force by 1 October 2009.

In the most important case on working time this year, the European Court of Justice has found that the UK has failed to adopt the measures necessary to give workers their right to daily and weekly rest. It has held that the DTI guidance, which fleshes out the provisions of the Working Time Regulations, breaches the Working Time Directive by informing employers that while they must make sure that workers can take their rest, they are not under an obligation to make sure that they do so. This decision has led to a change in the DTI guidance and means that UK employers who will now have to ensure they have policies in place to ensure their staff take the breaks they are entitled to.

*Commission v United Kingdom*

Following the Advocate General's opinion last year, the ECJ has now handed down judgment on the issue of rolled-up holiday pay. It has held that holiday pay arrangements under which workers receive holiday pay as part of their contractual hourly or weekly rates breach European law and cannot be lawful in any circumstances. However, if the arrangements are transparent and comprehensible, it is possible to set off sums already paid against payment due for specific leave actually taken by a worker.

*Robinson-Steele v RD Retail Services Ltd; Caulfield and others v Hanson Clay Products Ltd*
Following the above case, the Court of Appeal has remitted a rolled-up holiday pay case to the tribunal for re-hearing. However, the court did not give any guidance to the tribunal on how to interpret the set-off aspects of the ECJ's decision meaning that uncertainty on this issue remains.

*Clarke v Frank Staddon*

As reported last year, the Court of Appeal's decision on the issue of entitlement to holiday pay while on long-term sick leave has been appealed to the House of Lords. The House of Lords has now referred this issue to the ECJ.

*HM Revenue and Customs v Stringer (formerly Commissioners of Inland Revenue v Ainsworth)*

The ECJ has given a judgment in a Dutch case allowing for the possibility of carrying over any unused minimum annual leave to the following year. This is not currently permitted in UK law which states that a worker's annual leave “may only be taken in the leave year in respect of which it is due”. The effect of this judgment therefore remains to be seen.

*Federatie Nederlandse Vakbeweging v Staat der Nederlanden*

The ECJ has made it clear that it is settled law that that on-call duty performed by a worker where he or she is required to be physically present at the employer's premises is "working time" and that all time spent on-call must be taken into account in calculating a worker's daily and weekly work levels.

*Dellas v Prime Minister*

In line with previous decisions of the ECJ, the EAT has held that time spent by a care worker on-call did amount to "working time" for the purposes of the Working Time Regulations 1998, even though her employer had provided her with a home at her place of work. The EAT found that it was particularly relevant that the worker was required by her employer to remain at or within a very short distance of her home, that she had to be available to take calls and attend emergencies, that she was never off duty and that she was obliged to have her mobile phone with her at all times. The EAT also held that the employer had failed to provide the worker with sufficient rest breaks, saying that it was not sufficient for the employer to leave the worker to take such rest as she could during her working time. The worker should have been allowed an uninterrupted period of 20 minutes and she must have known at the outset of the break that it was to be such.

*MacCartney v Oversley House Management*

The EAT has found that the fact that an individual performed work personally was not sufficient to make him a "worker" under the Working Time Regulations 1998 and thus he was not entitled to claim holiday pay. Factors such as the individual working under an industry scheme governing the self-employed, having business accounts which were prepared and submitted to the Inland Revenue and being free to work for other people were all clear indicators that the individual was self-employed.

*Bacica v Muir*
The claimants were paid, in addition to basic pay, shift pay, the calculation of which had been agreed in a collective agreement. The shift pay was not paid in respect of periods of holiday and was discounted by 4/52 and paid proportionately over 52 weeks. The claimants argued that this reduction meant that their pay during holidays was not at the rate of a week's pay for each week of leave, in accordance with the Working Time Regulations, and was therefore in breach. The Court of Appeal disagreed: BA was entitled to apply the reduction and were not in breach of the regulations. The claimants received the same pay whether they were on holiday or at work and were, therefore, no worse off as a result of taking holiday.

*British Airways Plc v Noble*

In a case which concerned holiday pay under annual hours contracts, the EAT held that the employees had agreed to be rostered to work for 1,930 hours in exchange for an agreed annual salary. Those hours were spread throughout the year by way of an annual roster. The periods of 22 or 24 days' holiday to which they were entitled were "within" the 1,930 hours. There was no entitlement to be paid holiday pay, in a sum representing 22 or 24 days' pay, over and above the annual salary.

*Cook v C2C Rail Ltd*

18. **ENVIRONMENT**

18.1 Climate change

2006 was a moderately eventful year in terms of the steps being taken to combat the increasingly accepted threat of climate change.

At the international level, slow steps were taken at the meeting in Nairobi for the twelfth annual conference of the parties to the UNFCCC and the second meeting of the parties to the Kyoto Protocol (COP/MOP2) towards providing for the continuance of the Kyoto Protocol after 2012. Important moves were also taken at state and regional level in the United States in terms of action against climate change. Rules were issued for the operation of the Regional Emissions Trading Scheme in the North East of the United States which was established in 2005, and in California Governor Schwarzenegger signed into law a Climate Change Action Bill which will require the State, which has the fifth largest economy in the world, to reduce its Greenhouse gas emissions to 1990 levels by 2020 and 80% below 1990 levels by 2050.

In the EU, as Phase 1 of the EU Emissions Trading Scheme ("EUETS") draws to an end, preparations were being made for Phase 2. In November, the EU Commission cut down the allocations of nine member states in the draft National Allocation Plans which they had submitted to the Commission. Only the UK cap was approved. This action by the Commission was seen as an attempt to restore the credibility of the EUETS for Phase 2, against the background of the collapse of the price of carbon credits which occurred in May and which was attributed to the over-generous allocations of emission rights in Phase 1.

In the UK, the major event was perhaps the issue of the report of the Stern Committee at the end of October 2006 to coincide with the Nairobi COP/MOP2. The Committee's review accordingly achieved a considerable media success, in the US and China, as well as the UK. The report is one of the first significant reports to make a serious attempt at questioning the potential impact of climate change and the costs of abatement/mitigation.
The report described climate change as "The greatest and widest ranging market failure ever seen." It offered a simultaneously gloomy and optimistic message. On the basis of scientific work carried out by the International Panel on Climate Change, it argued that the high costs of stabilising greenhouse gas concentrations at 450 ppm of CO₂ equivalent, which would be needed to limit the rise of Global Mean Surface Temperature ("GMST") to 2°C by the end of the century in accordance with EU goals, is now almost out of reach.

The report then argued that "Business as Usual" would risk a 5°C rise in GMST, which would cost between 5% and 20% of global consumption and lead to a massive down-turn in the global economy. However, it said that prompt action taken now and sustained long-term could achieve stabilisation of greenhouse gas concentrations at between 500-550 ppm of CO₂ equivalent at a cost of only 1% of global GDP. This would offer at least a chance of holding the rise in GMST to 2°C by the end of the century. The report suggested that costs might be even lower if major gains in efficiency, or additional benefits, eg a reduction in the costs of air pollution and resulting health effects, are taken into account.

The significance of the Stern Review is not that it adds any certainty to the debate about Climate Change. It is essentially relying on IPCC scenarios to which considerable uncertainty attaches. The importance is the costing of the scenarios. The report reinforces the case for action on the basis of the Precautionary Principle.

The report has been criticised, and not merely by climate change sceptics. One well known environmental economist suggested that the review had over-estimated both the cost impacts of climate change and the costs of abatement/mitigation by 100%. However, even if allowance is made for the report's figures overstating the case to this extent, it would still appear that there is a strong argument for emission reduction measures.

In terms of practical measures, the Review called for: the broadening of the EUETS and for links to other trading schemes; greatly increased spending on R&D for low-carbon technologies; increased regulation through building and appliance standards; and increased information and education of the public. The review thus placed considerable emphasis on a long-term approach and the need to induce behavioural change in business and among the public at large.

The report has given considerable impetus to UK government policy on climate change.

The UK government wants to exceed its Kyoto commitment of a 12.5% reduction in greenhouse gases from 1990 levels by 2012 and to get closer to achieving its voluntary target of a 20% reduction in UK CO₂ emissions by 2010. Its stated goal is to cut UK CO₂ emissions by 60% by 2060, having achieved real progress (of the order of 30%) by 2020.

At the time of publication of the Stern Review, the Environment Secretary, David Miliband gave a commitment to introduce a Climate Change Bill which would give statutory effect to those long-term goals. It would also establish an independent Carbon Committee to identify means of reducing emissions across the economy, and provide new statutory powers to enforce emissions reduction measures.

It seems clear that effective action to reduce emissions will need to involve wider areas of business than those subject to EUETS, and include the public sector, other non-energy-intensive businesses, and even private individuals.
In November, DEFRA published a consultation paper. This sought views on proposals for an action-based mandatory emissions trading scheme (the Energy Performance Commitment or "EPC"). It also discussed a system of voluntary benchmarking and reporting, longer-term changes to business regulation, enhanced information and advice to business, and industry-led agreements to reduce emissions.

The proposed EPC would apply to businesses if their total annual consumption, measured by mandatory half-yearly electricity meters, exceeded 3,000 MWh. This would include many businesses whose energy use was intensive, but emissions covered by the EUETS would be excluded, as would organisations with more than 25% of their energy use subject to Climate Change Agreements. It is thought likely that the scheme will apply to businesses with a typical electricity bill in excess of £15,000 and will affect around 5,000 organisations.

The government is also looking into the feasibility of tradeable personal carbon allowances with carbon credits issued to the population. These would have to be surrendered on the purchase of energy fuel or transport, and those who needed or wanted to emit more than their allowances would have to purchase allowances from those consuming less.

For further information see http://www.defra.gov.uk/environment/climatechange/index.htm.

18.2 Contaminated land

18.2.1 New regulations and guidance

On 4 August 2006, a package of statutory instruments and guidance came into force in England, which modified and extended the statutory regime for the identification and remediation of contaminated land under Part IIA Environmental Protection Act 1990.

The main change was to extend the scope of the regime to cover land contaminated by radioactive material other than that due to natural causes. The necessary modifications to the statutory provisions were made by the Radioactive Contaminated Land Regulations 2005 (SI 2005/3467) the Radioactive Contaminated Land (Modification of Enactments) (England) Regulations 2006 (SI 2006/1379) and the Contaminated Land (England Regulations 2006 (SI 2006/1380). A new circular, DEFRA Circular 01/2006 describes the new regime and contains the statutory guidance for its application.

A further statutory instrument, the Clear Neighbourhood and Environment Act 2005 (Commencement No2) (England) Order 2006 (SI 2006/1361) brings into force in England section 104 of the Clean Neighbourhood and Environment Act 2005. This amends the provisions under Part IIA in respect of appeals against remediation notices, so that where a notice is served on or after 4 August 2006, the appeal lies to the Secretary of State rather than to the Magistrates Court.

The effect of this is that such appeals will be dealt with under similar procedures to those which apply to planning appeals and a number of other types of appeal under environmental statutes.

Similar provision has been made in Wales by a corresponding package which came into effect on 10 December 2006.
18.2.2 Liability

This year saw an important High Court case on the issue of liability under Part IIA Environmental Protection Act 1990.

That case involved a site in Bawtry that had been used as a gas works by the East Midlands Gas Board from 1915 until the 1950s. Thereafter it was purchased and redeveloped for residential use. In 2001 residents found a tar pit (tar is a by-product of gas production), which led to the site being designated as "contaminated land" under Part IIA and the Environment Agency ("Agency") undertaking remediation. In seeking to recover its remediation costs, the Agency identified two possible responsible persons, one of the residential developers, as a knowing permitter, and National Grid plc ("Transco"), as the statutory successor to the person who caused the contamination. Unfortunately for Transco, the site developer could not be found, which meant that complete responsibility for the clean-up cost was imposed on Transco.

Transco applied for judicial review of the Agency's decision on the grounds that it had not caused the contamination and therefore was not an appropriate person, as that term is defined in Part IIA. Transco argued they should not be held responsible for the actions of its statutory predecessor because Transco was a separate legal entity and because the gas transfer schemes under which it assumed responsibility for its statutory predecessor's activities did not transfer any potential or contingent liabilities that arose as a result of change in legislation after the transfer (ie the introduction of Part IIA of the Act).

The High Court dismissed Transco's objections, finding that responsibility for the remediation of contamination should rest with the polluter as compared to innocent owners/occupiers, except when that polluter could not be found. In this case the court held that the polluter had been found in the guise of Transco as the statutory successor to the Gas Board who had actually caused the pollution. The court determined that there was a chain of statutes that clearly demonstrated continuity between Transco and its predecessors, with the gas transfer scheme strongly suggesting that there should be a transfer of all liabilities between the companies. This meant that statutory transfer scheme did not merely have the effect of transferring actual liabilities as at the date of the scheme but also the potential liability which might crystallise in future as a result of regulatory action under Part IIA. Estimates are that Transco could face costs in the region of £1bn to remediate all of the sites contaminated by its predecessors.

Although this decision has been appealed by Transco to the House of Lords, it sends a clear and strong message to privatised entities that they can (and will) be held liable for the environmental legacy of the activities of their state-owned predecessors.

R (on the application of National Grid Plc) v Environment Agency

18.2.3 Soil thematic strategy and proposal for Framework Directive on the protection of soil

In October 2006, the European Commission agreed a thematic strategy for the protection of soil against erosion, contamination, salination, compaction, loss of biodiversity, sealing, declining organic matter, landslides and flooding.
The Commission also agreed a proposal for a framework directive for the protection of soil. Much of this proposal is concerned with the remediation of contaminated land. It contains requirements for member states to set up an inventory of contaminated sites, for the identification of sites where potentially soil polluting activities have taken place, and for the remediation of contaminated land. There are also more general measures aimed at requiring precautions to be taken against adverse effects on soil function, the identification of areas at risk, and programmes of measures for risk reduction.

The contaminated land provisions are, at first sight, not dissimilar to those contained in the UK legislation on contaminated land in Part II A EPA 1990. However, the provisions in the directive are more prescriptive and will not be capable of being diluted by administrative guidance in the same way. They contain specific targets for the assessment of identified sites and a requirement for site owners to draw up soil status reports on the sale of land which must be made available to prospective buyers and the competent authorities.


18.3 Producer responsibility

18.3.1 Implementation of the WEEE and RoHS Directives

The Waste Electrical and Electronic Equipment Regulations 2006 (SI 2006/3289 ("WEEE Regulations") came into force on 2 January 2007. They implement the Waste Electrical and Electronic Equipment Directive ("WEEE Directive"). The WEEE Directive aims at preventing waste electrical and electronic equipment from being consigned to the domestic waste stream and then landfill. It requires member states to ensure that consumers can return household waste equipment falling within the categories subject to the WEEE Directive free of charge to retailers or designated collection facilities, and to impose producer responsibility obligations on manufacturers and importers to finance the costs of collection, treatment, recovery and disposal. The scope of the producer responsibility obligations also extends to equipment used for business purposes. Member states are required to achieve targets for the recycling of WEEE, and disposal and recycling of WEEE must take place at authorised treatment facilities, which must meet specified operating standards.

A companion directive, the RoHS Directive, which aims at reducing the environmental risks of landfilling WEEE by banning (subject to certain exceptions) the use of certain hazardous substances, including lead and other heavy metals, in electrical and electronic equipment came into force on 1 July 2006.

Under the WEEE Regulations, "Producers" of relevant electrical and electronic equipment based in the UK will have to join an approved compliance scheme by 15 March 2007 and the main producer responsibility obligations will come into effect on 1 April of that year. Compliance schemes will be responsible for registering producers with the Environment Agency or the Scottish Environment Protection Agency and for supplying the data required to prove compliance. The first compliance period would then run until 31 December and subsequent compliance periods will be calendar years. There are likely to be separate compliance schemes for business and household WEEE, and producers of both types of equipment will be allowed to register with more than one scheme. Distributors will be able to choose
whether to provide an in-store take-back facility for customers purchasing similar items or items for similar use, or whether to join a local distributor take-back scheme which provides a local facility for the discarding of consumer WEEE.

In respect of electrical and electronic equipment designed exclusively for business purposes which is placed on the market on or after 13 August 2005, or equipment in that category placed on the market before that date which is replaced by equivalent new equipment supplied by a producer registered in the UK, the effect of the legislation will be to transfer collection, treatment and recovery and/or disposal costs from the end-user to the schemes (and thus to their members). However, the legislation allows producers to make agreement with end-users to make alternative arrangements. This is appropriate because businesses normally expect to meet the cost of disposing of their waste. Those who are "Producers" of electrical or electronic equipment should therefore ensure that as far as possible they have contractual arrangements in place to ensure that they do not bear responsibility for those costs. In respect of all other WEEE, the business end-user who is discarding it will have to meet the costs of collection, treatment, recovery and disposal in any event.

Businesses exporting electrical and electronic equipment to other member states will already have had to take the provisions of the directive into account, because the directive was implemented in most other member states in August last year. However, in most cases the equipment will have been sold via an importer established in that member state who is likely (depending on the local laws) to have stepped into the producer's shoes for the purposes of registration and other compliance requirements.


18.3.2 Consultation on changes to the Packaging Waste Regulations

In August 2006 DEFRA published a consultation paper on joint proposals by DEFRA itself, the Scottish Executive and the Welsh Assembly Government for new Producer Responsibility Obligations (Packaging Waste) Regulations to replace the existing 2005 regulations. The proposals involved a number of comparatively minor technical changes to the regulations together with proposals to allow for electronic packaging waste recovery notes and packaging waste export recovery notes. There were also proposals for increases in the Agencies' fees to pay for further development of the National Packaging Waste Database. The changes will be incorporated in a new consolidation of the regulations.

Please see http://www.defra.gov.uk/corporate/consult/packaging_reg06/index.htm

18.3.3 Permitting review in England and Wales and possible changes to the environmental enforcement regime

The government has been consulting this year on proposed changes to the environmental permitting system in England and Wales which would involve the
amalgamation of Pollution Prevention and Control ("PPC") and Waste Management Licensing. Two consultation papers have been issued by DEFRA, one in March, and another in September. The September consultation took into account responses to the earlier consultation, and also incorporates draft regulations and a partial regulatory impact assessment.

Instead of two separate legal regimes for PPC and waste management licensing, there would be a single regime divided into three tiers, bespoke permits, standard rules permits and registered exemptions.

The proposal is being put forward as a deregulatory measure and the government estimates that the amalgamation of the two regimes and other parts of the package will save regulators and industry more than £89m over 10 years.

The impact of the proposals will probably be greater at the lower end of the regulatory spectrum. It should be emphasised that the proposal is only concerned with the domestic enforcement legislation in England and Wales. Much of the existing legislation implements EU directives and the requirements of these directives cannot be affected. Hence there will be little change for installations subject to Integrated Pollution Prevention and Control ("IPPC"), as these installations will require bespoke permits. However, the proposals will significantly reduce the need for those currently holding PPC permits to hold a separate waste management licence for activities on the same site which for technical reasons do not form part of the PPC installation, as operators will be able to apply for a single site permit. At the lower end of the scale, in the case of activities exempt from waste management licensing, the need for prior inspection for registration of the exemption (and the corresponding fee) is likely to be removed. The proposal for standard binding rules (which will effectively amount to new legislation) for specific types of activity will enable many operators to apply (at significantly reduced cost) for a permit containing standard permit requirements. These requirements may not be varied, though they may be supplemented by additional conditions.

Effectively, the proposal will extend the legislation relating to PPC permits, particularly the procedural aspects, to cover activities previously subject to waste management licensing. One consequence of this is that the "due diligence" defence which has previously been available under Part II Environmental Protection Act 1990 for activities subject to waste management licensing, but not under the PPC Regulations, will no longer be available. The practical consequence of this will not be very great, as the defence is difficult to establish and rarely successful, but its abolition will mean that the operator will not be able to defend a charge of breaching a condition of a permit on the basis that the breach was due to the default of a junior employee which could not reasonably have been anticipated and in circumstances where the employee had been properly trained etc.

There will be some modifications to the PPC legislation adopted for the new regime, including provision for the deemed withdrawal of applications if the regulator considers the operator has failed to supply additional information. Under the latest proposals, this will, however, be subject to a right of appeal.

The new regime will not create a complete "one-stop shop" for operators because control of water discharges (save to the extent already covered by IPPC) and radioactive substances control will remain separate, though they could be added to
the new regime later. However, the regime represents a significant move in England and Wales from the current hotchpotch of environmental permitting legislation to a more systematic approach.

It is anticipated that the new regime will come into force in April 2008, but existing permit holders will not have to apply for new permits, as existing permits will be deemed to have been granted under the new regime.

The consultation closed on 6 December 2006.

In a parallel development, DEFRA published in mid-October in review of environmental enforcement in England and Wales. This followed work with a rather broader scope carried out by the Hampton Review of regulatory practices and the Macrory Review carried out for the Better Regulation Executive within the Cabinet Office.

The Review suggested that enforcement sanctions need to be broadened to make environmental enforcement more effective and flexible and echoed the Macrory Review in calling for a system of administrative penalties. Under this system, which is common on the Continent but not widely used here outside the competition sphere, the regulator can, instead of prosecuting an environmental offender in the courts, impose a financial penalty which, if unpaid, is automatically recoverable as a debt if not challenged. Offenders may, however, be able to challenge, on limited grounds, the basis of the decision or the amount of the penalty either before the courts or before a specialist tribunal. A similar system now applies in the UK as regards the EU Emissions Trading Scheme.

The DEFRA review suggested a variable system of penalties, with fixed penalties for minor breaches and tailor-made penalties to pay for remediation costs or eliminate any profits made from non-compliance. Penalties would be supplemented by a wider range of enforcement orders requiring positive remediation to be carried out. Regulators would also have power to serve various forms or stop-notice, failure to comply with which would a serious offence.

In future, however, criminal prosecutions would generally be reserved for more serious offences and for repeat offenders.

For further information see [http://www.defra.gov.uk/](http://www.defra.gov.uk/).

18.4 Waste

18.4.1 Landfill Directive: retrospective effect on contracts

Article 10 of Directive 1999/21/EC on the Landfill of Waste requires member states to take measures to ensure that all of the costs involved in the setting up and operation of a landfill site, including the costs of the financial security required by the directive and estimated closure and aftercare costs shall be covered in the price charged by the operator for the disposal of waste on the site. That provision is reflected in provisions of the Landfill (England and Wales) Regulations 2002, which require the Environment Agency to incorporate a corresponding condition in permits for landfills. The High Court has held in [3C Waste Ltd v Mersey Waste Holdings Ltd and Merseyside Waste Disposal Authority](http://www.defra.gov.uk/) [2006] EWHC 2598 that the effect of such
a condition is to render it unlawful, with retrospective effect, for an existing contract for the disposal of waste in a landfill to provide for charges which did not reflect all the costs referred to in article 10. Accordingly the imposition of the condition triggered a force majeure clause in the contract which suspended the parties' obligations pending agreement of new pricing arrangements which reflected the requirements of the Directive. This decision sharply illustrates the far-reaching effect of the policy behind the Directive that those consigning waste to landfill should be required to meet all the environmental costs of landfills and that operators should have ready access to the funds required to ensure that all their environmental responsibilities are properly discharged.

18.4.2 New Environment Agency policy on financial provision for landfills

On 31 January 2006 the Environment Agency issued a new policy and guidance on financial provision for landfills.

It has long been a requirement for operators of landfills in this country to provide financial security for the fulfilment of the requirements of conditions of their licence in permits, including provisions for restoration and aftercare of the landfill after cessation of landfiling operations. This requirement was imposed under the waste management licensing regime in the UK, and became an EU-wide requirement under the 1999 Landfill Directive, though member states are permitted to exempt inert landfills from the requirement. "Landfill Financial Provision", as it is called, has up till now normally been required to be made either by way of a bond issued by a bank or insurance company, or by way of an escrow account into which a proportion of gate receipts are paid. The requirement can be onerous, particularly for the operators of landfills which are not operated as a public facility, but merely to receive waste generated by a particular business, and which do not receive an income in the form of gate fees. Escrow funds can tie up cash flow for such operators, and bonds can be costly.

The new policy and guidance issued by the Environment Agency eases the burden for some of these "Non-merchant" operators by permitting them to make financial provision by way of a bond issued by the operator's parent company in certain circumstances. Effectively this bond operates as a parent company guarantee. The new policy and guidance permits financial provision for landfills to be made in this way if the parent company operates a diverse business, the security of the bond is similar to that offered by a bank or insurance company, and the assets of the guarantor bear a high ratio to guaranteed liabilities.

The new policy, which also requires financial provision to be made available to operators, rather than directly to the Agency, has been applied on an optional basis to applications for landfill permits from 1 February 2006, and will apply to all applications after 31 March 2007. For further information, see the Environment Agency website on http://www.environment-agency.gov.uk/.

18.4.3 Mining Waste Directive

In May 2006 the EU adopted the Management of Waste from Extractive Industries Directive (2006/21/EC) which member states have until 1 May 2008 to implement.
The directive was a response at European level to a number of major incidents involving mining waste including a cyanide spill into the Danube in Romania and a damburst which poisoned the environment of a National Park in Spain.

The directive covers the management and waste directly arising from the prospecting, extraction, treatment and storage of mineral resources and the working of quarries.

The operation of facilities for such wastes will require a permit, and the requirements of permits will be similar to those currently imposed in the EU in respect of landfills of waste generally (mineral waste has up till now generally benefited from an exemption from the normal regime applicable to waste under the Waste Framework Directive, and in consequence also from the specific rules applicable to landfills). There will be requirements on the location of facilities, requirements for a management plan competent staff and conditions to minimise environmental pollution and damage to land. There will be obligations in respect of closure rehabilitation and aftercare and operators will have to provide financial security to ensure that the obligations are discharged.

The management of extractive waste will be an activity giving rise to strict liability under the Environmental Liability Directive. This means that the operator will be responsible for making good environmental damage resulting from his activity, without it being necessary to prove that the damage was attributable to specific fault on his part.

In addition certain facilities, Category A facilities, which pose a major accident hazard, will be subject to provisions similar to those contained in the COMAH Regulations as regards sites to which those regulations apply. This will require the drawing up of major accident prevention policies and safety management systems, together with internal and off-site emergency plans.

The UK has yet to propose legislation to implement the directive, but it seems likely that this will involve the extension of the Pollution Prevention and Control Regime to activities involving mining waste, and additionally an element of HSE involvement, particularly in relation to Category A facilities.

18.4.4 Revision of Waste Framework Directive

On 12 October 2006 DEFRA published a consultation paper on the revision of the Waste Framework Directive (2006/12/EC). This is a proposal by the EU Commission which is proceeding through the European Institutions. The proposal will also involve the repeal of the Waste Oils Directive and the repeal and integration into the new directive of the Hazardous Waste Directive.

The proposal is not likely to involve radical changes to the regime or the fundamental definition of "waste". However it is likely that when the new measure is adopted it will include a measure of de-regulation to encourage the beneficial use of waste streams. This will involve subordinate measures adopted at EU level to recognise the full recovery of waste where there are adequate environmental safeguards. These could require the waste derived products to comply with protocols, such as the existing WRAP Quality Protocol in the UK for aggregates which are of waste origin. The benefit of this will be that waste derived products which meet the requirements...
of the Protocol will be deemed fully recovered, will no longer be "waste", and can be marketed without that stigma.

The consultation closed on 5 January 2007.

For further information, see http://www.defra.gov.uk/corporate/consult/waste-directive/index.htm.

18.5 REACH

On 18 December 2006, the European Parliament and the Council adopted the regulation on the Registration Evaluation Authorisation and Restriction of Chemicals (EC No. 1907/2006), ("REACH"). This regulation, which takes up 849 pages in the Official Journal, is the result of almost a decade of negotiations between EU institutions.

It is intended to ensure that manufacturers, importers and, to a lesser extent, downstream users, do not place on the market substances that would be a risk to health and safety or the environment unless at least basic health and safety testing has been carried out and appropriate health and safety data provided. Effectively, the onus will rest on them to show that their products can be used safely. The Regulation covers existing as well as new substances and is thought to affect some 30,000 substances used in everyday products.

A "substance" is defined as a chemical element and its compounds in the natural state or obtained by any manufacturing process, and the scope of the regulation will be considerably wider than merely covering "Chemicals", as that expression might be understood by ordinary members of the public. However, there are derogations for a number of categories of substances subject to other legal regimes, such as radioactive substances, waste, medicinal products for human or veterinary use, and food products. There are also a number of exemptions for common substances, the properties of which are well known, such as sugar, limestone and soy bean oil. REACH will apply to substances imported, manufactured or placed in the product in the EU in quantities greater than one tonne per annum.

As the name of the Regulation implies, it provides for the "Registration" and "Evaluation" of substances and, in the certain cases, the making of their marketing and use subject to "Authorisation" and "Restriction".

Substances which do not benefit from an exemption will need to be registered over an 11-year period. Registration will be effected with a new European Chemicals Agency to be based in Helsinki. A system of prioritisation will apply, with the more basic substances and those marketed in higher volumes needing to be registered first.

A controversy which held up agreement on the legislation was over the issue of requirements to replace the most basic substances with safer alternatives. Under the final compromise, dangerous substances will need to be replaced by an alternative, if such exists and is available at reasonable cost. If no such alternative is currently available, the responsible manufacturer or importer will need to produce a substitutions plan or an R&D programme with a view to replacing dangerous substances.

The legislation will come into effect on 1 June 2007 and an immediate concern is that it seems doubtful whether the package of guidance to assist businesses with compliance will be available until after that date. See http://www.hse.gov.uk/chemicals/reach.htm for further information.
19. FINANCIAL REPORTING

19.1 ICAEW: new Code of Ethics

The Institute of Chartered Accountants in England and Wales ("ICAEW") has adopted a new enforceable Code of Ethics (http://www.icaew.co.uk/index.cfm?route=136679). This is based on the International Federation of Accountants’ Code of Ethics and provides practical guidance for chartered accountants on the principles based (as opposed to rules based) approach to the application of ethical principles in their working practice.

The new Code came into effect on 1 September 2006.

19.2 ICAEW: guidance on inclusion of auditor's reports in prospectuses

In April 2006, the ICAEW issued a technical release (AAF 02/06) "Identifying and managing certain risks arising from the inclusion of reports from auditors and accountants in prospectuses (and certain other investment circulars)” aimed at accountants who prepare reports for prospectuses and other investment circulars, and auditors whose audit reports are included or referred to in these documents. The guidance highlights that:

19.2.1 whilst auditor's consent to the inclusion of the audit report in an investment circular is not always necessary, where consent is needed it arguably can extend the auditor's responsibility beyond that reflected in the audit. Questions have arisen as to whether the auditor should insist on additional clarificatory responsibility language (over and above that already in the audit report itself) as a condition for giving consent. The ICAEW's view is that additional clarificatory language is not desirable, provided that auditors (i) limit their consent to the inclusion of the audit report, (ii) clarify when consenting the specific purpose for which consent is given, and (iii) consider and follow SIR (Statement of Investment Reporting Standards) 1000 in terms of the form and context in which the audit report appears;

19.2.2 special purpose reports are prepared in the context of the particular investment (unlike an audit report). The guidance contains illustrative language for reporting accountants to include in their report to clarify the particular special purpose for which it is prepared to avoid them giving consent for its inclusion in the investment circular in a manner which is inconsistent with their report; and

19.2.3 the inclusion of a person as an addressee of a report can affect responsibility assumed by the reporting accountant. To evaluate such risks, the ICAEW recommend that accountants should consider, amongst other things, why the person has asked for the report to be addressed to it and the role that person will undertake in relation to the circular/transaction. Where reporting accountants do agree to address a report to a particular person, they should make clear in their engagement letter (that "the responsibility assumed to the addressee is in respect of the addressee's own responsibility to others arising from the contents of the report included in the investment circular, and not in respect of any profit/claim that the addressee may have incurred.

http://www.icaew.co.uk/index.cfm?route=135510
19.3 Disclosure of audit/non-audit fees

The Companies (Disclosure of Auditor Remuneration) Regulations 2005 require companies to disclose remuneration receivable by their auditors (and their auditors’ associates) for audit and other non-audit work for financial periods commencing on or after 1 October 2005 (hence the first disclosures are now being seen in accounts prepared reflecting the new rules).

In October 2006, the ICAEW published "TECH 04/06 Disclosure of Auditor Remuneration" (http://www.icaew.co.uk/index.cfm?route=142622) containing guidance on such disclosures. In broad terms, the guidance clarifies that the regulations preserve the requirement for all companies to disclose auditors’ remuneration for audit services (although there are some differences of drafting which affect amounts disclosed in some cases). In relation to non-audit services, more extensive disclosure is now required, including fees in respect of subsidiaries outside the UK - previously, a single aggregate figure was required for a company and its UK subsidiaries only. Small and medium sized entities are exempt from the requirements relating to non-audit fee disclosures.

19.4 Clarification of audit exemption for dormant companies

The Department of Trade and Industry ("DTI") has clarified the audit exemption for dormant companies by reinforcing the incorrect cross-referencing in section 249AA(2) of the Companies Act 1985 ("1985 Act") (concerning when a company is dormant and exempt from having its accounts audited). The DTI considers that the cross-reference (which is to provisions of section 247A which no longer exists) must be construed as a reference to the provisions of new section 247A, which corresponds to section 247A(1)(a)(i) and (b) - that is, to new section 247A(1B)(a) and 247A(1A)(b) of the 1985 Act. (See the DTI factsheet online at http://www.dti.gov.uk/bbf/financial-reporting/small-companies/page23516.html.).

19.5 Companies Act 1985 (Small Companies Accounts and Audit) Regulations 2006

The Companies Act 1985 (Small Companies Accounts and Audit) Regulations 2006 came into force on 8 November 2006 (http://www.opsi.gov.uk/si/si2006/20062782.htm). They extend the small companies audit exemptions to certain categories of small financial services companies and limited liability partnerships which are authorised by the Financial Services Authority to carry on a regulated activity (see the DTI guidance online at http://www.dti.gov.uk/bbf/financial-reporting/small-companies/page23516.html). The regulations apply in respect of financial years ending on or after 31 December 2006.

19.6 Narrative reporting: the business review

19.6.1 Background

In December 2005, the government repealed legislation which would have imposed a requirement on Official List public companies to prepare an operating and financial review ("OFR") for financial periods commencing on or after 1 April 2006. This left in force the less onerous business review provisions, introduced in the UK for accounting periods commencing on or after 1 April 2005 through amendments to the Companies Act 1985 to implement the EU Modernisation Directive.
These require all companies (except those defined as small) to include a business review in their directors' report. This must:

- contain a fair review of the company's business and a description of the principal risks and uncertainties facing the company;

- be a balanced and comprehensive analysis of the development and performance of its business during the year and its position at the end of it (consistent with the size and complexity of the business);

- to the extent necessary for an understanding of the development, performance or position of the company's business, include analysis using financial key performance indicators ("KPIs") and, where appropriate, analysis using other KPIs including information relating to environmental and employee matters (note that medium sized companies need only include financial KPIs); and

- where appropriate, cross refer to and contain additional explanations of amounts included in the accounts.

Auditors are required to report on the consistency of the directors' report with the accounts. In addition, a parent company that prepares group accounts must include a group business review in its directors' report.

The Companies Act 2006 ("2006 Act") (due to be implemented by October 2008) will make a number of changes to the business review provisions.

19.6.2 Purpose of the business review

The 2006 Act will clarify the purpose of the business review, being to inform members of the company and help them assess how the directors have performed their statutory duty to promote the success of the company (see, further, paragraph 7.1.3) (even though other interested parties such as employees, suppliers, prospective investors etc will be users of the report).

19.6.3 Content of the business review

Helpfully, the 2006 Act will enable a company to exclude information from its business review about impending developments or matters in the course of negotiation if such disclosure would (in the directors' opinion) be seriously prejudicial to the company's interests.

The abolition of the OFR and reversion to the less stringent business review provisions attracted much criticism. As a result, additional requirements for official list companies' business reviews will be introduced by the 2006 Act. These require the business review to include, to the extent necessary for an understanding of the development, performance or position of the company's business:

- the main trends and factors likely to affect the future development, performance and position of the company's business;

- information about (i) environmental matters (including the impact of the company's business on the environment), (ii) the company's employees, and

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Excellence through know-how
(iii) social and community issues, including information about any policies of the company in relation to those matters and the effectiveness of those policies; and

- information about persons with whom the company has contractual or other arrangements which are essential to the business of the company - this will require disclosure of key supply chain and customer relationships. It is not intended to require companies to list their suppliers and customers, nor to provide details about contracts - it is about reporting significant relationships, such as with major suppliers or key customers critical to the business, which are likely to influence, directly or indirectly, the performance of the business and its value. It will be up to the directors to decide the extent of the information necessary for an understanding of the development, performance or position of the business. Such information on business relationships does not have to be included where it would “in the opinion of the directors, be seriously prejudicial to that person and contrary to the public interest” (but note, not the interest of the company itself).

These additional requirements are not dissimilar to the old OFR disclosure requirements for official list companies.

19.6.4 Liability for the business review

One of the main concerns in relation to the both the old OFR and the current business review regime was the lack of a "safe harbour" in relation to statements made in them (particularly those which were forward looking) by directors in good faith that later turned out to be untrue. This led to the inclusion of provisions in the 2006 Act dealing with the liability of directors in relation to the directors' report (including the business review), the directors’ remuneration report and information in summary financial statements derived from these.

They provide that:

- a director will be liable to compensate the company for any loss suffered by it as a result of any untrue or misleading statement in, or omission from, such a report, but only if he knew, or was reckless as to whether, the statement was untrue or misleading or knew the omission to be a dishonest concealment of a material fact; and

- a director will not have any civil liability to anyone other than the company resulting from reliance on these reports.

If companies provide a wider range of information than is strictly required in their business reviews, they will be able to benefit from the “safe harbour” provisions.

19.6.5 Guidance

One of the most helpful guidance tools in respect of the business review is the historic guidance issued by the DTI in March 2006. Whilst the guidance has no legal force, it acts as a user-friendly tool to understand the main features of the directors' report requirements. It will need updating to reflect the provisions of the 2006 Act when they come into force.

19.7 Auditing Practices Board ("APB"): new Ethical Standard for Reporting Accountants

The APB has issued a New Ethical Standard for Reporting Accountants ("ESRA") (http://www.frc.org.uk/apb/publications/pub1186.html), which will be effective for reporting engagements on or after 1 April 2007. The ESRA applies to all engagements that are subject to the requirements of the Standards of Investment Reporting ("SIRs") and which are in connection with an investment circular (eg a prospectus) in which a report from the reporting accountants is published (new SIRs were issued by the APB in July 2005 and January 2006 to support the Prospectus Directive and associated revisions of the Listing Rules). Under the regulations supporting the Prospectus Directive, reporting accountants are required to be independent when undertaking a public reporting engagement on historical financial information concerning an investment circular. The APB consider that the level of independence required is similar to that for an audit and the new ESRA aims to keep standards of audit and investment circular reporting closely aligned where possible.

19.8 Changes to pensions disclosures in accounts

The ASB has been reviewing the disclosure requirements for defined benefit pension schemes contained in FRS 17. In May 2006 it issued an exposure draft (available online at http://www.frc.org.uk/asb/press/pub1110.html) setting out (1) proposals to amend FRS 17, effectively replacing the current disclosures requirements with those of IAS 19 (thus achieving convergence with International Financial Reporting Standards on disclosures) and (2) providing details of a new reporting statement "Retirement Benefit - Disclosures".

The proposed new reporting statement (intended to have persuasive rather than mandatory effect) aims to complement the disclosures required under the amended FRS 17 by any company operating or sponsoring a defined benefit scheme, by setting out six principles to be considered when providing defined benefit scheme related disclosures. These include how the liabilities arising from the scheme are measured and its the future funding requirements. The introduction of FRS 17 proved hugely controversial, having a fundamental effect on the accounting of pensions (because of the requirement for companies to show the amount of any pension fund deficits/surpluses on their balance sheets). The ASB hopes that the new reporting statement will allow companies flexibility to make disclosures that are appropriate to the risks and rewards that the company is exposed to.

The amendments to FRS 17, together with notice promising publication of the reporting statement in January 2007, (http://www.frc.org.uk/asb/press/pub1211.html and http://www.frc.org.uk/asb/press/pub1210.html), were published on 7 December 2006 by the ASB. FRS 17 as amended will be effective for accounting periods ending on or after 6 April 2007 (although earlier adoption is encouraged).

19.9 Accounting for small and medium sized entities

In April 2006, the ASB issued an exposure draft containing proposals to amend its Financial Reporting Standard for Smaller Entities (known as "FRSSE")
to ensure that it is kept up to date to be effective for accounting periods beginning on or after 1 January 2007. However, this date was confirmed as uncertain at that time.

The IASB has also issued the latest "staff" draft of an exposure draft for an International Financial Reporting Standard for small and medium sized entities ("SMEs"). The draft was posted along with a draft Invitation to Comment and draft implementation guidance (comprising illustrative financial statements and a disclosure checklist). The IASB has not completed its consideration of the text, and further changes will be made before the IASB publishes a formal exposure draft (which had not materialised as at 31 December 2006). Note the draft is not approved by the IASB. The IASB Working Group is scheduled to meet in the first half of 2007 to consider comments to the exposure draft and make recommendations to the IASB board. The staff envisage that a final standard will be issued in the second half of 2007.

19.10 ASB: convergence project/future application of UK reporting requirements

In May 2006, the ASB commenced consultation on the future application of reporting requirements for UK companies, in particular on its plans for convergence between UK FRSs and IFRS. It sought views on:

19.10.1 whether all UK public quoted and other publicly accountable companies should be required to apply full IFRS, irrespective of turnover and whether they present group accounts or not;

19.10.2 whether the FRSSE should be extended beyond small companies to include SMEs;

19.10.3 whether UK subsidiaries of group companies that apply full IFRS should also be required to apply full IFRS in respect of measurement and recognition, but with reduced disclosure requirements; and

19.10.4 what should happen to companies that do not fall within the criteria set out above (in particular, should the FRSSE be extended to apply to them, should IFRS be applied to more companies, or should UK GAAP be maintained for them).

In October 2006, the ASB issued a summary of responses received. Respondents were reported to support a two-tier approach, with the lower level potentially (and ideally) being based on the IASB SMEs project (as to which, see paragraph 19.9) which is yet to reach a conclusion. The ASB states that it will be necessary to review the IASB’s proposals when an exposure draft is published to judge whether or not they are suitable for the UK’s needs.

The ASB also released a more detailed paper, "Further consideration of the ASB’s strategy for the convergence of UK standards with IFRS", in which the ASB reconfirmed that it proposed not to continue to follow the phased convergence approach it historically proposed (ie over a three to four year period). Instead, it proposes to issue new "IFRS based" UK accounting standards, but these will not be mandatory before a single date. This is currently estimated to be for financial periods beginning on or after 1 January 2009.

19.11 APB: revised example auditor's reports issued

In September 2006, the APB published Bulletin 2006/6 "Auditor's Reports of Financial Statements in the United Kingdom". It sought views on:

In October 2006, the ASB issued a summary of responses received. Respondents were reported to support a two-tier approach, with the lower level potentially (and ideally) being based on the IASB SMEs project (as to which, see paragraph 19.9) which is yet to reach a conclusion. The ASB states that it will be necessary to review the IASB’s proposals when an exposure draft is published to judge whether or not they are suitable for the UK’s needs.

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Bulletin2006_6 web optimized.pdf) containing illustrative examples of both unmodified and modified auditor’s reports of financial statements of UK companies. The examples take account of:

19.11.1 legislative changes requiring auditors to give a positive opinion as to the consistency of the directors’ report with the financial statements; and

19.11.2 the revised standard formulation for expressing compliance with IFRS as adopted by the EU.

Further changes to forms of auditor’s report will be needed to reflect the implementation of the 2006 Act (see, further, paragraph 7.1).

19.12 Statutory Audit Directive

The directive (2006/43/EC) relating to the statutory audit of annual accounts and consolidated accounts came into force on 29 June 2006, with member states having until June 2008 to implement its provisions. The directive’s provisions include a requirement to use international auditing standards for all EU statutory audits, compulsory auditor rotation for certain public companies (including those on the UK Official List but not the AIM or PLUS markets), and a requirement for public companies (again, only Official List companies in the UK)\(^\text{26}\) to set up an audit committee.

The DTI intends to consult in due course on the implementation proposals for the UK but as yet have not specified a timescale.

19.13 4th and 7th Company Law Directives

Amendments to the 4th and 7th Company Law Directives ("Accounting Directives") (2006/46/EC) came into force on 5 September 2006, with member states having until September 2008 to implement the provisions. Key features include:

19.13.1 the imposition of a collective duty on board members of limited companies to ensure that the annual accounts, the annual report and, when provided separately, the corporate governance statement, are drawn up and published in accordance with the requirements of the Accounting Directives and, where applicable, in accordance with IAS (previously, the directive was silent on International Accounting Standards);

19.13.2 extending the obligations to disclose related party transactions between a company and its affiliated undertakings to limited companies. These will include transactions with key management and spouses of board members not on an arms length basis (ie the amendments will apply only to significant transactions with related parties not carried out under normal business circumstances). Member states will, inter alia, be able to exempt medium-sized, non-public, unlisted companies from these requirements (as well as certain intra-group transactions);

\(^\text{26}\) Member states may also designate other entities as “public interest entities” (ie not just Official List public companies) under the directive.
19.13.3 a 20% increase in the thresholds used to define SMEs (which member states will have the option to introduce);

19.13.4 a requirement for all companies to disclose off balance sheet arrangements, but with the discretion for member states to permit SMEs to omit or limit the disclosure of certain off balance sheet arrangements only (eg in respect of "special purpose vehicles" and "off shore activities") (currently, member states have the discretion to exempt only small companies from such disclosure requirements); and

19.13.5 the introduction of a corporate governance statement requirement for all listed companies, which may be provided separately from the annual report if the document is publicly available on the company's website.

The DTI has yet to announce its proposals for implementation in the UK, but says it will consult in due course.

20. FINANCIAL SERVICES AND MARKETS

It has been a relatively quiet year in terms of domestic legislation for the UK financial services sector, outside of consumer credit (see section 12, Consumer Credit). However the impact of the European Financial Services Action Plan is likely to see some major legislation come through in 2007.

In the EU, the Commission's statements that a more evidence-based approach will be taken to regulation, and that they will review past legislation for effectiveness, along with the FSA's commitment to a principles-based regime, should bode well for the future. However, as many of the complicated directives are approaching full implementation, the FSA's attempts to cut down on prescriptive rules will be tested to the full.

20.1 Main developments in the UK in 2006

20.1.1 Capital requirements

The Capital Requirements Regulations 2006 were laid before Parliament on 5 December and are due to come into force on 1 January 2007. These regulations partly implement the Capital Requirements Directive ("CRD") by imposing obligations on the Financial Services Authority ("FSA") with regard to procedural requirements for the prudential supervision of pan-European groups, co-operation between competent authorities and the recognition of external credit assessment institutions by the competent authorities so that their credit assessments may be used to calculate capital requirements. The regulations allow pan-European groups to calculate their capital requirements in accordance with one of the advanced methods allowed by the Banking Consolidation Directive. There is also provision made for the FSA to recognise External Credit Assessment Institutions (ECAIs) as eligible, so that their credit assessments may be used by credit institutions and those investment firms to calculate their capital requirements. The regulations will amend UK primary and secondary legislation in consequence of the adoption of the CRD.

See, further, paragraph 20.10.
20.1.2 Personal pension schemes

The FSMA (Regulated Activities) (Amendment) Order 2006 ("Order") creates the new regulated activity of establishing, operating and winding up a personal pension scheme. Most of the provisions of the order come into force on 6 April 2007, when they will amend the existing Regulated Activities Order. Under the Order, rights under a personal pension scheme will become designated investments. The new activity and investment will be contained in articles 52 and 82 of the Order respectively.

20.1.3 Home reversion and home purchase plans

Three statutory instruments were passed in relation to home reversion and home purchase plans. The FSMA (Regulated Activities) (Amendment) (No. 2) Order 2006 will introduce new regulated activities of entering into, administering, arranging and advising in relation to home reversion and home purchase plans from 6 April 2007. Firms have been able to apply for part IV permissions to conduct these activities from 6 November 2006. The other two instruments update the Terrorism Act 2000 and the Proceeds of Crime Act 2002 to bring the new regulated activities within the list of excluded activities.

For further information on home reversion and home purchase plans, see paragraphs 20.8.4 and 20.9.

20.2 Progress on some key EU initiatives

20.2.1 Markets in Financial Instruments Directive ("MiFID")

The Commission and the European Parliament approved the secondary legislation for MiFID in June 2006 and the implementing measures were published in the Official Journal in September 2006. The MiFID transposition date for EU Members States is 31 January 2007 and the implementation date for firms is 1 November 2007.

The FSA has published four consultation papers in 2006. For further information, see paragraph 20.4.

20.2.2 Capital Requirements Directive

See paragraph 20.10.

20.2.3 Transparency Directive

See paragraph 8.3.

20.2.4 Solvency 2 Project

The Solvency 2 Project is an overhaul of the capital adequacy system for the EU insurance industry, and aims to create requirements that more accurately reflect the insurance undertaking's true risk. The Committee of European Insurance and Occupational Pensions Supervisors has been tasked with creating technical advice for the Commission, and released a flurry of consultation papers on the project, including six in November 2006. Also in November, HM Treasury and the FSA published a
The Commission intends to publish a proposal for a Framework Directive by July 2007, and to have implementation for member states set for 2010.

20.2.5 Payment Services Directive

The Payment Services Directive was adopted in December 2005 with the aim of creating a single payment market in the EU. The directive introduces a licensing scheme for "Payment Institutions" to allow payment service providers, who are not banks, to offer EU-wide services after obtaining a licence in any member state. In July 2006, HM Treasury issued a consultation document setting out the background to the directive. The EU Economic and Financial Affairs Council discussed the directive in November. Work on the directive is also currently underway in the European Parliament. Although the date has yet to be finalised, it is proposed that the directive will be implemented by 1 January 2008.

20.2.6 Third Money Laundering Directive

The Third Money Laundering Directive was adopted in October 2005 to replace the first and second Money Laundering Directives, and is to expand existing EU legislation. On 4 August 2006, the implementing measures were published in the Official Journal. HM Treasury plans to have final regulations before Parliament in mid 2007, to comply with the implementation date of 15 December 2007.

20.2.7 Consumer Credit Directive

The proposed Consumer Credit Directive is designed to create a single market for unsecured consumer credit. See paragraph 12.7.2.

20.3 Enforcement update

Below are examples of enforcement action taken by the FSA during the year.

20.3.1 Market misconduct

In March, the FSA's investigation into GLG Partners LP ("GLG") and Philippe Jabre concluded with both parties receiving a fine of £750,000 for market abuse and breaching FSA Principles. The FSA found that Mr Jabre traded on inside information. GLG was also found responsible for Mr Jabre's market abuse, with the FSA emphasising that firms are accountable for the behaviour of their employees, particularly if they are at a senior level. Mr Jabre was made an insider on the pre-marketing of an issue in convertible bond preference shares in Sumitomo Mitsui Financial Group and agreed not to trade in the securities of Sumitomo before the issue. Despite this agreement, Mr Jabre proceeded to sell short around $16m of ordinary shares in Sumitomo just days before the new issue. Mr Jabre subsequently launched an unsuccessful appeal to the Financial Services and Markets Tribunal (see paragraph 20.4.1).

In April, the FSA imposed a penalty of £6.3m on Deutsche Bank AG ("Deutsche") for breaches of Principles 2 (failing to exercise due skill, care and diligence) and 5 (failing to observe proper standards of market conduct). The sanction arose from two separate transactions conducted by Deutsche during March 2004.
Scania AB B shares and the stabilisation of Cytos Biotechnology AG shares. The FSA also fined Mr David Maslen, Deutsche’s former head of European cash trading, £350,000 for being knowingly concerned in the failure to observe proper standards of market conduct in the Scania transaction. The only companies to be fined more than Deutsche are Shell and Citigroup - which were fined £17m and £13.9m respectively.

20.3.2 Actions against approved persons

A former Credit Suisse First Boston Europe ("CSFB") salesman, Mr Pignatelli, was fined £20,000 in November after he passed on potentially market sensitive information about a company to his clients. His actions were picked up by CSFB’s own compliance department and he was dismissed for serious misconduct. Mr Pignatelli received an analyst's report about a US medical supplies company which he was warned could contain inside information. Notwithstanding the warning, Mr Pignatelli passed on the information to his clients. Although the information turned out not to be market sensitive, Mr Pignatelli was still found to have breached Principles 2 and 3 of the FSA’s Statements of Principle for Approved Persons. The action was a first of its kind by the FSA. Even though Mr Pignatelli did not have a positive belief he was in possession of inside information and the information turned out to be publicly available, he was nonetheless sanctioned for failing to turn his mind to the issue and passing on the information regardless.

20.3.3 Systems and controls

Responsibility for proper systems and controls ultimately lies with the firm’s senior management. Senior management need to understand their responsibilities and the potential risks caused by any failings.

In March, the FSA imposed its first fine for anti-fraud systems and controls failures. The FSA fined Capita Financial Administrators ("CFA") £300,000 for poor anti-fraud controls over client identities and accounts. CFA was a third party administrator of collective investment schemes and was responsible for maintaining client records and carrying out client instructions to buy and sell investments. Between August 2004 and December 2005, CFA discovered (by virtue of reports from clients) that a small number of staff had colluded in a number of actual and attempted frauds against clients.

In April, the FSA fined Royal Liver Assurance ("RLA") £550,000 for mis-selling with-profit endowment policies. Although this was principally a mis-selling case (RLA failed to take reasonable steps to obtain relevant information about customer circumstances before making recommendations and did not pay sufficient regard to product suitability), the FSA also found that RLA had failed to establish and maintain adequate systems and controls and had, therefore, breached Principle 3 and the Senior Management Arrangement, Systems and Controls ("SYSC") sourcebook SYSC 3.2.6 (under their predecessors).

In June, the FSA fined Rainbow Homes Limited ("RHL"), a sub-prime mortgage broker £35,000 for systems and controls failings which exposed around 1,000 people to the risk of being sold unsuitable products. RHL’s management relied, to an inappropriate extent, on an external consultant to oversee compliance-related matters and ultimately for ensuring the fair treatment of their customers.
The Kyte Group Limited ("Kyte") was fined £250,000 in August for systems and controls failings resulting in inadequate client money protection and poor accounting systems. Kyte provides independent trading facilities, including broking and clearing, to clients ranging from private investors to multi-national institutions.

Langtons (IFA) Limited was fined £63,000 in September for failing to properly apportion roles and responsibilities to its senior management and for not having systems in place to ensure that its advisers were trained and competent. The FSA considered that customers were potentially put at risk as a result. Senior management roles were not effectively allocated with the result that the firm failed to determine the training needs of its investment advisers and failed to put in place adequate complaints-handling procedures. Further, approval of the firm's financial promotions was not carried out by someone with adequate expertise.

The FSA continued with its principles-based approach to Enforcement in November this year with a fine of £1.225m against General Reinsurance UK Limited ("GenRe UK") for arranging two improper reinsurance transactions and failing to exercise due skill, care and diligence (breach of Principle 2) and failing to control its business effectively (breach of Principle 3). Transactions were not fully assessed and monitored and senior management failed to exercise adequate supervision.

20.3.4 Misleading the regulator

The FSA has re-emphasised the need for firms and individuals to provide the FSA with accurate information. In April, Paul Tebbutt, Chief Executive of Financial Advisers Millfield Partnership Limited ("MPL"), was fined £35,000 for providing misleading information to the FSA in connection with an application by MPL to merge with another financial adviser group (resulting in a change of control). In a letter to the FSA, Mr Tebbutt confirmed that the directors of the merged company would provide a directors’ guarantee for £3m but Mr Tebbutt failed to ensure that there were sufficiently firm intentions on the part of the directors and it transpired that the guarantee could not be provided. After learning that the full guarantee could not be provided, Mr Tebbutt then failed to inform the FSA of this crucial information.

20.3.5 Mis-selling and treating customers fairly

See paragraph 20.6.4.

20.4 Case law update

Below are some of the more important cases that have been heard either at the Financial Services and Markets Tribunal ("Tribunal"), or in the courts, during the course of the year.

20.4.1 Market misconduct

In late December 2005, Mr Carl Rigby, former Chief Executive and Chairman of software company AIT, and Mr Gareth Bailey, AIT’s former Finance Director, had their sentences reduced following an appeal. The two former directors were convicted of recklessly making a false statement to the London Stock Exchange and received prison sentences of 18 months and nine months respectively. They were
also ordered to pay compensation to investors by way of confiscation of assets totalling nearly £533,000.

In January 2006, the Tribunal overturned the decision of the FSA to impose penalties on Mr Timothy Baldwin and WRT Investments Limited (his investment vehicle) for market abuse under section 118 of the Financial Services and Markets Act. It was asserted that, during a telephone conversation, the Chief Executive Officer of Minmet PLC provided non-public information to Mr Baldwin concerning the positive performance of Minmet's main asset, a gold mine in Sweden, and that Mr Baldwin then purchased shares in the company. Mr Baldwin sold the shares shortly after the information was announced to the market at an increase in share price in excess of 100%. There was a dispute on the evidence as to whether the telephone conversation had taken place with the Tribunal ultimately deciding in favour of Mr Baldwin.

The FSA's lack of success continued in May when the Tribunal issued its decision in the case of Mr Paul Davidson (also known as "the Plumber") and Mr Ashley Tatham. The case concerned an alleged spread bet in connection with the planned flotation on AIM of Cyprotex, a company in which Mr Davidson was the majority shareholder. The Tribunal found that the FSA had acted unreasonably when it ruled that Mr Davidson and Mr Tatham were guilty of market abuse. In an unprecedented decision, the Tribunal subsequently ruled that costs should be awarded against the FSA which left the regulator with a bill estimated to be between £5-10m. The industry now awaits the extent to which this decision will impact upon the FSA's appetite to take people on in the Tribunal in the future.

At the end of July 2006, Mr Philippe Jabre withdrew his reference to the Tribunal following his lack of success at a preliminary hearing. At that hearing, the Tribunal rejected arguments put by Mr Jabre that his alleged conduct could not constitute market abuse because the trades in the Sumitomo shares occurred on the Tokyo market and could not, therefore, fall within the provisions of section 118 FSMA. The Tribunal ruled that it is not possible to circumvent the market abuse regime by trading a UK-traded stock on an overseas market.

In August, the Tribunal published its decision in the case of Mr James Parker upholding the finding by the FSA that Mr Parker had engaged in market abuse. Mr Parker was employed as Credit Risk and Treasury Manager by Pace Micro Technology plc ("Pace"), a company listed on the London Stock Exchange. Serious financial difficulties for one of Pace's customers, NTL, were causing problems for Pace and talks of an agreed takeover by a large American competitor were abandoned in early 2002. On learning that Pace was about to issue a profits warning, Mr Parker sold both his and his wife's shareholdings in the company. Mr Parker contended that the relevant information was in the public domain and that his transactions were part of a pre-conceived strategy of hedging shares but his appeal failed.

20.4.2 Fitness and propriety

April 2006 saw the conclusion of the FSA's first case in which the Tribunal based its decision on the findings of another disciplinary tribunal. The case of Mr Allen Phillip Elliott set a precedent for the FSA being able to rely on the conclusions of other courts and tribunals when considering whether individuals are fit and proper to undertake regulated activities. In 2002, the Solicitors Disciplinary Tribunal ("SDT") struck Mr Elliott off the Roll of Solicitors for misconduct in relation to the operation of

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of a mortgage investment scheme. At a preliminary hearing of the Tribunal, it was decided that the FSA could rely on a previous finding against Mr Elliott made by the SDT.

In July, the Tribunal published its decision on the referral by Mr Ravi Manchanda for a rehearing of his case following a refusal by the FSA of his application to acquire a controlling interest in, and to perform a controlled function at, a mortgage broker. The FSA’s decision was overturned. Mr Manchanda was Chief Operations Officer of a company which was being investigated for fraud. Mr Manchanda was not implicated in the proceedings, but at the time of his application to the FSA, it seemed that he could be interviewed by the Serious Fraud Office about possible involvement in a fraudulent scheme. The FSA rejected Mr Manchanda's application due to concerns about whether he satisfied the threshold conditions of fitness and propriety. The FSA invited the Tribunal to conclude that even if Mr Manchanda did not know about the fraud, he should have done. The Tribunal, however, overturned the FSA’s decision.

20.5 Markets in Financial Instruments Directive ("MiFID")

20.5.1 Introduction

MiFID has been the subject of extensive discussion throughout the EU as the level 1 directive provisions have been developed and refined through the Lamfalussy process. It is the most significant development in the regulation of investment services in the EU since the Investment Services Directive ("ISD") was implemented in 1993. In preparing for implementation, regulators, exchanges and industry participants are assessing and responding to the changes that MiFID will make to regulation, systems, processes and business structures. The implementation deadline is 1 November 2007 and an enormous amount of work remains to be done in advance of that date.

This section looks at how MiFID is perceived in the UK and the impact it will have in the UK and in other EU jurisdictions.

20.5.2 What is MiFID and what does it do?

MiFID will replace the ISD and is a key component of the EU’s Financial Services Action Plan. It will widen both the scope of investment services requiring authorisation by member states of the EU and the range of investments falling within the ambit of regulation. The aim of MiFID is to provide for the degree of harmonisation needed to offer investors a high level of protection. It also aims to enhance the possibilities for investment firms to provide services throughout the EU, being a single market, on the basis of home state supervision and remove barriers to competition in the investment services industry.

In terms of the impact of MiFID, it is useful to itemise, in very broad terms, the range of key activities it will affect:

*Conduct of business rules harmonisation*

Article 19 of MiFID sets out a number of principles with which investment firms will be required to comply. They include the obvious need for investment firms to act
honestly, fairly and professionally in accordance with the best interests of their clients and information requirements. There are also suitability requirements, and in defined circumstances investment services or products must be "appropriate" (with "investment advice" becoming a regulated activity throughout the EU). Terms of business with clients must be documented and clients must receive adequate reports on the services they receive and the costs associated with the relevant transactions and services.

Obligations of best execution and order handling

Investment firms will be required to take all reasonable steps to obtain, when executing orders, the best possible result for their clients taking into account (among other things) price, costs, speed, likelihood of execution and settlement, and size, which will apply across all instruments covered by MiFID. On order handling, investment firms will need to implement procedures and arrangements which provide for the prompt, fair and expeditious execution of client orders, relative to other client orders or the trading interests of the firm. The Level 2 measures set out the detailed requirements.

Client classification

Customer classification is key in determining the level of protection afforded to customers. The classes of client have been categorised as: eligible counterparties, professional investors and retail investors. These categories reflect to a larger or lesser extent the manner in which clients are classified in a number of jurisdictions already. However, there are distinctions to be drawn which will have an impact on how relationships are documented and managed post-implementation.

Passporting rights

In the context of cross-border business, home state rules rather than host state rules will be applicable.

Exchanges and markets

The "concentration rule" will be abolished and there will be prescriptive requirements for pre-trade and post-trade transparency, and transaction reporting. These measures will offset the imbalance that a number of commentators have feared might result from the abolition of the concentration rule.

Conflicts management

This (along with a number of other governance issues) is a focus of MiFID. Firms will have to map conflicts and work out a methodology for managing them. Firms will also be required to formulate their conflicts management policies and disclose the same to clients.

Outsourcing

Regulatory responsibility for outsourced activity will remain with the outsourcing firm. In general, the requirements as to outsourcing within the EU are not particularly different in substance from what prevails today. However, where
functions are outsourced to a third country provider, there is a requirement that the party to whom the activity is outsourced must itself be subject to prudential supervision. In the absence of meeting this requirement, notification of the outsourcing arrangement must be made to the home state regulator who will have the opportunity to object.

**Systematic internalisation**

Firms which regularly execute client orders in securities on own account rather than on exchange will become subject to the requirements as to pre- and post-trade transparency - in effect, this will mean they need to publish a quotation and disclose internal crosses to the market in order to aid price formation.

### 20.5.3 How has MiFID been received in the UK?

Given the depth of regulatory provision in the UK, MiFID has not been without criticism. Indeed, it has been said that it is deeply unsatisfactory that UK investment services firms face major changes, with the associated costs, for an initiative which has been subject to no comprehensive EU cost-benefit analysis to assess the specific contribution it might make to unlocking the prize of a more integrated European capital market. Whether the benefits to the UK market will outweigh the costs of MiFID remains to be seen. The FSA has tried to assure the UK market that, when it comes to detailed implementation in the UK, it will seek to avoid imposing unnecessary costs and will not seek any super equivalent provisions unless there is a clear market value in so doing.

Industry participants have been quite vocal too in their criticism of the costs and structural changes arising from MiFID implementation. In particular, issues such as divergence between current UK client classification requirements and those of MiFID, best execution policies, conflicts policies and customer documentation are all matters which will require considerable internal review and which will involve a substantial degree of expense in communicating changes to terms of business, and other such matters to customers.

### 20.5.4 FSA role

The FSA has been working assiduously to develop its Handbook in preparation for MiFID implementation. It issued four consultation papers, a discussion paper and several other documents on MiFID in 2006. CP06/9 deals with organisational systems and controls in which (in view of the overlap between MiFID and the Capital Requirements Directive (see paragraph 20.10), each of which contains requirements intended to secure effective management and internal systems and controls) the FSA has proposed a common platform for those firms which will be subject to both directives. CP06/14 covers market transparency, transaction reporting, authorisation and permissions, client assets and other matters but excludes conduct of business and financial promotions. These latter issues are dealt with in CP06/19 and CP06/20 respectively, which were both published in October 2006. These papers contain substantial proposed changes to the FSA's Handbook and firms will be pressed to digest the contents and absorb them in time to adapt themselves to the new regulatory requirements. In essence, any market participant who has not begun to address MiFID implementation will be in danger of being too late to undertake the work required, unless they begin to focus immediately on what needs to be done.
20.5.5 A level playing field?

The EU Commission has taken a twofold approach to implementation, using a regulation, which is directly applicable, to impose measures required under MiFID where possible, and a directive for other measures, which will require separate local implementing legislation. These level 2 measures were approved by both the European Commission and Parliament in June and were finally adopted in September 2006. The implementing regulation covers: record keeping; transaction reporting; market transparency (pre-trade transparency and post-trade transparency); admission of financial instruments to trading; and derivative financial instruments.

Many of the remaining issues to be addressed by MiFID are covered in the implementing directive which will need to be transposed into national law by each member state. These include: organisational requirements; conflicts of interest; investment research; inducements; suitability and appropriateness; reporting requirements; best execution; client order handling; and investment advice.

While the Commission has been clear that the implementing directive has been drafted tightly in order to ensure so far as possible that member states will not gold plate, there is always the possibility that, at national level, there may be some differences in the manner in which certain of the provisions of MiFID are implemented. The Committee of European Securities Regulators ("CESR") has attempted to ensure, however, that there will be a framework for convergence amongst supervising authorities throughout the EU.

Another issue of concern to many industry participants is the existing degrees of sophistication among the EU member states in terms of market regulation, a number of which only recently joined the EU and which have far younger capital markets than those that prevail in other member states. This may translate into a possibility for some degree of differentiation among the member states in the implementation of MiFID and it remains to be seen if and how this will develop into a problem as we approach the November 2007 deadline.

20.5.6 Next steps: planning and strategy

In an environment which moves and changes very quickly, it is important to be mindful of what strategic issues firms should be thinking about in their approach to MiFID implementation. Below are a few "bigger picture" areas which firms should focus on.

Outsourcing

Outsourcing presents a number of challenges. In the first place, firms will need to ensure that they can comply with their obligations of best execution, even where the execution of client orders is outsourced to third parties.

Another area worthy of mention in the context of outsourcing is portfolio management. It is not uncommon for EU managers to outsource the management of portions of managed portfolios to third parties. For example, US equity portfolios are commonly managed by US advisors. Under article 15 of the implementing directive, the service provider in a third country to which a portfolio management function is outsourced must be authorised or registered in its home country to provide that
service and must be subject to prudential supervision; and there must be an appropriate cooperation agreement between the competent authority of the investment firm and the supervisory authority of the service provider. US investment advisors are not subject to the same prudential supervision as firms in the EU subject to MiFID are, so firms need to identify those non-EU providers and the services they provide in order to determine how they will manage the outsourced functions going forward. Such firms may need to notify their competent authority of the relevant arrangements and hope that objections are not raised.

Execution

From a competitive perspective, execution is an area which firms will need to focus on very quickly if they are to survive in the post-MiFID environment. Those order-takers who insist on continuing to execute on their traditional venues will soon find they are faced with competition that can offer much greater diversity (eg systematic internalisers, MTFs and other execution venues). In that scenario, it is not difficult to see which firms will attract custom. Liquidity pools will be much more numerous than today and that is the environment for which firms must prepare.

Passporting

Passporting under MiFID has not been the subject of much scrutiny, either at the level 2 advisory stage or in the discussions following the CESR level 2 advice. It appears sensible that host state rules should apply to activities conducted and services provided within the territory of the host member state. On a closer look at the passporting provisions, however, perhaps the new regime will not be as straightforward as it might at first appear.

For example, if a UK investment firm elects to provide services on a cross-border basis to France and Spain and notifies the FSA accordingly, article 31 of MiFID provides that the conduct of business by the UK investment firm in France and Spain on a cross-border basis will be governed by the FSA rules. If the UK firm also decides to establish a branch in Germany pursuant to article 32 of MiFID, the conduct of business in Germany by the German branch will be subject to German rules. However, if staff at the German branch conduct business on a cross-border basis in either Spain or France, FSA rules will apply to those activities. The German personnel will, therefore, be subject to German rules in relation to business they conduct with their German clients and UK rules in relation to business they conduct with French or Spanish clients. This could potentially give rise to difficulties from a compliance perspective and firms will need to think about how they will manage them.

20.5.7 Conclusion

On balance, there is going to be a great deal more opportunity across the EU for participants in the investment services industry once MiFID is implemented. Firms that were previously at a disadvantage because host state rules for cross-border activity were prohibitively difficult in comparison with their home state rules should now enjoy much greater freedom to engage in the single market for the provision of services.
MiFID is not straightforward, however, and the costs of implementation and compliance do not come cheaply. Transparency for the consumer is, of course, to be welcomed. It remains to be seen whether the burdens of disclosure and the systems changes it requires, the obligations of best execution, conflicts management and other MiFID requirements will be worth that cost.

20.6 Treating customers fairly: update

20.6.1 Overview

Treating customers fairly ("TCF") continues to be one of the FSA's major business priorities and initiatives in the retail sector, and a key element underpinning the movement towards more principles-based regulation. TCF covers the whole product life cycle, from product design through to after sales care and complaints handling, and the FSA has made it clear that TCF should be an integral part of business culture, driven by senior management.

In July, in an update paper, "Treating customers fairly - towards fair outcomes for consumers", the FSA published six consumer outcomes that TCF was committed to achieving, namely:

- consumer confidence that fair treatment is central to corporate culture;
- products and services designed to meet the needs of identified groups of consumers and targeted accordingly;
- consumers are provided with clear information before, during and after the point of sale;
- where consumers receive advice, the advice is suitable and takes account of their circumstances;
- consumers receive the expected product performance and associated services of an acceptable standard they have been led to expect; and
- consumers do not face unreasonable post-sale barriers imposed by firms to change product, switch providers, submit a claim or make a complaint.

These outcomes are designed both to give firms and consumers guidance on what the FSA expects the TCF initiative to achieve, and to form part of a framework which will allow the FSA to measure firms progress in implementing and embedding TCF in their businesses and demonstrating real benefits to consumers.

In September 2006, the FSA published a discussion paper (06/04) which identified that, whilst providers and distributors of financial products have differing but interlocking responsibilities for TCF, they needed to work more closely together to help avoid future customer detriment.

The FSA has also published four further case studies on its website this year to assist firms in understanding practical examples of TCF implementation and embedding. Two case studies have been published relating to quality of advice, flowing from the FSA's Quality of Advice cluster report published in July this year. Three other
cluster reports were published this year in relation to management information, mortgages, and general insurance. Case studies relating to both marketing and promotion and designing and selling a new product have also been released.

20.6.2 Self assessment tool

In March, the FSA produced a TCF self assessment tool for small firms. TCF applies equally to all firms regardless of size, but the FSA acknowledges that smaller firms may have more difficulty identifying risks within their structures which would impact on their ability to treat customers fairly. The self assessment tool is designed to help small firms identify these risks and then mitigate them.

20.6.3 Payment protection insurance

In October, an FSA review reported that some firms selling payment protection insurance were still failing to treat their customers fairly, identifying serious concerns about the clarity of information provided to customers during the sales process, the suitability of PPI in each case and the prevalence of single premium policies irrespective of circumstances. These deficiencies can result in customers being unable to make informed decisions about PPI cover. PPI remains an FSA priority due to the continuing level of risk presented to consumers. The OFT has referred the PPI market to the Competition Commission following similar findings in their investigation into PPI to the conclusions drawn by the FSA (see paragraph 12.6).

20.6.4 Enforcement

Major enforcement actions relating to TCF this year have included fining:

- Loans.co.uk £455,000 in relation to selling payment protection insurance ("PPI"). The FSA found that the firm did not have appropriate systems and controls to minimise the risk of unsuitable sales. Policies were sold on an advised basis over the phone. The firm, however, failed to gather and record information to show that the recommendations it made were suitable. Customers did not receive sufficient information to enable them to ascertain whether the policy being sold was the right option for them;

- Regency Mortgage Corporation Limited £56,000 in relation to the sale of sub-prime mortgage-related PPI. Customers were sold a policy for which they already had cover or pursuant to parts of which they were unable to claim. It was also found that Regency's procedures for compliance and record keeping were inadequate and that senior management did not receive sufficient information to identify risks in PPI sales;

- The Carphone Warehouse Ltd £245,000 in relation to telephone sales of general insurance products;

- Hoodless Brennan £90,000 for using unacceptable sales practices and failing to treat its customers fairly when selling shares in a particular company; and

- Royal Liver Assurance Limited £550,000 for selling unsuitable with-profits policies to customers who, in many cases, had no need for life cover.
20.6.5 What can we expect to see in 2007?

The FSA expects TCF implementation to be happening in a substantive part of all businesses no later than March 2007. They will place even greater focus on helping firms to implement and embed TCF, and make examples of firms lagging behind and/or failing to take TCF seriously. Also expect to see the FSA working more closely with trade associations to assist firms in delivering their TCF obligations and facilitating the spread of good practice.

The FSA's focus on TCF should sound alarm bells in the regulated community (particularly in small firms) that steps need to be taken to ensure that TCF is implemented and embedded at all levels in a firm, or be prepared to suffer the consequences of not doing so.

20.7 Financial crime and money laundering update

20.7.1 K Ltd v NatWest

The decision of the Court of Appeal in *K Ltd v National Westminster Bank Plc* considered the anti-money laundering provisions of the Proceeds of Crime Act 2002 ("POCA"), what a bank's obligations are when requested by a client to transfer funds which are suspected to be the proceeds of crime, the definition of "suspicion" and the courts' powers to order the bank to make a payment out of a customer's account.

**Background to the case**

The bank's customer, K Ltd, was involved in the business of buying and selling, among other things, mobile telephones. On 18 August 2005, the customer made two transactions. In the first, it agreed to purchase a consignment of mobile telephones for £200,000 plus VAT (total: £235,000). In the second, it agreed to sell the same telephones for £215,200 to a Swiss company, thereby making a profit of almost £20,000, since the VAT paid on the purchase would be reclaimable. On 22 August 2005 the Swiss purchaser paid £215,200 into the customer's account at the bank and on the same day the customer instructed the bank to pay £235,000 to an account in the Netherlands Antilles. On 23 August 2005 the customer was told by the bank that it was not in a position to honour the transaction. No reason was given.

On 5 September 2005, the customer applied for an injunction ordering the release of the funds. On 6 September 2006, the bank's solicitors (DLA Piper) wrote to the customer informing it that a suspicious activity report ("SAR") had been made to the relevant authorities and that consent had been refused. The customer's application was refused and an order for costs was made against the customer in favour of the bank.

On 15 September 2005 consent was given by the authorities and the transaction proceeded. The customer appealed to the Court of Appeal. By permission of the court, Her Majesty's Revenue & Customs and the Serious Organised Crime Agency ("SOCA") intervened in the appeal.
The law: POCA

Section 328(1) of POCA provides that: "A person commits an offence if he enters into or becomes concerned in an arrangement which he knows or suspects facilitates (by whatever means) the acquisition, retention, use or control of criminal property by or on behalf of another person."

The relevant threshold is suspicion (as opposed to speculation) and a bank does not need to have actual evidence of money laundering. As soon as a bank suspects that monies in its customer's account may be the proceeds of crime then (whether or not they in fact are) the bank is prohibited from entering into any arrangement in relation to those funds without obtaining consent.

Once a SAR has been made, the prosecuting authority may consent to (or refuse to consent to) the transaction or, if a disclosure has been made and no notice refusing consent has been received from the authorities within seven working days, consent is deemed to have been given.

If consent is refused within seven working days, the relevant prosecuting authority has a further 31 calendar days ("moratorium period") to consider the matter and the transaction cannot proceed until such time as consent is given or the moratorium period expires. Unless and until consent is given (or is treated as having been given), the bank or financial institution may commit a criminal offence if it proceeds with the transaction in question, and/or tips off the customer that a disclosure has been made.

The decision of the Court of Appeal

In dismissing the customer's appeal, the court held that:

- the bank had complied "lawfully and properly" with the relevant procedure laid down by Parliament in POCA;

- if the bank held a suspicion, it was prohibited by criminal law from honouring the customer's mandate. This provided the bank with a defence to any claim for breach of mandate. The contract with the customer was temporarily suspended until the illegality was removed;

- the court should refuse any application for an injunction as a matter of discretion, as it would not be right to compel the bank to perform a criminal act;

- a person held a suspicion if he or she thought there was a "possibility, which is more than fanciful, that the relevant facts exist". This was subject, in an appropriate case, to the further requirement that "the suspicion so formed should be of a settled nature". Suspicion is subjective and there is "no legal requirement that there be reasonable grounds for suspicion";
on the basis of DLA Piper's letter of 6 September 2005 to the customer's solicitors (confirming that a disclosure had been made), it was clear that the bank held a suspicion. The bank correctly followed the statutory procedures under section 333 POCA by having its professional legal advisers write to the customer once legal proceedings were contemplated;  

- it would not be appropriate for the court to examine the suspicion through cross-examination of the professional legal adviser or relevant bank employees. There was no mechanism for this in POCA and it may well have been the intention of Parliament to protect those reporting suspicions from having their identity revealed to money launderers;  

- Parliament had struck a "precise and workable balance of conflicting interests" in POCA. The temporary interference to the free flow of trade was preferable to allowing the undoubted evil of money laundering to run rife in the community. Such a temporary interference was reasonable and did not, therefore, breach the customer's human rights.  

**Conclusion**  

This case has provided banks and financial institutions with further clarity concerning the meaning of "suspicion". It has also confirmed that, providing a suspicion is held, the bank will have a defence to any breach of mandate claim.  

The court's comments on the "professional legal adviser exception" do, however, need to be approached with some caution. On the face of it, section 333 makes it clear that no tipping off will occur when a disclosure is made by a professional legal adviser in relation to actual or contemplated legal proceedings. Circumstances may, however, arise where confirmation from a legal adviser that a disclosure has been made may prejudice an ongoing investigation and it may still be prudent and/or good practice for firms, when faced with actual or contemplated legal proceedings, to liaise with the authorities first to endeavour to agree the wording of any disclosure to a customer.  

**20.7.2 The Stephen Judge case**  

Recently, in the first case of its kind, the Crown Prosecution Service ("CPS") withdrew charges under the Proceeds of Crime Act 2002 ("POCA") against a money laundering reporting officer ("MLRO"). This was the first time the CPS had exercised its powers under POCA against an MLRO.  

Stephen Judge, ex-MLRO at spread betting firm City Index, was charged under section 336 of POCA which is the offence of "consent to the doing of a prohibited act."  

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27 Sections 333(2)(c) and (3)(b) of POCA provide that a bank does not commit a tipping-off offence if a disclosure is made by a "professional legal adviser... to any person in connection with legal proceedings or contemplated legal proceedings."
Facts of the case

Mr Judge had a suspicion about an account holder and reported it to the City of London Fraud Squad, after which he submitted a suspicious activity report to the National Crime Intelligence Service.

Mr Judge, without receiving consent to do so, allowed the transaction to go ahead thereby giving back over £30,000 to the account holder. By doing so, it was alleged that Mr Judge had committed an offence under POCA. In his defence, Mr Judge argued that he was trying to prevent the account holder being tipped off.

The outcome

At trial, the CPS expressed the view that they had insufficient evidence to secure a conviction against Mr Judge without the results of the ongoing criminal investigation being disclosed. The investigation is not likely to be concluded until next year. As a result, the CPS decided that it would not be in the public interest to adjourn Mr Judge's case for such a long time and therefore a decision was taken to withdraw the charges.

The police made a statement to the press in which they emphasised that they could not prove that the £30,000 involved in the suspected transaction was actually the proceeds of crime.

20.7.3 JMLSG Guidance Notes (2006 edition)

On 1 September 2006, the Joint Money Laundering Steering Group Guidance Notes (2006 edition) ("Guidance") came into force. The Guidance encourages financial services firms to adopt a risk-based approach when dealing with the issue of money laundering. The Guidance is in two parts: Part I gives generic guidance that applies across the UK financial sector; and Part II comprises extensive additional guidance aimed at particular sectors. The key changes in the Guidance are:

Senior management responsibility

The role of senior managers will increase with the wider use of a risk-based approach, which will require firms to assess their vulnerability to money laundering and/or terrorist financing. Firms will be required to have systems and procedures to manage this, rather than the box-ticking approach previously adopted by many firms.

Risk-based approach

The revised Guidance encourages firms to assume that most customers are not money launderers, but to have systems in place to highlight those customers, products and jurisdictions which, on the basis of the firm's assessment, may indicate that they present a higher risk. The Guidance does not prescribe in detail the approach that firms should adopt, but outlines the stages that such an approach should encompass, and the questions that a firm should ask itself at each stage. This is supplemented by sector-specific advice.
**Simplification of customer identification**

For the first time, the Guidance distinguishes between the information about a customer that a firm should obtain, and the extent to which it should be required to verify it. It is also recognised that the standard level of identification for individuals is capable of being met, at least in face-to-face situations, by a single document. This is a major departure from the current approach of a "Passport/driving licence and utility bill", which has been the cause of negative comment from customers and the media.

The Guidance also addresses how to deal with those customers who cannot reasonably be expected to have standard identification and more guidance is provided on the use of electronic data sources for identification.

Other changes effected by the Guidance are that there are now clearer, simpler identification procedures where more than one firm is involved in a single transaction. These are designed to avoid the customer being asked to produce ID documents more than once. It has also enabled firms to rely on "confirmations" provided by other regulated firms that have already undertaken due diligence, which should assist in reducing the compliance burden.

**Initial ID and ongoing checks**

The Guidance represents a better balance between initial identification procedures and the ongoing monitoring of customers accounts to identify unusual and potentially suspicious transactions, and to collect additional KYC information. The Guidance recommends that firms consider this balance against the risks that they face and the nature of the products that they provide.

20.7.4 Fraud Act 2006

See paragraph 13.5.

20.7.5 "SOCA - The agency you do not want to play around with" 28

See paragraph 13.1.1.

20.7.6 Serious Organised Crime and Police Act 2005

See paragraph 13.1.2.

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20.7.7 Proceeds of Crime Act 2002

There have been a number of amendments to the Proceeds of Crime Act 2002 including:

- a new defence to the offences of failing to disclose money laundering under sections 330-332. If a person can prove that the conduct giving rise to the alleged proceeds of crime was committed outside the United Kingdom and was legal in the jurisdiction in which it occurred, no offence under sections 327-9 will have been committed. However, there is a proviso concerning conduct described by the Secretary of State;

- where a bank or other deposit taking body operates an account of a person suspected of money laundering, an offence will not be committed in respect of transactions below £250 or such higher amount as may be specified by a constable or an officer of the Revenue and Customs, or by a person authorised by the Director General of SOCA. The £250 threshold can be varied and different thresholds can be specified in relation to the same account, for example, there may be different thresholds for withdrawals and deposits;

- an amendment to the failure to disclose provisions. The obligation to disclose a suspicion of money laundering will now only apply if the person required to make the disclosure knows the identity of the person engaged in the money laundering offence or the location of the laundered property or if the disclosure of information may assist in establishing the identity of the person engaged in the money laundering or the location of the laundered property;

- the removal of the requirement to follow an employer's procedures when making a disclosure to a nominated officer. It is an offence, however, not to use the form and manner prescribed when making a disclosure to SOCA, unless there is a reasonable excuse for not doing so. Failure to follow the prescribed form is now punishable by a fine not exceeding level 5 on the standard scale.

See also section 13, Corporate Crime.

20.8 FSA handbook update

20.8.1 Introduction

The FSA Handbook has undergone a number of changes this year, due particularly to implementing European initiatives. The FSA has also produced a number of consultation papers outlining their proposed changes to many of the core elements of the Handbook. Some of the more important changes and possible modifications are listed below.
20.8.2 Money Laundering sourcebook

The Money Laundering sourcebook was removed from the Handbook this year. It has, however, been replaced by a number of provisions in the SYSC sourcebook. The change was made to simplify the FSA’s anti-money laundering regulations and to place more of the responsibility on senior management. In addition, the changes allow for a risk-based approach to anti-money laundering procedures.

20.8.3 Prudential requirements

The FSA made a number of changes to the prudential requirement sourcebooks, in part to implement the Reinsurance Directive and the Capital Requirements Directive. The General Prudential sourcebook ("GENPRU") has been created for banks and building societies, and contains rules regarding valuation, calculation of capital adequacy requirement and adequacy of financial resources. GENPRU also contains some of the roles originally found in the Integrated Prudential sourcebook ("PRU") regarding insurers.

The Banks, Building Societies and Investment Firms sourcebook ("BIPRU") is also for banks and building societies as well as BIPRU investment firms. It includes rules covering the definition of a trading book, operational and group risk, and securitisation, and disclosure. BIPRU comes into force in part on 1 January 2007, with the remainder of the provisions coming into force on 1 January 2008.

The Insurers Prudential sourcebook ("INSPRU") has been created for insurers, the Society of Lloyd's and Lloyd's managing agents, and comprises rules originally found in PRU and the Lloyd's sourcebook. INSPRU also includes changes regarding off-market derivatives in insurance.

The Mortgage and Home Finance Firms, and Insurance Intermediaries sourcebook contains the prudential requirements for firms who engage in Home Reversion ("HR") and Home Purchase Plans ("HPP"), as well as the level of capital requirements for providers of HR and HPP's.

The Undertakings for Collective Investments in Transferable Securities (UCITS) Prudential sourcebook incorporates rules on capital measurement and capital standards from the Revised Basel Framework.

20.8.4 Reporting for Home Reversion and Home Purchase Plans

HR and HPP's will become regulated from 6 April 2007. As a result, the FSA made a number of modifications to the Supervision sourcebook ("SUP") regarding the regulatory reporting requirements of HR and HPP's. HR and HPP's will have to comply with the complaints handling requirements set out in Dispute Resolution: Complaints, as well as collect and record complaints received on or after 6 April 2007. The FSA made some changes to the rules to incorporate HR and HPP reporting requirements, and proposed to create an additional report to specifically obtain HR and HPP product sales data. In addition to these changes there have been other changes in a number of the sourcebooks, including the Mortgages: Conduct of Business sourcebook, regarding HR and HPP's.
20.8.5 Fee changes

There have been a host of changes to the Fees sourcebook in 2006. One important change will affect the funding arrangements of firms that establish, operate and wind up personal pension schemes. The rules change the basis of the application fees, the FSA periodic fees, and the Financial Services Compensation Scheme and the Financial Ombudsman Service ("FOS") levies. The FSA also set the new 2006/7 FSA periodic fees and the FOS general levy tariff rate. In addition, the FSA made many small changes including: changing the minimum listing application fee; introducing a new fee for variations of permission; removing discounts for payment of fees by direct debit, BACS and CHAPS; and reducing the application fee for firms to make simple changes in their legal status.

20.8.6 Changes to Conduct of Business

In October, the FSA published two consultation papers (CP06/19 and CP06/20) containing proposals for the implementation of the provisions of the Markets in Financial Instruments Directive. These proposed changes will affect many of the sourcebooks including COB, SYSC, DISP, SUP and Training and Competence. The changes to COB include new requirements from MiFID, as well as a rearrangement of the material originally in COB. The draft sourcebook has been titled NEWCOB by the FSA. The proposed changes include the requirements for client categorisation, the obligation of suitability for advice on investments, appropriateness tests for some non-advised sales and the requirement of firms to provide best execution to its clients. The changes to the other sourcebooks would include complaints handling procedures, record keeping, non-scope transaction reporting, the outsourcing of portfolio management, and training and competence requirements.

The second Consultation Paper (CP06/20) also deals with proposed changes to COB, but is confined entirely to financial promotions and communications from firms. The changes are intended to provide the standards for communication with clients who fall in the new client categories of professional and retail clients. The overriding theme is that communications must be "fair, clear and not misleading". The changes also intend to simplify the approval and communication of financial promotions that are aimed at retail clients. The changes create high-level requirements for firms, and eliminates much of the detail originally contained in COB. These changes are intended to take effect on 1 November 2007.

20.8.7 Approved persons regime

In August of this year, the FSA published an informal paper on reforming the approved persons regime. As of July, the FSA removed the reporting requirement for firms to submit an annual significant management function report. All of the significant influence functions will be merged into two new functions, and the sole trader function will be deleted. Following this line of consolidation, the FSA has proposed that it would merge the different customer functions into a single generic customer function.
20.9 **Home reversions and Islamic home purchase plans**

The Financial Services Authority published its final rules on home reversion plans and Islamic law compliant home purchase plans on 30 October 2006, which will come into force on 6 April 2007.

The new rules require firms undertaking these activities to be authorised by the FSA or be exempt. The new rules are designed to provide consumer protection, which is comparable to that already in place for similar products. The FSA has outlined the key benefits to customers of the new rules. These are:

- firms offering these products must be fit and proper and appropriately resourced with staff competent to undertake this business;
- consumers will get clear, concise and consistent information about a firm's services and products on offer (including appropriate risk warnings) so they can make informed choices;
- consumers will get good quality advice and be sold suitable products which take account of their circumstances and needs; and
- if things go wrong, consumers are able to obtain redress, if appropriate.

20.10 **The capital requirements directive and investment firms**

The Capital Requirements Directive is a short-hand reference for two separate directives that will amend or "re-cast" the existing Banking Consolidation Directive and the Capital Adequacy Directive ("CAD"). Investment firms will only be affected by the amendments to the CAD.

The new prudential rules which implement the CRD are effective from 1 January 2007. However, there are transitional provisions which effectively mean that firms will largely continue to apply the rules of the relevant IPRU Interim Sourcebook during 2007. The transitional period expires at the end of 2007 so that the CRD will be fully implemented from 1 January 2008. Firms that are not currently subject to the Investment Services Directive, but will become subject to the Markets in Financial Instruments Directive, such as firms that deal exclusively in commodity derivatives, will not become subject to the CRD until MiFID is implemented on 1 November 2007. For more information about MiFID, see paragraph 20.5.

Firms that conduct designated investment business will broadly fall into four categories:

- Firms that are not subject to the CAD - this includes firms that do not conduct MiFID activities; advisers and arrangers who do not hold client money (and firms that deal exclusively with large clients may be able to fall within this category by relying on the FSA's client money exemptions); and firms that deal exclusively in non-MiFID investments.
- Limited Licence Firms - being CAD firms that are not permitted to deal on own account.
- Limited Activity Firms - CAD firms that can deal on own account, but only on behalf of clients, and which are not permitted to undertake safe custody activities.
• Full-Scope BIPRU Firms - namely firms that do not fall within any of the above categories.

Firms that are not subject to CAD will continue to be subject to the Interim Prudential Sourcebook for Investment Firms after 1 January. CAD firms will become subject to two new sourcebooks, GENPRU and BIPRU, after the expiration of applicable transitional provisions.

Limited Licence Firms will be subject to a €50,000 or a €125,000 base requirement (which largely mirrors the existing ISD categorisation). In addition, they will need to calculate their credit risk, market risk and fixed overheads. Their overall capital requirement will be the higher of:

• the base requirement;

• the sum of the credit risk and the market risk requirement; and

• the fixed overheads requirement.

Limited Activity Firms will automatically have a €730,000 base requirement, as at present. Their overall capital requirement will be the higher of:

• €730,000; and

• the sum of the credit risk, market risk and fixed overheads requirements.

Full-Scope BIPRU Firms will be subject to a new operational risk requirement. Their overall capital requirement will be the same as for Limited Activity Firms, except that the operational risk requirement will supplant the fixed overheads requirement.

The firms whose position is likely to change most are Full-Scope BIPRU firms and firms whose activities fall under MiFID but did not fall under the ISD (and that do not fall within an exemption). In certain cases, such firms are permitted to apply for standard waivers, granting them up to four more years in which to comply with the new rules, but it is the firm's responsibility to apply for the waiver, which will not be automatically granted.

Groups will obviously have to reassess their consolidated supervision position if any group members become subject to new rules.

Although the FSA has been extremely active in trying to promote firms' interest in these matters through a series of targeted "Dear CEO" letters, the timetable that the industry has been allotted to absorb the new rules is short, although many of the CRD requirements will not be imposed on firms until 1 January 2008 when the transitional period ends.

20.11 Data protection: financial messaging and payment service

See paragraph 15.5.
21. FREEDOM OF INFORMATION: SCOTLAND

For FREEDOM OF INFORMATION: ENGLAND, see section 22.

Two years on from the introduction of the Freedom of Information (Scotland) Act 2002 ("FOISA"), here are some key developments to take note of:

- **Take note of the test cases on the Act from the Court of Session** which required the NHS Scotland to release "statistically translated" information relating to the incidence of childhood leukaemia in Dumfries and Galloway. The court confirmed that the Scottish Information Commissioner ("SIC") has wide ranging powers which the Scottish courts will be reluctant to restrict and that public bodies will have to go further than originally thought to provide and process information to respond to a request.

  Most recently, the Court of Session has again found in favour of the SIC in a further two cases which call for the disclosure of highly sensitive Scottish Executive documents: the first case related to why the exclusive rights of solicitors and advocates to represent clients in the Scottish courts has been protected for so long; and the second concerned plans for dumping waste in a protected Scottish quarry.

  The decisions of the SIC have been upheld in all three cases.

- **Be aware of the SIC's interpretation of exemptions** to ensure you can effectively protect your organisation's sensitive information. In a recent case for example, the SIC considered there would be public interest in disclosing information held in confidence, where to withhold the information would cover up a wrong doing, allow the public to be misled or unjustifiably inhibit public scrutiny of matters of genuine public concern.

- **Consider the indirect impact**: some bodies are still underestimating the potential for their sensitive information to be obtained from another body covered by the regime. Information at risk of such "back door" access includes information passed to the Scottish Executive, Scottish Parliament and regulators. Ensure that any sensitive information which is passed to other public bodies is clearly marked as such, and that a process for consultation is in place.

- **Ensure you have robust procedures in place for classifying, filing and disposing of records**: the 2006 Scottish Annual Freedom of Information Conference identified the need for detailed guidance on records management to improve access to information. The SIC indicated that, in 2007, he will be more focused on good records management and assessing whether public bodies are meeting their obligations to date.

- **Provide an up to date disclosure log** of requests and information released under the FOISA. As increasingly encouraged by the SIC, this helps ensure transparency and avoids "reinventing the wheel" when receiving duplicate requests. Also, releasing information on your website contemporaneously with its release to a requester can also allow you to put the information in a fuller context and help take the wind out of the sails of an "information scoop".
22. FREEDOM OF INFORMATION: ENGLAND

For FREEDOM OF INFORMATION: SCOTLAND, see section 21.

22.1 DCA\textsuperscript{29}/OGC\textsuperscript{30} procurement guides

The Freedom of Information Act 2000\textsuperscript{31} ("FOIA") provides individuals with an opportunity to access information held by government and public bodies, with the objective of a more open government. FOIA is an important consideration in public procurement as it provides a general right of access to information about all public contracts and procurement activity held by public authorities, including information held by another on behalf of such authority. The information must only be held by the authority at the time of the request and therefore covers existing and completed contracts. There is no requirement under FOIA that the person requesting and/or receiving the information be of special status, such as a losing bidder, so it is open to a supplier to request information on its competitor solely for commercial purposes.

On 23 February 2006 the Department of Constitutional Affairs ("DCA") published working assumptions providing guidance on how requests for certain types of information should be processed within the different phases of the procurement process and immediately after a contract has been completed\textsuperscript{32}. The DCA's guidance makes it clear that whenever information provided by a supplier is requested, whilst the final decision on the release of the information rests with the authority, the authority should seek the supplier's views about the sensitivity of the information. The guidance is relevant to all "procurement information" which is defined as "information generated by and given to public authorities as part of the process of procuring goods and services from commercial suppliers".

The Office of Government Commerce ("OGC") has also issued a policy and guidance statement which, whilst primarily aimed at central government departments, has wider application across the public sector in relation to civil procurement. The OGC guide represents the government's view of the application of FOIA to public procurement and applies and complements the DCA's guidance in the context of civil procurement.

Both the OGC and DCA guidance demonstrate that a public authority can only withhold information requested under the FOIA in exceptional circumstances. The most relevant exemptions relevant to procurement activities are (i) the Commercial Interests exemption contained in section 43 and (ii) the Information provided in confidence exemption contained in section 41.

The DCA assumptions give examples of the types of information that should be released by a contracting authority and also the information which may be withheld under one of the exemptions according to the different phases of the procurement. The principle is that commercially-sensitive information which is received or created by the contracting authority

\begin{itemize}
\item \textsuperscript{29} http://www.dca.gov.uk/procurement/index.htm
\item \textsuperscript{30} http://www.ogc.gov.uk/procurement_policy_and_the_eu.asp
\item \textsuperscript{31} http://www.opsi.gov.uk/acts/acts2000/20000036.htm
\item \textsuperscript{32} http://www.foi.gov.uk/practitioner/handlingrequests.htm
\end{itemize}
at one stage of the procurement may not be commercially sensitive at a later stage in the procurement, depending on the circumstances. The assumptions clarify a public authority's position in the following four phases of the procurement process:

- Requests for procurement information made before invitations to bid have been issued.
- Requests for procurement information made after requests for tender have been issued but before the selection of the preferred bidder.
- Requests for procurement information made after a contract has been let and during the delivery of the contract.
- Requests for procurement information or for commercial market information made after a contract has been delivered, or made outside the procurement process.

22.2 John Connor Press Associates Limited ("JCPA") v The Information Commissioner (25 January 2006)\(^3\)

A significant decision in the application of the section 43(2) FOIA exemption in relation to procurement arrangements was reached in this appeal by JCPA against the Information Commissioner's decision that it was in the public interest to withhold information requested by JCPA. This represents the first substantive case considering the public interest test to be applied under section 43.

In this case, the National Maritime Museum ("NMM") staged an exhibition by an artist called Conrad Shawcross as part of its contemporary arts programme. On 12 January 2005 JCPA requested NMM under FOIA to provide all documents and correspondence relating to any payments made to Conrad Shawcross. NMM redacted all financial details from the documents it provided to JCPA, explaining that it should not disclose this since it would be likely to prejudice the commercial interests of both NMM and Conrad Shawcross, relying on section 43(2) of FOIA.

The information redacted included NMM's contribution to production of the work, the valuation of each work, estimated costs of production and exhibition and sums sought from other sponsoring bodies. A substantial amount of information about the transaction was however disclosed by NMM, such as NMM's financial support taking the form of a costs contribution and the total contribution of the Arts Council England. JCPA complained that NMM did not have the right to withhold financial information but NMM maintained its refusal, stating that disclosure at that time would be likely to prejudice NMM's bargaining power during contractual negotiations with other artists and would compromise Conrad Shawcross's bargaining position in relation to negotiating subsequent sales of similar works.

JCPA lodged an application with the Information Commissioner under section 50 of FOIA for a decision as to whether the request had been dealt with by NMM in accordance with FOIA. The Information Commissioner's decision notice, issued on 20 June 2005, recorded that the financial information fell within section 43(2) and that the public interest in maintaining that exemption overrode the interest in disclosing it. The Commissioner's reasoning in applying the public interest test was that, although he recognised the public interest in financial

http://www.informationtribunal.gov.uk/Files/ourDecisions/connorpress_v_infocommissioner.pdf
transparency and accountability where public authorities commission new works of art, particularly where that is not their core activity, NMM was in active negotiations with another artist for its arts programme. Premature release of the financial arrangements would prejudice its bargaining power, which overrides the public interest in releasing those arrangements. He gave particular weight to the fact that NMM were dealing with public funds and needed to ensure value for public money.

JCPA appealed the Information Commissioner's decision on the grounds that the Commissioner wrongly decided that the exemption under section 43(2) of FOIA was relevant in this case and that, even if the information was exempt, it should have been disclosed on the basis that the public interest in disclosure outweighed the public interest in protection NMM from prejudice.

The Information Tribunal considered the impact on negotiations with the next artist with which NMM was in active negotiations at the time the request for disclosure was made, Beth Derbyshire. NMM conceded that Beth Derbyshire's work was different from that of Conrad Shawcross but stated that there were important common elements, such as that they were both part of the arts programme and that the investment of public money was involved in both cases.

The tribunal accepted that the commercial interests of a public authority might be prejudiced if certain information in relation to one transaction were to become available to a counterparty in negotiations on a subsequent transaction. However, whether they were or not would depend on the nature of the information and the degree of similarity between the two transactions. This issue was whether disclosure of the particular information withheld from JCPA would have been likely to cause such prejudice to NMM at the time of refusal of disclosure, by undermining its negotiating position with Beth Derbyshire. The tribunal did not consider this threshold reached as the information already disclosed by NMM would have provided any artist entering negotiations with substantial information, and that the nature of the works were so different that they could not be treated as true comparables for the purpose of negotiation. It was concluded that no sufficient risk of prejudice to the commercial interests of NMM was demonstrated to justify the exemption under section 43(2) and the tribunal therefore did not consider the balance of public interest.

23. HEALTH AND SAFETY

23.1 The Construction Design and Management Regulations

The Construction (Design and Management) Regulations 2007 ("CDM 2007") are due to come into force on 6 April 2007. CDM 2007 will apply to all construction projects, whether or not they started before the commencement date.

CDM 2007 expands the definition of the "client" to include any "person who in the course of a business seeks or accepts the services of another person which may be used in the carrying out of a project for him, or if he carries out a construction project himself". This broad definition means that more persons than ever before will have duties under the regulations.

CDM 2007 also extends the scope of clients' duties for health and safety on a construction site. This includes the introduction of a new duty requiring clients to establish that management arrangements are in place to ensure that:

- construction work can be carried out without health and safety risks; and

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any structure designed as a workplace has been designed so that it can be used as a workplace without health and safety risks.

Clients will also be obliged to assume the roles of any other duty-holder (eg the principal contractor and/or the coordinator) to the extent that he fails to make those appointments.

Currently a client has the right to appoint a third person (eg a contractor) to perform his duties and assume his liabilities under CDM 1994. However, this right will be abolished under CDM 2007. That means that, from 6 April 2007, clients will be obliged to undertake all of the responsibilities imposed by CDM unless they can find another client on the project willing to undertake those responsibilities (as it will still be possible to delegate responsibility to another client on the project). The narrowing of the delegation rules will have a significant impact on clients who currently assign their duties to third parties as a matter of course. Note that any person acting as a client's agent under CDM 1994 will be permitted to continue in that role until the end of that project or April 2012, whichever comes first.

The role of the planning supervisor will be scrapped as from April 2007. That role will be taken over by a "coordinator", who will advise and assist the client to meet its obligations under CDM 2007. While some of the coordinator's duties are similar to the planning supervisor's duties, there are a few new duties that may increase the involvement (and possibly the cost) of coordinators. Planning supervisors who were appointed to a project under CDM 1994 will have until April 2008 to become "competent" coordinators for that project. Similarly, the clients who have appointed those planning supervisors will have 12 months to ensure that those appointees become competent coordinators.

CDM 1994 currently obliges designers to assess their designs so as ensure that the structures designed can be built, maintained and demolished safely. This duty has been extended under CDM 2007 to require designers to ensure that the structures they design can be used safely as well. Also, the obligations under CDM 2007 will be extended to foreign designs used in projects within Great Britain, which could affect the terms of appointment for foreign designers.

There have also been a few minor changes to the duties of principal contractor and contractors.

To support CDM 2007, a new Approved Code of Practice has been prepared and is due to be published in January 2007.

For further information, see http://www.hse.gov.uk/construction/cdm.htm.

23.2 Control of Noise at Work Regulations 2005

These regulations, which implement the EU Directive on the exposure of workers to physical agents, repeal and replace the Noise at Work Regulations 1989. They came into force on 6 April 2006 and significantly change the requirements to be placed on employers and others as regards control or exposure to noise. They apply to self-employed persons as well as employers. They impose lower noise exposure and level limits and significantly increase paperwork, particularly in respect of the risk assessments which employers and other duty-holders have to make. They apply to nearly all workplaces, including workplaces where the risk of exposure to noise might not be immediately obvious. The musical entertainment sectors and, to the extent the regulations are applicable to it, the merchant shipping sector,
will not be subject to the regulations until 6 April 2008. Guidance on Compliance with the regulations is available on the HSE website. See http://www.hse.gov.uk/noise/.

23.3 Control of Asbestos Regulations 2006

These regulations came into effect on 13 November 2006. They revoke and replace three sets of existing regulations, the Control of Asbestos at Work Regulations 2002, the Asbestos (Licensing) Regulations 1983, and the Asbestos (Prohibitions) Regulations 1992. Each of these sets of regulations had its associated Approved Code of Practice and these are also replaced by a single new ACOP.

The changes made by the new regulations are mainly concerned with workers engaged in the removal of asbestos containing materials and the maintenance and servicing of building which may contain such materials. The new regulations also introduce a new control limit common to all types of asbestos and lower than that previously applying to any type of asbestos. They also provide for the provision of respiratory protective equipment, so far as is reasonably practicable to any employee exposed to asbestos. While the existing UK regime requiring the use of licensed contractors for high risk work is retained, and strengthened by a limit of three years placed on the duration of licences, the licensing requirements are disappplied for work which is likely to be sporadic and of low intensity. The regulations retain the duty to manage asbestos in non-domestic premises which was introduced in May 2004. For further information see http://www.hse.gov.uk/asbestos/index.htm.

See also the OPSI website: http://www.opsi.gov.uk/si/si2006/20062739.htm

A Transposition Note setting out how each article of the directive has been transposed into national legislation is also available on the HSE website:


23.4 Regulatory Reform (Fire Safety) Order 2005

The biggest single reform of the fire safety regime in England and Wales came into effect on 1 October 2006. The Regulatory Reform (Fire Safety) Order 2005 ("Order") consolidates and replaces many of the current fire safety requirements. It abolishes the requirement for fire certificates and, instead, places general duties on those with responsibility for premises which are in line with the general principles of health and safety law.

The Order applies to virtually all premises including any workplace, subject to limited exceptions such as domestic premises, agricultural land and mines. Vacant premises can also fall within the scope of the Order.

The Order is intended to protect the safety of "relevant persons" which includes (i) any person who may be lawfully on the premises and (ii) any person in the immediate vicinity of the premises who is at risk from fire on the premises.

The duty for ensuring compliance with the Order is on the "responsible person" for each premises. The responsible person is (a) in relation to a workplace, the employer, if the workplace is to any extent under his control; and (b) in relation to any other premises: (i) the person who has control of the premises (as occupier or otherwise) in connection with the carrying on by him of a trade, business or other undertaking (for profit or not); or (ii) the
owner, where the person in control of the premises does not have control in connection with the carrying on by that person of a trade, business or other undertaking. If there is more than one person responsible for the premises, they must take all reasonable steps to co-operate with one another.

There is an overarching obligation imposed on the responsible person to (i) take such general fire precautions as will ensure, so far as is reasonably practicable, the safety of his employees and (ii) in relation to relevant persons who are not his employees, take such general fire precautions as may reasonably be required in the circumstances of the case to ensure that premises are safe.

The expression "general fire precautions" is broadly defined as including measures to reduce the risk and spread of fire, measures in relation to the provision of means of escape from the premises that are safe and effective to use and measures in relation to means for fire fighting and fire detection.

The key to deciding what general fire precautions must be taken is the carrying out of a suitable and sufficient risk assessment. This risk assessment must be recorded where, for example, more than five employees are employed by the responsible person.

The preventative and protective measures which are identified by the responsible person as a result of the carrying out of the risk assessment should be applied on the basis of the principles of prevention. The principles of prevention include avoiding risks and giving appropriate instructions to employees.

The responsible person must make and give effect to such fire safety arrangements as are appropriate having regard to the size of his undertaking and the nature of its activities, for the effective planning, organisation, control, monitoring and review of the preventative and protective measures. Again, there is a requirement for such arrangements to be recorded in certain circumstances.

Where dangerous substances are present on premises, the responsible person must ensure that the risk-based assessment which is carried out covers, for example, the hazardous properties of the substance and information provided by the supplier. It may also be necessary to adopt additional emergency measures in respect of dangerous substances.

In addition to the duties set out above, there are also duties in relation to the appointment of one or more "competent persons" to assist in undertaking the preventative and protective measures. Also, adequate safety training and information must be given to employees and a system of maintenance put in place for fire safety equipment, including fire-fighting and fire detection equipment.

In most cases the enforcing authority will be the local fire and rescue authority, which is charged with responsibility for undertaking regular inspections of premises. Three notices may be served for non-compliance with the Order (alterations notices, enforcement notices or prohibition notices). Failure to comply with the Order itself and/or the requirements of any such notices could lead to criminal liability, resulting in fines and potential imprisonment for individuals.

For further information, see paragraph 42.5 which includes a link to guidance on the new regime.
23.5 Criminal liability

R v HTM Ltd [2006] EWCA Crim 1156

The Court of Appeal has provided important clarification on two key points regarding criminal liability for breaches of the "general duties" imposed under health and safety law. However the practical impact of the decision covers a fairly narrow area, and the decision could well be reversed by legislation, particularly if another case currently pending before the Court of Justice of the European Communities goes against the UK government.

The case came before the Court of Appeal on appeal from a determination of a Crown Court Judge made at a preliminary hearing before trial. It concerned a fatal accident suffered by two employees who had moved mobile telescopic towers used for illumination for traffic management during road resurfacing works. The mobile telescopic towers were set up in proximity to high voltage overhead power lines. Contrary to the instruction and training given to the more senior of the two employees, and despite a notice placed on the towers indicating that the towers should be lowered before moving, the employees moved the towers without lowering them, and were electrocuted.

Their employers were prosecuted for an alleged breach of the general duty to employees under section 2(1) Health & Safety at Work (etc) Act 1974 in failing to provide a safe system of work, and the necessary information instruction and supervision.

The defence sought to argue that the actions of the deceased employees, at least one of whom had been properly trained and instructed, were not reasonably foreseeable, so that there were no reasonably practicable measures which they could have taken to prevent the accident. The prosecution then sought to prevent this line of argument being advanced, on the basis that foreseeability was irrelevant to the issue of reasonable practicability, and that regulation 21 Management of Health & Safety at Work Regulations 1999 prevented the company from relying on any act or default of either of their employees.

The Court of Appeal held that, in the case of a duty such as that in section 2(1) HSWA, which is "qualified" in the sense that the duty holder must only do all that is reasonably practicable, evidence of the foreseeability of a risk is relevant for the limited purpose of supporting a case that the duty holder had taken all reasonable means to eliminate it.

The Court of Appeal also held that, while regulation 21 prevents a defendant putting forward a defence based on the act or default of an employee, it does not prevent a defendant putting forward evidence tending to show that what happened was purely the fault of an employee, and that everything reasonably practicable had been done by the defendant to prevent it. This is because that would not amount to a defence, but rather an argument that the prosecution had not made out its case with regard to an essential ingredient of the offence.

The Court of Appeal decision makes it clear that regulation 21 does not, as has been widely assumed, make employers automatically or "vicariously" liable in criminal law for the acts or defaults of their employees.

However, the decision in R v HTM Ltd is only likely to assist employers in a case where the charge relates to a "qualified" duty, and the circumstances are such that the employer can prove that all reasonably practical steps have been taken to prevent the risk. It will not assist employers charged with a breach of an absolute duty which is placed on them, as is the case under most health and safety regulations. Nor will it assist employers where the duty is a
"qualified" one, but the drafting of the regulations is such that it is stated to be a defence to show that all reasonable steps have been taken. In that case regulation 21 will almost certainly preclude the employer relying on the act or default of an employee. It should also be pointed out that, even in cases where the duty is "qualified", the onus of showing that it has been discharged is effectively on the defendant as a result of the reversal of the burden of proof effected by section 40 HSWA, and it is only in fairly exceptional circumstances that the defendant is likely to be acquitted.

The HSE sought to take the case to the House of Lords, but their Lordships declined to review it.

However, it is quite possible that the decision may effectively be reversed by legislation.

There are proceedings currently before the ECJ in Luxembourg under which the EU Commission is challenging the existence of the "qualified" general duty owed by employers to their employees under section 2 HSWA as incompatible with the requirements of the Health and Safety Framework Directive (Directive 89/391/ECC). It is likely that judgment will be handed down early next year.

The argument of the Commission is that the obligations of employers as set out in the directive are not qualified in this way, but for most purposes are set out in absolute terms, and therefore the UK government has failed to implement the directive by relying on legislation which predates the directive and falls short of its requirements.

If the ECJ finds for the Commission in this case, then the UK government would be obliged to amend the legislation so as to remove the "qualification" by reference to reasonable practicability of the general duty under section 2 HSWA and any comparable qualification in all the subordinate legislation enforcing duties imposed under the directive (other "general duties" under HSWA, such as those employed under section 3 HSWA to the employees of other employers, or to the public at large, would not necessarily be affected, because the directive is not concerned with such duties). If the qualification by reference to reasonable practicability is removed, that would also remove the whole basis of the decision in R v HTM Ltd. Accordingly the fact that the validity of the "qualification" of the general duties was about to be revised by the ECJ may well have been one of the factors behind the decision of the House of Lords not to consider a prosecution appeal.

It should however be noted that, in the particular case where an accident is the result of an unforeseeable act of an employee, the directive itself would permit a similar result, though by a slightly different route. This is because, although article 5(3) of the directive provides that "the worker's obligations in the field of safety and health at work shall not affect the principle of the responsibility of the employer", article 5(4) gives member states the option to provide for the exclusion or limitation of the employer's responsibility where occurrences are due to "unusual and unforeseeable circumstances, beyond the employer's control, or to exceptional events, the consequences of which could not have been avoided despite the exercise of all due care".

Whether the UK government would exercise this option is perhaps another matter, as the history of regulation 21 Management of Health and Safety of Work Regulations 1999 (which was apparently drafted in order to give effect to article 5(3) but not to article 5(4)) suggests that the government is likely to come under pressure from the HSE to make life easier for regulators by not exercising the option.
23.6 Sentencing

R v Balfour Beatty Rail Infrastructure Services Ltd

In July 2006 the Court of Appeal announced its decision in the appeal against sentence brought by Balfour Beatty Rail Infrastructure Services Ltd, formerly Balfour Beatty Rail Maintenance Ltd (“Balfour Beatty”) following its guilty plea to a charge under section 3(1) HSWA in respect of the Hatfield derailment in October 2000, in which four passengers were killed and 102 injured. Balfour Beatty had also been prosecuted for manslaughter, but the trial judge had ruled that there was no case to answer in respect of that charge. Balfour Beatty appealed against a fine of £10m on four grounds. The first was that the judge had assessed Balfour Beatty's failure as excessively grave, the second was on allegation that the fine was disproportionate to the fine of £3.5m imposed on Network Rail in respect of the same incident, the third was that the fine was at an excessive level in all the circumstances, and having regard to other large fines for health and safety offences, the fourth was that there should have been a discount for a (belated) plea of guilty.

Only the second ground of appeal was successful, and in order to reduce the disparity in sentence the Court of Appeal made a modest reduction of the fine to £7.5m.

The case is significant in that the Court of Appeal clearly endorsed the principle of very large fines in respect of fatal accidents resulting from the health and safety failings of large companies.

The case is also of interest because the court pointed out that, while large fines can be expected in the case of a systemic failure attributable to a fault of management, a deterrent sentence on a company was neither appropriate nor possible where the relevant breach of duty was due to negligence or inadvertence on the part of an individual which did not reflect a systemic management failing. The court indicated that, where the consequences of an individual's act or default have been serious, the fine should reflect this, but should be an order of magnitude smaller than the appropriate fine for a breach of duty consisting of a systemic failure.

The court also observed that, since the 1974 Act allows the court to pass a sentence reflecting the full culpability of a company which had caused a fatal accident, prosecutors should think carefully before bringing charges of manslaughter which involve strict proof of causation.

Since the proposed new offence of corporate manslaughter (see paragraph 13.7) also will require proof of causation, the Court of Appeal's observation would seem to be equally relevant to that offence.

23.7 Coroners Bill

The Department for Constitutional Affairs published a draft Coroners Bill 12 June 2006. This will replace the whole of the Coroner's Act 1988 and is aimed at modernising the system of coroners and inquests.

Coroners will continue to be appointed and funded by local authorities but the Lord Chancellor will have power to determine new coroner area boundaries. This is likely to lead to the establishment a core service of fewer full time coroners, supported by part-time assistant coroners in particular areas. There will be a new position of Chief Coroner assisted by Partition Deputy Chief Coroners. There will be a new system of appeals against decisions...
or determinations of coroners with the appeal going to the Chief Coroner. Any further appeal will lie to the Court of Appeal on points of law only.

Investigations relating to treasure will be carried out by a designated Coroner for Treasure who will act in the whole of England & Wales.

The Bill draws a clearer distinction between investigations into deaths and inquests. It removes the need for coroners to investigate certain enquiries into deaths, such as those which occurred more than 50 years ago or deaths abroad, except in particular cases where there is considered to be a special public interest in conducting such an investigation.

The Bill will give coroners new powers to acquire information to be given to them, and powers of entry, search and seizure.

There are provisions aimed at ensuring the earlier release of bodies. The number of jurors required for a coroner's jury will be reduced; and there are also changes to the law regarding the suspension and resumption of inquests.

23.8 HSE Large Organisation Partnership Pilot

In October 2006 the HSE reviewed a 12 month-partnership pilot project involving some 13 large companies. The purpose of the initiative was to provide a more effective and efficient use of regulatory resources by establishing central contact points with larger and better managed organisations. It is intended to reduce the need for inspection visits on such organisations by agreeing standards at a national level and focussing on sample inspections with centralized report writing. This is likely to be beneficial both to the HSE and the organisations concerned. Following the review the HSE has decided to pursue those approaches which were determined to have proved successful in the pilot project with other comparable large organisations.

23.9 HSE stress web page

The HSE has established a web-page on work-related stress. This provides material and resources to help employers and employees understand the causes of stress at work and help identify and solve problems. Associated with the web-page is a series of free one-day workshops organised by the HSE on reducing work-related stress using the HSE's Management Standards Approach which is on the worksite. The workshops which took place in 2006 and will continue in early 2007, are aimed at the five sectors reporting the highest levels of stress-related ill-health: Education Health Services Central Government, Local Authorities and Financial Services.

For further information, see http://www.hse.gov.uk/stress/index.htm

23.10 Corporate manslaughter/homicide

See paragraph 13.7 for information about the Corporate Manslaughter Bill (in Scotland, Corporate Homicide Bill).

23.11 Smoking ban

See paragraph 29.10.3.
24. HUMAN RIGHTS: SCOTLAND

For HUMAN RIGHTS: ENGLAND, see section 25.

24.1 New legislation

24.1.1 Scottish commission for Human Rights Act 2006

This Bill was passed by the Scottish Parliament on 2 November 2006 following a consultation exercise that began in December 2001. The Bill received royal assent on 8 December 2006.

Preparations for establishing the Commission will be the responsibility of the Scottish Parliamentary Corporate Body.

The Commission once it is established will have a duty to promote human rights, and in particular, to encourage best practice in human rights among public authorities in Scotland. It will do so by publishing information about human rights; providing advice or guidance; conducting research; providing education and training; and monitoring law, policies and practice and recommending changes. It will have power to conduct inquiries into Scottish public authorities and compel any member of staff or officer to give evidence or produce documents in relation to an inquiry. It will also have power to enter places of detention in connection with an inquiry and to intervene in civil proceedings in the Scottish courts and in any other court or tribunal where the rules allow.

The Commission will be independent from the Scottish Ministers and Scottish Executive and accountable to the Scottish Parliament. It will deal with all devolved human rights, with reserved matters being handled by the Commission for Equality and Human Rights.

For further information, see the Scottish parliament website at http://www.scottish.parliament.uk/business/bills/48-scottishCommissioner/b48s2-aspassed.pdf

24.2 Case review

24.2.1 Delay in proceedings and the right to a fair trial

Article 6 of the European Convention provides for a right to a fair and public hearing within a reasonable time by a fair and impartial tribunal. Section 6 of the Human Rights Act 1998 requires the Scottish courts not to act in a manner which is inconsistent with the Convention. This has lead to arguments in the Scottish courts about whether the court in fact requires to throw out claims where it considers there has been inordinate and inexcusable delay which is inconsistent with Article 6 of the Convention.

Over the last twelve months there have been two important developments on this issue. Firstly, in the case of McKie & Others v Macrae & Others, Lord Glennie held in the Outer House that the Court of Session required to throw out an action which was raised in 1996 (pursuant to a traffic accident in 1986), sisted (or frozen) for six years and in which the pursuers sought to amend their pleadings (their written case)
in 2005, for want of prosecution. It was suggested that to do otherwise would be to act inconsistently with Article 6 of the Convention.

The second development in this area is the appeal to the Inner House of the Court of Session on the same issue in the case of Tonner v Reiach and Hall. In 2005, when the case was first heard, Lady Smith took a different view from Lord Glennie in McKie and held that the Court of Session could not dismiss an action for want of prosecution regardless of the provisions of the Human Rights Act and European Convention. The appeal was heard in November this year and the judgement is expected shortly.

For more information on McKie & Others v Macrae and Others and Tonner v Reiach and Hall, see the Scottish courts website:


24.2.2 'McKenzie Friends' in the Court of Session

Following the decision in McKenzie v McKenzie in 1971, the concept of the 'Mckenzie Friend' has developed in England and Wales to allow friends or relatives to assist litigants in court. The practice has not be adopted in Scotland until now. In June this year Lord Glennie broke with established Court of Session practice by allowing one of the parties to a litigation to be represented by his wife. He considered that there was a strong presumption in favour of allowing such representation because of the guarantees in respect of the right to a fair trial enshrined in article 6 of the European Convention on Human Rights. This decision has the potential to encourage non-lawyers to extend their provision of legal services.

Kenneil v Kenneil

For further information please see the Scottish Courts Service website:


24.2.3 Recovery of documents and the right to privacy

An action for rectification of a company's register seems an unusual arena in which to find a human rights claim in relation to the right to privacy. However, such a claim arose in this action. Two of the five respondents in the action sought the recovery of documents belonging to the other three. They followed established court procedures to recover the documents and then sought an order for disclosure. This was opposed by the other three who were anxious to maintain the confidentiality and privilege of the documents. They contended that the procedure followed to recover the documents failed to protect their rights under Article 8 of the European Convention of Human Rights (the right to privacy) and the court had no right to make such an order. Temporary Judge MacDonald agreed with the respondents and held that the court would be acting unlawfully if it ordered disclosure of the documents notwithstanding that they had followed established procedures. He therefore continued the action to allow the respondents to set out their claim of confidentiality.

Narden Services Ltd v Inverness Retail and Business Park & Others
25. **HUMAN RIGHTS: ENGLAND**


For HUMAN RIGHTS: SCOTLAND, see section 24.

25.1 **Human rights guide**

This detailed guide, updated in October 2006, explains how the Human Rights Act works and how the various rights have been applied is available on request.


25.2 **Human rights annual report published by the Foreign and Commonwealth office**


The Lord Chancellor published a review on the implementation of the Human Rights Act on 25 July 2006. It includes its impact on development of substantive law, direct impact on policy formulation and decision making, myths and misperceptions and an analysis of its overall effect.

25.3 **Lord Woolf's review of the Working Methods of the European Court of Human Rights.**

[http://www.echr.coe.int/ECHR/Resources/Home/LORDWOOLFREVIEWONWORKINGMETHODS.pdf](http://www.echr.coe.int/ECHR/Resources/Home/LORDWOOLFREVIEWONWORKINGMETHODS.pdf)

The European Convention on Human Rights was drafted in the wake of the second world war and the Holocaust. It was conceived as an early warning system to prevent states from lapsing into totalitarianism. It sets out the fundamental rights and freedoms that states should secure to everyone in their jurisdiction and provided a judicial enforcement system. But now, after 50 years of the Convention system, the courts risks being drowned by its success. The exponential rise in the number of applications stems in no small part from the enlargement of the Council of Europe after 1990 when countries of the former Soviet Bloc acceded to the Convention. In the first nine months of 2005, more than 50% of applications pending at the court were from just four states: The Russian Federation, Turkey, Romania and Poland.

In the review, Lord Woolf suggests ways of improving the administration of the ECHR.

- it should be the responsibility of the individual applicant to submit a properly completed application form;
- there should be greater information and education at national level on the jurisdiction and purpose of the court and on the court's admissibility criteria;
- there should be increased recourse to national ombudsmen and other methods of alternative dispute resolution;
- the court's priority should be to deal, without delay, with admissible cases that raise new or serious convention issues. It therefore follows that clearly inadmissible cases and
repetitive cases should be handled in a way that has the minimum impact on the court's
time and resources;

• the management and organisation of the Registry should ensure that the court's workload
   is processed as efficiently and effectively as possible.

26. INFORMATION TECHNOLOGY

26.1 The Waste Electrical and Electronic Equipment ("WEEE") Directive

The WEEE Directive encourages and sets criteria for the collection, treatment, recycling and
separate recovery of "waste" electrical and electronic equipment ("EEE"). It makes
"producers" responsible for financing most of these activities and by obliging distributors to
allow consumers to return their waste equipment free of charge. Producers must set up
systems for the take-back and treatment of WEEE as well as providing for separate collection
and recovery of WEEE from consumer households. The WEEE Directive does not contain
any mandatory requirement for householders to separate all EEE but member states must seek
to minimise co-disposal and encourage appropriate behaviour. As such, a product of IT
equipment may have potential liability under this directive or find that the disposal and
recycling obligations introduce new costs.

The Waste Electrical and Electronic Equipment Regulations (SI 2006/3289) implementing the

For further information, see paragraph 18.3.1.

26.2 The "Restriction of the use of certain hazardous substances in electrical and electronic
equipment" ("RoHS") Directive

The UK implemented the RoHS Directive by bringing the RoHS Regulations into force on
1 July 2006. The aim of the RoHS Directive is to restrict the quantities of four heavy metals
and two brominated flame retardants used within the manufacture and production of EEE that
are put on the market after 1 July 2006, in order to protect human health and reduce damage
to the environment.

The RoHS Directive applies to any "producer" within the EU and also to producers of EEE
outside the EU (if the equipment they produce is ultimately imported into an EU member
state). A "producer" is defined very widely to include anyone who manufacturers, sells, re-
sells, imports or exports EEE, irrespective of method or selling technique (including internet
sales and distance selling).

There are a number of exempted applications for these substances, some of which have
been agreed since the UK laid the RoHS Regulations before Parliament.

See paragraph 18.3.1 for more information.

Also see http://www.dti.gov.uk/innovation/sustainability/rohs/page29048.html.
OGC Model ICT Services Agreement and Guidelines

Version 2 of the output based ICT service agreement and guidelines was published in September 2006. It comprises a full model agreement (terms and conditions and schedules) with embedded guidance as well as a short series of Guidance Notes on cross-issue topics.

For more information, see http://www.partnershipsuk.org.uk/ictguidance/

A company’s implied consent to receive emails was not without limits and did not cover emails sent to disrupt the proper operation and use of the computer system

What recourse do you have against a disgruntled employee who decides to activate a mail bombing program against your company?

This case concerned the respondent ("L") who had been dismissed from his employment with Domestic & General Group plc ("Company") and subsequently started using a mail-bombing program which was set to "mail until stopped" against the Company. It was estimated that L's use of the program caused five million emails to be received by the Company's email servers. The DPP appealed by way of case stated against the decision of the youth court that L had no case to answer to a charge under section 3 of the Computer Misuse Act 1990 which states:

"(1) A person is guilty of an offence if (a) he does any act which causes an unauthorised modification of the contents of any computer; and (b) at the time he does the act he has the requisite intent and the requisite knowledge."

Section 17 (interpretation clause) states that "17(7) A modification of the contents of any computer takes place if, by the operation of any function of the computer concerned or any other computer…

(b) any program or data is added to its contents "and goes on to state "17(8) Such a modification is unauthorised if …the person whose act causes it ….does not have consent to the modification from any person who is so entitled."

The DPP asserted that, as such, under section 17(7) and (8) of the Act, L's actions amounted to an unauthorised modification of the contents of any computer by the adding of the data. It also alleged that L had the requisite knowledge to commit the offence as he knew that the modifications were unauthorised. L contended that there was no case to answer because the purpose of the Company's server was to receive emails and the company had consented to the modifications in data content consequent upon receipt of emails.

The court held that the owner of a computer able to receive emails would ordinarily be taken to have consented to the sending of emails to his computer but that such implied consent was not without limits. A limit was not defined but Lord Justice Keene continued by saying that "the consent did not cover emails which are not sent for the purpose of communication with the owner but are sent for the purpose of interrupting the proper operation and use of his system". The fact that an email purported to come from someone other than its true author did not mean that that email was automatically unauthorised and its classification was dependent upon the circumstances.

Director of Public Prosecutions v David Lennon [2006] EWHD 1203 (Admin)
Lord Justice Keene and Mr Justice Jack
High Court allows service out of the jurisdiction in relation to claims for alleged unauthorised access to a computer server in London

This case is interesting because it illustrates how the Civil Procedure Rules ("CPR") relating to service out of the jurisdiction apply to claims involving software and the downloading of information over the internet.

The background of the dispute is very complex and the subject of ongoing litigation in England in which the claimants allege that the defendant Russian companies wrongfully ousted the first claimant ("Ashton") from a joint venture and its trading position with a state-owned aluminium smelting plant in Tajikstan ("TadAZ proceedings").

The facts of this case are that, in January 2006, during a routine security scan of the Ashton server located in its offices in London, a hidden spyware software product was discovered which had been installed on the computer. Further examination revealed that there had been two attempts to gain unauthorised access to the system in January 2006, one of which had been successful. The IP address from which such access was made was registered to the first defendant ("Rusal"). The claimants viewed the discovery very seriously in the context of the bitter disputes with Rusal.

The claimants issued proceedings against the defendants for breach of confidence and/or inducing or procuring such a breach, wrongful interference with the claimant's business and conspiracy by unlawful means. The claimant's sought to serve out of the jurisdiction on various grounds set out under CPR 6.20 including tortious damage within the jurisdiction under rule 6.20(8) and breach of confidence in relation to property within the jurisdiction under rule 6.20(10) of the CPR.

In May 2006, the defendants applied for an order that the English court had no jurisdiction to try the proceedings because it had failed to satisfy the requirements of Rule 6.21(2A) which are that:

- it has a cause of action against the defendant with a reasonable prospect of success;
- the case falls within one of the heads of rule 6.20 of the CPR; and
- England is the appropriate forum.

The judge held that service out of the jurisdiction was justified in relation to the two defendant companies (not the defendant individuals) as there was a "serious issues to be tried" and that the claimants had a good arguable case. It agreed with the defendants that it was critical to the claimants' case to show that the two attempts to access Ashton's server in January 2006 were by Rusal.

Under rule 6.20(8), the judge held that the rule was satisfied as (1) significant damage occurred in London where the server was improperly accessed and the confidential and privileged information was viewed and downloaded and (2) the damages were not trivial: if successful the court would have to consider what damages should be granted for the "substantial injury caused" from the improper obtaining of the information.

Under rule 6.20(10), the judge held that the rule extended to "claims in respect of confidential information if it can be established that the information was really located in the jurisdiction. Information contained in digital form on a server in London satisfied this test."
As for England being the appropriate forum, the judge gave the following affirmative reasons:

- the location of the server in London: this was where the tort was committed in substance and the breach of confidence occurred;
- other connections with London: if the Rusal defendants did hack into the Ashton server, they may have obtained information relating to the TadAZ proceedings which were continuing in the High Court;
- uncertainty about Russian law on the legal status of information and the technicalities on commercial secrets;
- the need to resolve the case before the TadAZ trial started in the UK in October 2007.

(1) Ashton Investments Ltd (2) Ansol Limited v (1) OJSC Russian Aluminium (RUSAL) (2) Rusal Management Company (3) Oleg Vladimirovich Deripaska (4) Alexander Stanislavovich Bulygin [2006] EWHC 2545 (Comm), 18 October 2006, Jonathan Hirst QC

See, further, paragraph 34.9.3.

27. INSOLVENCY

See RESTRUCTURING, section 43.

28. INSURANCE/PI: SCOTLAND

For INSURANCE/PI: ENGLAND, see section 29.

28.1 New legislation

28.1.1 Rights of Relatives to Damages (Mesothelioma)(Scotland) Bill

The Scottish Executive introduced the Rights of Relatives to Damages (Mesothelioma)(Scotland) Bill on 27 September 2006. The Bill will amend section 1(2) of the Damages (Scotland) Act 1976. It addresses the problem relating to relatives' claims for damages in fatal cases. At present, claimants face the dilemma of having to choose whether to settle their claim while alive or alternatively allowing their family to claim an award, of perhaps greater value, after their death. The Bill proposes that relatives' claims are not extinguished by settlement of the claim while the claimant is still alive.

For further information, see the Scottish Parliament website: http://www.scottish.parliament.uk/business/bills/75-relativesrights/index.htm

28.1.2 Family Law (Scotland) Act 2006

This Act came into force on 4 May 2006. Section 35 amends the Damages (Scotland) Act 1976 by adding new categories of relative to the definition of 'immediate' family, who are entitled to claim compensation for a non-financial loss (eg for grief and sorrow) where a relative dies as a result of an act or omission of another person. In particular, same sex partners, as provided for in the Civil Partnership Act 2004, can now claim.
28.1.3 Compensation Act 2006

The Scottish Parliament moved to allow the UK Parliament to legislate in this area and so the Compensation Act 2006 will affect Scotland as well as the rest of the United Kingdom.

See paragraph 29.3.

The official report from the debate (Col27047) can be obtained at: http://www.scottish.parliament.uk/business/officialReports/meetingsParliament/or-06/sor0629-02.htm


From 29 January 2007, NHS Scotland will be able to recover treatment costs incurred by anyone who successfully pursues a personal injury claim against a third party. This is an extension to the current scheme which relates to road traffic accident cases only. Employer's liability, public liability and product liability cases will all be affected in future. The NHS will now be able to recover £620 for each hospital admission (per day), £505 for each day outpatient treatment and £159 for each ambulance journey, subject to a total maximum recovery of £37,100.

For further information, see the OPSI website: http://www.opsi.gov.uk/legislation/scotland/ssi2006/draft/20061109.htm

28.2 Case review

28.2.1 Fatal claims

One important Scottish case in 2006 involving a fatality was that of Audrey Weir and Others v Robertson Group Construction Ltd and Others. In that case, the pursuer, Audrey Weir and her children, sued her late husband's employers for funeral expenses, loss of support, services and non-patrimonial loss (ie grief and sorrow) in connection with an accident at work in which her husband was killed. Liability was admitted although contributory negligence and quantum were disputed. There were no eye-witnesses to the accident. Lord Glennie held that, in the absence of any evidence, it was impossible for him to find the pursuer's deceased husband at fault. In relation to the claim for non-patrimonial loss, he awarded £35,000 to Audrey Weir and £17,000 to each of her children. The case is particularly important because of the guidance offered by Lord Glennie in relation to assessing awards for grief and sorrow. He stated that there is a hierarchy of awards and that an award to a widow is likely to be significantly higher than an award to parents or children as a husband and wife will have grown together throughout their marriage. With regard to other relatives, he considered that the level of award would depend on age and vulnerability. For example, the likely award to a parent of a deceased child will vary according to the age of the child and the emotional dependency of the parent on that child. He also considered that awards in relation to sudden death cases would be greater than cases where the deceased has suffered a long debilitating illness before death, particularly where the deceased in elderly.
Although Lord Glennie has tried to provide guidance in this area, it is likely that pursuers will, in future, seek to challenge the suggested hierarchy of awards outlined by him. For further information, see the judgment on the Scottish Court Service website: [http://www.scotcourts.gov.uk/opinions/2006csoh107.html](http://www.scotcourts.gov.uk/opinions/2006csoh107.html)

28.2.2 Employers liability: manual handling

An employer's duty to provide refresher training came into focus this year in the significant case of *James Walsh v TNT UK Limited*. Mr Walsh raised an action for damages sustained as a result of a lifting accident at work arguing that his employer had breached the Manual Handling Operations Regulations 1992 in failing to provide refresher training in lifting for over seven years. His employers conceded that he had not had training in over seven years but argued that they had provided him with training in lifting (albeit seven years ago) and that training ought to be sufficient to enable him to carry out a simple lifting operation. The Court of Session found in favour of Mr Walsh and held that TNT had been in breach of the Manual Handling Operations Regulations in failing to provide a refresher course for seven years. This decision emphasises that employers should provide regular refresher training courses to discourage casual practices that cause injury.

For further information, see the judgment on the Scottish Court Service website: [http://www.scotcourts.gov.uk/opinions/2006csoh149.html](http://www.scotcourts.gov.uk/opinions/2006csoh149.html)

28.2.3 Employers liability: work equipment and suitability of purpose

In 2006, the House of Lords considered a Scottish 'employer's liability' case in *Robb v Salamis (M&I) Limited*. In this case, the pursuer, Mr Robb, worked on an offshore oil platform. He was injured in the sleeping accommodation when he descended from a top bunk on a removable suspended ladder which had not been replaced correctly. The issue in dispute was whether the defenders (Mr Robb's employers) were in breach of the Provision and Use of Work Equipment Regulations 1998 in providing such a ladder for use by their employees. The House of Lords held that the defenders had breached the 1998 Regulations in providing the ladder as it was reasonably foreseeable that an injury would result if it was not replaced correctly. Despite that, the pursuer was held to be 50% contributorily negligent because he knew that the ladder was often moved and should have checked the ladder before descending. The Law Lords' decision confirmed that an employer has to take care to ensure that any equipment which is made available to employees can be used without impairment to their health and safety.

For further information, see the House of Lords judgment: [http://www.publications.parliament.uk/pa/ld200607/ldjudgmt/jd131206/robb-1.htm](http://www.publications.parliament.uk/pa/ld200607/ldjudgmt/jd131206/robb-1.htm)

28.2.4 Motor accident claims involving children

An important decision in 2006 relating to a road traffic accident involving a child was that of *Christopher King v Iain Neilson and Carol Neilson & Partners in the firm of Kinneil Coaches and Others*. In that case, Mr King, who was twelve at the time of the accident, was knocked down when crossing a road after alighting from a coach driven by the defenders' employee. Mr King accepted a degree of contributory negligence but argued that the accident was caused by the fault and negligence of the
defenders. He said that they had failed to drop him off at the agreed place and had breached their duty of care to him in so doing and instead dropping him off on a busy road which he had not been assisted in crossing. The defenders argued that the accident was caused by Mr King alone. Damages were agreed at £300,000 although liability was disputed. The court found in favour of the defenders. They held that at twelve years old he had failed to keep a proper lookout and take reasonable care for his own safety. This decision confirms the position that even as a child there is a duty to look out for yourself.

For further information, see the judgment on the Scottish Court Service website: http://www.scotcourts.gov.uk/opinions/2006csoh108.html

28.3 Other developments

28.3.1 Reform of personal injury actions in the Sheriff Court

There was a consultation process in relation to the introduction of new personal injuries rules in the Sheriff Court in 2006. New rules were introduced in the Court of Session in 2003 and they have worked well ensuring that personal injury cases are simpler and processed more quickly. It is envisaged that a similar procedure might be introduced in the Sheriff Court.

29. INSURANCE/PI: ENGLAND

For INSURANCE/PI: SCOTLAND, see section 28.

29.1 Alternative Dispute Resolution ("ADR"): remain ignorant at your peril!

On 6 April 2006, significant changes to many of the Pre-Action Protocols, in an attempt to further encourage ADR, came into force (as introduced in the 41st Update to the Civil Procedure Rules ("CPR")). To view the changes to the practice directions, see the DCA website:


Both claimants and defendants may be required by the court to provide evidence that alternative means of resolving their dispute were considered. Parties are warned that if a Protocol is not followed (including the paragraph on ADR) then the court must have regard to such conduct when determining costs.

The regulation of pre-action conduct via the Pre-Action Protocols has worked due to a perception amongst lawyers that there is a real risk a breach of the Protocol will result in cost penalties.

The 41st Update follows on the heels of Burchell v Bullard (Court of Appeal), being the latest in the line of cases to confirm that costs consequences will follow an unreasonably refused request to mediate, "The profession can no longer with impunity shrug aside reasonable requests to mediate".
Whilst it can still be difficult to persuade lawyers (particularly claimants) to mediate, the clear signal to penalise parties who choose to ignore proper consideration of ADR means that there is likely to be a significant increase in the number of personal injury claims being mediated.

The consequences of not complying with a Protocol depends entirely upon the attitude of the judiciary. However, those parties/advisers who now remain resistant to ADR will do so at their peril and potential cost.

Every claims handler should receive an adequate level of training to understand when and how mediation should be used as an alternative resource for settling claims.

For further information on ADR, please contact Alan Jacobs at mailto:alan.jacobs@dlapiper.com or on 0121 262 5743.

29.2 Clinical negligence: NHS Redress Act 2006

This Act received royal assent on 8 November 2006 (see the OPSI website for further information: http://www.opsi.gov.uk/acts/acts2006/ukpga_20060044_en.pdf.) It is the much awaited conclusion of a process which commenced as long ago as July 2000 when the government published a paper committing the Department of Health to investigate ways of improving the system for handling clinical negligence claims which was perceived as complex, unfair, slow, and expensive.

Essentially the Act enables the Secretary of State to establish, by regulations, a redress scheme which will avoid the need to go to court.

It will apply to liabilities in tort in respect of personal injury or loss arising out of a breach of a duty of care in relation to the diagnosis, care or treatment, of a patient by a healthcare professional or arising as a consequence of any act or omission by such professional.

There are some exclusions. In particular, it will not apply to cases which are, or have been, the subject of civil proceedings. There will also be no appeal, but an aggrieved patient may elect to pursue civil proceedings (provided they do not accept the offer), and there will be a cap on the amount which can be recovered, likely to be £20,000. Free legal advice may, however, be provided to patients which is likely to be limited to the consideration of any offer/settlement agreement put forward under the scheme.

Whether this Act succeeds in reducing the complexity and cost of low value clinical negligence cases remains to be seen. Both breach of duty and causation will still require investigation, questioning the reduction in complexity. Furthermore, it is anticipated that the scheme will encourage more cases to be brought, so the anticipated savings of legal costs may be subsumed by increased payments made.

We shall have to wait and see how well this Act achieves its purpose.

For further information, please contact Christopher Briggs, at mailto:christopher.briggs@dlapiper.com or on 0161 235 4022.
29.3 Compensation Act 2006: do we live in a "compensation culture"?

Whether we do or not, the government has been sufficiently concerned to try and address this debate. The Compensation Act received royal assent on 25 July 2006 (see the OPSI website for further information http://www.opsi.gov.uk/acts/acts2006/ukpga_20060029_en.pdf); we shall have to see whether the debate now goes away. The government has also taken the opportunity to overturn a recent judgment of the House of Lords.

Most of the Act relates to claims management companies which have become a feature of the claims arena, but they have not had any regulation. Stories of underhand practices and aggressive marketing have abounded. Now, regulation will be put in place to curtail such practices.

However, the Act starts with two important general, and short, clauses. Firstly, the courts are told to consider whether a finding of breach of duty would stop a desirable activity. Clearly, the intention is to give organisations such as the Scouts some comfort that they can operate with less fear of being sued. We have all heard tales of charities, and other "desirable" organisations, cancelling events because of such fears. Secondly, the Act states that it is alright to say sorry; an express or implied apology cannot be used against you.

It is arguable whether these two clauses actually change the law; but the intention is to at least make sure these principles are there in black and white for all to see.

By contrast, section 3 certainly does change the law. Only in May, the House of Lords gave a highly controversial and politically uncomfortable decision in Barker v Corus (see paragraph 29.7.3). This decision effectively reduced the compensation for employees with mesothelioma, where a former employer was uninsured. The Act swiftly reverses this, with little consultation, making any unsuccessful defendant liable for the whole damage, however limited its exposure.

For further information, please contact Alan Dury, at mailto:alan.dury@dlapiper.com, or on 0114 283 3498.

29.4 Costs

29.4.1 Sanderson Order

Where the claimant suffered injury when delivering goods to the defendant's home and the defendant occupier had, in defending the claim, sought to blame the claimant's employers, the trial judge had correctly exercised his discretion in directing the defendant to pay the employer's costs ("Sanderson Order") rather than for the claimant to do so.

See the Bailii website for further information: http://www.bailii.org/ew/cases/EWCA/Civ/2006/1121.html.

See also paragraph 29.13.1.

Moon v Garrett - Court of Appeal - 28 July 2006
29.4.2 Conditional fee agreements

These two conjoined appeals concern the enforceability of conditional fee agreements ("CFA's"). Both arose from modest personal injury claims, but have much wider application.

The Court of Appeal emphatically decreed that the question of whether a breach of the CFA Regulations is "material", and therefore renders a CFA unenforceable such that none of the costs incurred under it can be recovered from the client or the defeated opponent, must be answered by reference to the date on which that CFA was made. It followed that breaches which in fact caused no loss at all could still render a CFA unenforceable.

In Myatt, by leaving the clients to check their own household insurance policies and then tell their solicitor whether they had legal expenses cover which would have covered their claims, the court held that the regulations had been materially breached, and that no costs were recoverable. The conclusion was reached despite the fact that there was not, in fact, any legal expenses cover to find.

In Garrett, failure to declare an indirect interest in recommending a particular after-the-event insurance product had the same consequence. Much of the discussion in these two cases will centre on the facts leading to the individual breaches, and the implications for other modest personal injury claims. But for clients interested in more substantial commercial cases, the underlying message is shorter. The Court of Appeal has made successful challenges to CFAs a much more attainable objective, and any litigant faced with a CFA based claim for costs would be well advised to ensure that its lawyers have genuine expertise in this niche area.

See the Bailii website for further information:
http://www.bailii.org/ew/cases/EWCA/Civ/2006/1017.html or please contact Paul Dowle, Head of Costs, at mailto:paul.dowle@dlapiper.com, or on 0161 235 4437.

Garrett v Halton MBC; Myatt v NCB - Court of Appeal - 18 July 2006

DLA Piper successfully attacked the legality of the CFA between the claimant and his solicitors which resulted in the costs order made against the defendant becoming worthless.

See the Bailii website for further information
http://www.bailii.org/ew/cases/EWHC/Costs/2006/90053.html or please contact Paul Dowle at mailto:paul.dowle@dlapiper.com or on 0161 235 4437.

Oyston v The Royal Bank of Scotland PLC - Manchester Mercantile Court - 16 May 2006

29.4.3 Medical agencies' fees

Master Hurst overturned the recent Supreme Court Costs Office ruling and held that so long as fees charged by medical agencies for supplying medical reports and records are reasonable and proportionate, they can be recovered in full as a
disbursement from the defendant liability insurer. This case is being appealed to the Court of Appeal and will be heard on 15 January 2007.

See the Bailii website for further information:

_Wollard v Fowler_ - Supreme Court Costs Office - 24 May 2006

29.5 Court documents: access by non-parties

New rules which came into force on 2 October 2006 mean that non-parties are now able to access statements of case after they have been lodged at court and before they have been referred to or used at a hearing.

For further information, see paragraph 34.22.

29.6 Damages

29.6.1 Prepare for cost increase in all personal injury claims

Over four years ago, a proposal was introduced to extend the system of recovering NHS costs for hospital treatment from those responsible for road traffic accidents so as to apply to all accident cases. This proposal was later contained in the Health and Social Care (Community Health and Standards) Act 2003, Part 3, http://www.opsi.gov.uk/acts/acts2003/20030043.htm and is now expected to be introduced on 29 January 2007.

Whilst insurers have been expecting this, they must now prepare for a significant increase in the cost of all types of claims involving personal injury where liability is established and compensation is paid, but can breathe a sigh of relief in disease claims which are excluded from the scheme unless they can be directly attributed to the injury for which compensation is being claimed.

The intention is that the existing tariffs and statutory ceiling for the road traffic accident scheme will also apply to this new scheme but with one additional element to cover the cost of any ambulance journeys. See the Personal Injuries (NHS Charges) (General) and Road Traffic (NHS Charges) Amendment Regulations 2006 for further information: http://www.opsi.gov.uk/si/si2006/20063388.htm (Explanatory note: http://www.opsi.gov.uk/si/em2006/uksiem_20063388_en.pdf). These tariffs will be subject to revision each year. There will also be allowance for contributory negligence in certain circumstances.

Only time will reveal the actual cost of this scheme but, in 2005/06, over £121m was paid by insurers to the NHS for road traffic accidents alone which is four times the amount paid out in 1999. The total cost to the NHS in treating personal injury cases other than road traffic accidents is estimated to be in the region of £170m to £190m.
It is anticipated that the impact on the public sector will only be a small rise in insurance premiums, suggested to be in the region of 2%. Insurers must ensure that they now take this scheme into consideration when calculating their premiums and setting their reserves.

See also paragraph 29.10.3.

29.6.2 New proposals for low value personal injury claims - Law Society - 13 October 2006

"Fast and Fair" contains the Law Society’s proposals for lower value personal injury claims which it believes would avoid the need to increase the small claims limit and would streamline the process for personal injury claims which can sometimes take a considerable amount of time to resolve and involve costs which can appear disproportionate to the amount at stake. The proposals include solicitors providing early notification of an injury to the insurer within seven days; making rehabilitation more of a priority; and encouraging early offers of settlement. The proposals have been sent to a range of government ministers, MPs and policy makers.

For further information see the Law Society website:


29.6.3 Periodical payments

In last year's review, we reported that new provisions on periodical payments in personal injury cases came into effect on 1 April 2005. There have been a number of cases where the provisions have been applied.

In Flora v Wakom, at first instance, Sir Michael Turner dismissed the defendant's application to strike out all elements of the claimant's case which contended that any periodical payments that the claimant will receive should be subject to annual increases pursuant to a wage related index rather than the retail prices index. That decision was reviewed by the Court of Appeal on 28 July 2006.

The Court of Appeal indicated that the determination as to whether the retail prices index or another index, such as one based upon wages, was the appropriate method of annual assessment for periodical payments, was a matter which should be decided by the trial judge. Unsurprisingly, the court declined to provide any preliminary guidance as to its views on which would be the most appropriate index. Leave to appeal this ruling was refused by the House of Lords.

On 23 November 2006, in the landmark decision of Thompstone v Tameside & Glossop Acute Services NHS Trust, Queen's Bench Division, Manchester District Registry, the court held that it was appropriate to use a measure other than the retail prices index to increase periodical payments for future care costs. Instead, an earnings-linked periodical payment was deemed appropriate. It is understood that this decision will be appealed.
For the *Flora* judgment see the Bailii website: [http://www.bailii.org/ew/cases/EWCA/Civ/2006/1103.html](http://www.bailii.org/ew/cases/EWCA/Civ/2006/1103.html) or for further information please contact Mark Hemsted at [mailto:mark.hemsted@dlapiper.com](mailto:mark.hemsted@dlapiper.com) or on 0161 235 4447.

*Flora v Wakom (Heathrow) Ltd* - Court of Appeal - 28 July 2006 and

*Thompstone v Tameside & Glossop Acute Services NHS Trust*, Queen's Bench Division, Manchester District Registry, 23 November 2006

29.6.4 Appropriate law to determine damages

In this case, the House of Lords allowed the appeal of the claimant and held that the calculation of damages in respect of a tort (in this case it involved damages for personal injury) is an issue of procedural law and not of substantive law. English procedural law therefore governed the quantification of damages in the claim whereas New South Wales law governed the substantive law issues. Had New South Wales law governed the calculation of damages quantum may have been 30% less.

The case involved a road traffic accident in New South Wales, Australia in February 2002. The claimant, Mr Harding, who is English, was a passenger in a vehicle driven by the negligent Ms Wealands. She is Australian but they both lived together as a couple in England. They were on holiday in New South Wales at the time of the accident. After the accident they returned to live in England. The claimant was rendered tetraplegic as a result of the accident.

In the appeal to the House of Lords there was no issue raised against the jurisdiction of the English courts.

The matters in dispute before the House of Lords were all in relation to quantification of damages of the personal injury claim. Overruling the Court of Appeal, it was held that the calculation of damages for personal injury is an issue of procedural law and not of substantive law. As the case was being heard in the English courts then English procedural law applies to determine the quantification of damages. The outcome of applying English law to quantification rather than New South Wales law would be that the level of damages would be approximately 30% greater under English law.

The implication of this judgement is that if the application of a foreign country's laws to the quantification of damages would mean that those damages would be considerably less than under English law, there is the need to be extremely careful in accepting that a claim is subject to the jurisdiction of the English courts, without first having taken detailed advice on that issue.

For further information, see the UK Parliament website: [http://www.publications.parliament.uk/pa/ld200506/ldjudgmt/jd060705/hardin-1.htm](http://www.publications.parliament.uk/pa/ld200506/ldjudgmt/jd060705/hardin-1.htm) or please contact Alan Jacobs at [mailto:alan.jacobs@dlapiper.com](mailto:alan.jacobs@dlapiper.com) or on 0121 262 5743 for information on this case or any other international claims.

*Harding v Wealands* - House of Lords - 5 July 2006
29.7 Disease

29.7.1 Control of Asbestos Regulations 2006 (SI 2006/2739)

See paragraph 23.3.

29.7.2 Improvements to mesothelioma compensation scheme - Department for Work & Pensions - 20 July 2006

Provides details of how the system for compensating sufferers of mesothelioma, the debilitating form of lung cancer caused by exposure to asbestos, would be improved and speeded up. A Consultation Paper on "Improving Claims Handling for Mesothelioma Cases" was also issued by the DWP on 17 October 2006. That Consultation ended on 23 November 2006. Developments are awaited.

For further information see the DWP website:

The Treasury also announced new Financial Services Compensation Scheme ("FSCS") rules on mesothelioma to allow the Financial Services Authority to make changes to the FSCS to help victims of mesothelioma receive more timely access to compensation. Under the changes, which are in force from 7 December 2006, negligent employers and their insurers, who have paid victims of the disease, will now be able to claim a contribution from the FSCS in certain cases.

For further information see "The Compensation Act 2006 (Contribution for Mesothelioma Claims) Regulations 2006" on the OPSI website:
http://www.opsi.gov.uk/si/si2006/20063259.htm (Explanatory Memorandum:

29.7.3 Mesothelioma claims

The House of Lords held that it is both fair and possible to apportion mesothelioma claims between persons who had contributed to exposure, whether tortiously or not, by the means of assessing the contribution of each to the overall risk.

The issues centred on whether or not mesothelioma claims were apportionable as between persons who had contributed to exposure, whether tortiously or not, or whether the claimant was entitled to recover in full from any tortfeasor.

Decisions at first instance and in the Court of Appeal had upheld the view that full recovery was possible from any one company who had made a material contribution to the risk of the claimant contracting mesothelioma. In the Barker case, allowance for a period of negligent exposure by the claimant while self employed was dealt with by way of a 20% deduction for contributory negligence.

In the House of Lords considerations in Fairchild, apportionment was not raised but it was noted in the judgment as being potential unfinished business.
In summary, the House of Lords has now ruled on apportionment of mesothelioma claims as follows:

- in *Fairchild*, the House of Lords ruled on policy grounds that material contribution to the risk of mesothelioma was sufficient to render a tortfeasor liable when the disease did occur. It did not rule that the material contribution to risk meant a material contribution to the disease itself, which was likely caused by only one of the exposures;

- if a defendant is liable because of his contribution to the risk, it is both fair and possible to apportion the claim as between various exposerers, whether tortious or non-tortious, by the means of assessing the contribution of each to the overall risk;

- although the disease is indivisible, in the sense that the particular asbestos exposure causing it cannot be proven, chances are infinitely divisible and relative degrees of responsibility can be assessed, something which the courts routinely have to do;

- the other issue was fairness to claimants and defendants. The *Fairchild* exception was created as it was perceived to be unfair to leave a claimant with no remedy. However, fairness does not require that in a situation where there are increasingly fewer of the past exposerers before the court, and the burdens would increasingly fall on a limited number of companies, the latter should be required to compensate for others in circumstances where they may not even on a balance of probabilities have been responsible for the damage;

- the attribution of liability according to the relative degree of contribution to the chance of the disease being contracted smoothes out the roughness of the justice which joint and several liability creates;

- this approach solves the problem of the difficulties of a single compensator seeking contributions from a diminishing number of possible contributors and also deals with the issue of contributory negligence by a claimant as in *Barker*.

The defendant's appeals were therefore allowed and the cases remitted back to the lower courts for re-determination of damages by reference to relative shares of risk attributable to the conduct of the various defendants in the cases.

For further information, see the UK Parliament website: [http://www.publications.parliament.uk/pa/ld200506/ldjudgmt/jd060503/barker-1.htm](http://www.publications.parliament.uk/pa/ld200506/ldjudgmt/jd060503/barker-1.htm) or contact [John Butterworth](mailto:john.butterworth@dlapiper.com) at 0114 283 3421.

Also, see paragraph 29.3.

*Barker v Corus (UK) Plc (formerly Barker v St Gobain Pipelines Plc) & Others* - House of Lords - 3 May 2006
29.7.4 Asbestos-related disease

The insurance company’s appeal against the decision that it was liable in respect of an asbestos-related disease which occurred during the period of a public liability insurance policy that it had issued, failed. The court upheld the decision that the correct public liability policy to respond was the policy in force at the time when the disease first occurred or manifested itself, rather than the policy in force at the time of the exposure to asbestos.

For further information see the Bailii website: http://www.bailii.org/ew/cases/EWCA/Civ/2006/50.html

*Bolton Metropolitan BC v Municipal Mutual Insurance* - Court of Appeal - 6 February 2006

29.7.5 Pleural plaques

During the year, the Court of Appeal has handed down its judgment in these test cases and, by a majority, it has reversed nearly 30 years of case law and practice by ruling that claims founded on the three elements of pleural plaques, future risks of other asbestos conditions and associated anxiety are not compensatable. Leave to appeal this decision has been granted by the House of Lords and the hearing is due to be heard from 25 June to 2 July 2007.

For further information, see the HMCS website: http://www.hmcourtsservice.gov.uk/judgmentsfiles/j3783/rothwell_v_chemical_0106.htm

*Pleural Plaques Test Cases* - Court of Appeal - 26 January 2006

29.7.6 Stress and harassment

Claims arising from stress at work have been under scrutiny by the courts over recent years, with the result that any claimant has a high bar to get over before his claim will succeed. Claims for stress have consequently not been as popular as insurers had feared.

At the very least, there must be a recognised psychiatric disorder for such a claim to be successful. However, now it is clear that an employee can successfully claim against his employer by simply showing that s/he suffered some distress, if that distress occurred because of harassment by a fellow employee. In fact, even feeling distress may not be necessary to succeed - mild anxiety would be enough to get some damages.

The House of Lords has now made this clear in *Majrowski v Guy's and St Thomas' NHS Trust* (12 July 2006). The Protection from Harassment Act 1997 makes it a criminal and civil offence to harass someone else. It was thought to be intended to apply only to stalkers. Now we know that an employer is likely to be vicariously liable for harassment by one of its employees.

Harassment is not defined, but liability will be much easier to prove than stress at work, and it will be much easier to prove that compensation is due. Damages are
likely to be low, but will be a useful safety net for claimants bringing a stress claim where (for example) the stress is alleged to have come from an overbearing manager. If the stress claim does not succeed, the harassment claim may well, with the possibility that this success will entitle the claimant to his costs of the whole action. It may also lead to a swell of small harassment cases, which will have to be settled, not only because the bar is so low and on economics, but also because evidence may be difficult to come by. For claims of this type, the claimant has six years to make a claim, by which time the evidence (and the manager) may long since be gone.

For further information, see the UK Parliament website: 
http://www.publications.parliament.uk/pa/id200506/idjudgmt/id060712/majro-1.htm
or please contact Alan Dury, at mailto:alan.dury@dlapiper.com, or on 0114 283 3498.

*Majrowski v Guy's & St Thomas's NHS Trust - House of Lords - 12 July 2006*

See paragraph 17.9 for further cases on psychiatric injury.

See, also, paragraph 23.9 for information about the HSE stress web page.

29.8 Fatal: corporate manslaughter

A Bill to create a new offence that, in England and Wales or Northern Ireland, is to be called corporate manslaughter and, in Scotland, is to be called corporate homicide; and to make provision in connection with that offence.

See paragraph 13.7 for details.

For further information, see the UK Parliament website: 
http://www.publications.parliament.uk/pa/pabills/200607/corporate_manslaughter_and_corporate_homicide.htm

*Corporate Manslaughter and Corporate Homicide Bill (Bill No 220)*

29.9 Fraud

29.9.1 Fraud Act 2006

The Fraud Act received royal assent on 8 November 2006 and makes provision for, and in connection with, criminal liability for fraud and obtaining services dishonestly. For further information, see paragraph 13.5.

29.9.2 Fraudulent motor claim

DLA Piper successfully defended a claim brought by four claimants following a rear end shunt.

The defendant and his wife remained adamant there were only three people in the car but four claims for personal injury were received. A defence was filed alleging fraud against all the claimants by virtue of the fact that their claims were tainted as they were all supporting the one fraudulent claim.
The judge held that the claimants had lied on oath and colluded to pervert the course of justice in an attempt to further false claims by them. She struck out all four claims including the first claimant's claim in its entirety, notwithstanding that he was a genuine victim of a road traffic accident.

For further information on this case, please contact Karen Langridge atmailto:Karen.langridge@dlapiper.com or on 0121 262 5977.

*Patel & Ors v Ali - County Court - 30 January 2006*

29.10 Health & safety

29.10.1 Regulatory Reform (Fire Safety) Order 2005

In force: 1 October 2006

This Order reforms the law relating to fire safety in non-domestic premises. It replaces fire certification under the Fire Precautions Act 1971 with a general duty to ensure, so far as is reasonably practicable, the safety of employees, a general duty, in relation to non-employees, to take such fire precautions as may reasonably be required in the circumstances to ensure that premises are safe, and a duty to carry out a risk assessment. The Order imposes a number of specific duties in relation to the fire precautions to be taken.

For further information, see paragraph 23.4.

Also see the OPSI website: [http://www.opsi.gov.uk/si/si2005/20051541.htm](http://www.opsi.gov.uk/si/si2005/20051541.htm)

29.10.2 Management of Health and Safety at Work (Amendment) Regulations 2006 (SI 2006/438)

In force: 6 April 2006

These regulations amend regulation 22 of the Management of Health and Safety at Work Regulations 1999 ("1999 Regulations"), which concerns civil liability for breach of the duties imposed by those regulations.

For further information, see the OPSI website: [http://www.opsi.gov.uk/si/si2006/20060438.htm](http://www.opsi.gov.uk/si/si2006/20060438.htm)

29.10.3 Health Act 2006

This received royal assent on 19 July 2006. Amongst other matters, it includes provision for the prohibition of smoking in certain premises, places and vehicles; and further provision about the recovery of NHS costs.

For further information, see the OPSI website: [http://www.opsi.gov.uk/acts/acts2006/20060028.htm](http://www.opsi.gov.uk/acts/acts2006/20060028.htm)

See also paragraph 29.6.1 in relation to recovery of NHS costs.
29.11 Limitation

29.11.1 Court's power to disapply time limit

The House of Lords departed from the decision in *Walkley v Precision Forgings Ltd* [1979] 1 WLR 606 which held that the court may not exercise its power to disapply the ordinary time limit in a personal injuries action under section 33 of the Limitation Act 1980, where a claimant had issued proceedings in respect of those injuries before the ordinary time limit expired but had brought a second action after expiry.

In the lower court, the judge gave reasons for holding that, but for *Walkley*, he would have exercised his discretion in the appellant's favour. The House of Lords has now given effect to the judge's exercise of judgment that "in a straightforward case in which the appellant's delay was short and understandable and caused the effective defendant no forensic prejudice at all, the judge was entitled to view a motor insurer (or in default, the MIB) as the primary source of compensation for the victim of a road traffic accident".

The House of Lords gave three grounds for its departure, taken together:

- "it unfairly deprives claimants of a right Parliament intended them to have;
- it has driven the Court of Appeal to draw distinctions which are correct but which are so fine as to reflect no credit on this area of the law; and
- it subverts the clear intention of Parliament".

Accordingly, the appeal was allowed and the case remitted to the Salford County Court.

For further information, see the Bailii website: [http://www.bailii.org/uk/cases/UKHL/2006/27.html](http://www.bailii.org/uk/cases/UKHL/2006/27.html) or contact Carol Warmisham at [mailto:carol.warmisham@dlapiper.com](mailto:carol.warmisham@dlapiper.com) on 0161 235 4434.

*Horton v Sadler* - House of Lords - 14 June 2006

29.11.2 Accountant's negligence

The claimant's negligence claim against the defendant accountants accrued when it first received a claim on the Solicitors' Compensation Fund because until such a claim was actually made no loss or damage had been sustained by the fund.

For further information, see the Bailii website: [http://www.bailii.org/uk/cases/UKHL/2006/22.html](http://www.bailii.org/uk/cases/UKHL/2006/22.html) and the comment by Patric Rouendaal: [http://www.dlapiper.com/files/Publication/c9909f30-28e4-4327-8013-32733f538a23/Presentation/PublicationAttachment/5ff35d06-0615-4505-bc56-344522d58fde/Law_Society.pdf](http://www.dlapiper.com/files/Publication/c9909f30-28e4-4327-8013-32733f538a23/Presentation/PublicationAttachment/5ff35d06-0615-4505-bc56-344522d58fde/Law_Society.pdf)

29.11.3 House of Lords decide limitation issue on timing, knowledge and causation in claims against professionals

This case (an accountant's negligence matter) focused on the application of the extended three year limitation period under section 14A of the Limitation Act 1980.

In March 2004, the Court of Appeal had allowed the claimant to rely upon the extended three year limitation period. Whilst relevant facts were known more than three years before commencement of the action, there were a range of possible causes of the damage and the claimant (so the Court of Appeal held) could not have known that all or part of the damage was attributable to the defendant's professional advice. The Court of Appeal had held that such a causal link was necessary. The defendant accountants appealed.

Almost two years later to the day, the House of Lords allowed the appeal. However, it has done so on the facts. Their Lordships have broadly supported the approach to the law taken by the Court of Appeal in 2004 but have determined on the facts that there was sufficient causal link prior to the three year period. Different routes have, however, been followed by the Law Lords to reach that end point, which may result in claimants yet being able to try to distinguish the decision.

For further information, see the UK Parliament website:
http://www.publications.parliament.uk/pa/ld200506/ldjudgmt/jd060301/haward-1.htm and DLA Piper's Legal Update produced by Patric Rouendaal
http://www.dlapiper.com/files/Publication/a9e34199-98b6-489d-80f4-1e9b1dc7a6f7/Presentation/PublicationAttachment/58f7deef-4a71-4fb1-80e6-25db42d1e18a/John_Hedley_Haward.pdf

Haward v Fawcetts - House of Lords - 1 March 2006

29.11.4 Contributions and indemnities from other parties

By setting the necessary start date for such claims, the Court of Appeal decision in Aer Lingus assists the party who invokes the 1978 Act to seek contributions or indemnities from other parties.

In addition or in the alternative to any contractual rights, the Civil Liability (Contribution) Act 1978 ("1978 Act") provides a mechanism whereby one liable party can claim a contribution or indemnity from another person who is also liable in respect of the same damage.

However, pursuant to section 10 of the Limitation Act 1980 ("LA 1980"), a claim for contribution under the 1978 Act has a limitation period of two years from the date on which the main proceedings were either: (i) concluded by way of a judgment in any civil proceedings or by an award made on any arbitration; or (ii) concluded by way of an agreement.

The issue before the Court of Appeal was whether for limitation purposes the "judgment" spoken of by the LA 1980 includes a judgment on liability only, with damages to be assessed, or whether a judgment on quantum as well as liability is required to start time running.
The Court of Appeal overruled the trial judge and held that the two year period ran from the date of the judgment on quantum and not from the date of judgment on liability.

For further information, see the Bailii website http://www.bailii.org/ew/cases/EWCA/Civ/2006/4.html and DLA Piper's alert produced by Robert Welfare and Sonja Dale of our Property Solutions team http://www.dlapiper.com/files/Publication/f8ecec06-18e6-43f3-8284-2bf8cf43ab3/Presentation/PublicationAttachment/0c283db0-5d8f-4e4c-8f73-2c0da4ead095/Aer_Lingus.pdf

Aer Lingus v Gildacroft Ltd & Another - Court of Appeal - 17 January 2006

29.12 Motor

29.12.1 Road Safety Act 2006

This Act received royal assent on 8 November 2006. It includes provision about road traffic, registration plates, and vehicle and driver information.

For further information, see the OPSI website: http://www.opsi.gov.uk/acts/acts2006/ukpga_20060049_en.pdf

29.12.2 Low velocity road traffic claims

In the 2005 Legal Review, we reported on the case of Kearsley v Klarfeld - CA - 6 December 2005 in which the Court of Appeal gave guidance in cases where fraud is alleged in low speed impact claims and reinforced the view that oral expert evidence should be allowed in such relatively low value cases despite the proportionality of the costs and expense. This year, we have seen the Court of Appeal decide the case of Casey v Cartwright and provide further guidance on the procedure to be followed where a defendant in a low-velocity road traffic claim sought to adduce his own expert evidence on causation.

In Casey, the claimant brought a personal injury claim following a road traffic accident where the defendant's car had collided with the rear of a car driven by the claimant. The claimant relied on medical reports from a medical expert, M, that she had sustained a typical soft tissue whiplash injury. The defendant's insurers considered that the claim was a low-velocity impact case and, therefore, causation would be in issue.

The district judge had given the claimant permission to rely on M's evidence and for both parties to instruct a further expert, W, to deal with orthopaedic issues. However, following a case management conference, the judge found that W was not suitable as an expert witness and revoked the permission to rely on W's evidence.

The defendant appealed this decision on two grounds. Firstly, he argued that defaults in W's evidence could have been rectified. Secondly, the judge had made an error when deciding on the permissibility of expert evidence in low-velocity impact cases.
The defendant claimed that, following the decision of the Court of Appeal in *Kearsley v Klarfeld*, where a defendant showed reasonable grounds for believing that the claimant had suffered no injury, the defendant should generally be permitted to adduce his own expert evidence on the causation issue.

The Court of Appeal held that the judge had been entitled to disqualify W from giving evidence. Secondly, only where the claimant appeared to be fabricating the claim because it was impossible or very unlikely that the claimant had suffered any injury, or any more than a trivial injury, would the causation issue arise. In ordinary whiplash cases there would therefore be no need for expert evidence on causation.

However, if a defendant wanted to raise a causation issue he should follow the following formalities: (i) he should notify the other parties in writing that he considered the matter to be a low impact case and that he intended to raise the issue of causation. This should be done within three months of receipt of the letter of claim; (ii) the issue should be expressly identified in the defence, supported by a statement of truth; (iii) a witness statement should be served within 21 days of the defence, identifying the grounds on which the issue was raised and dealing with the defendant's evidence relating to the issue.

If these conditions are met and the court is satisfied the issue has been properly identified and raised, it will generally give permission for the claimant to be examined by a medical expert nominated by the defendant. If there is then sufficient evidence that the causation issue had a real prospect of success then the court will generally give the defendant permission to rely on such evidence at trial.

For further information, see the Bailii website: [http://www.bailii.org/ew/cases/EWCA/Civ/2006/1280.html](http://www.bailii.org/ew/cases/EWCA/Civ/2006/1280.html)

*Casey v Cartwright* - Court of Appeal - 5 October 2006

29.12.3 The Motor Vehicles (Wearing of Seat Belts) (Amendment) Regulations 2006 (SI 2006/1892)

In force: 18 September 2006

Relates to the wearing of seat belts and other restraints by children and adults.

For further information, see the OPSI website: [http://www.opsi.gov.uk/si/si2006/20061892.htm](http://www.opsi.gov.uk/si/si2006/20061892.htm)

29.12.4 Water on highway

The Court of Appeal overturned the judge's decision and held that a highway authority is liable for damage caused by water on the highway.

For further information, see the Bailii website: [http://www.bailii.org/ew/cases/EWCA/Civ/2006/1089.html](http://www.bailii.org/ew/cases/EWCA/Civ/2006/1089.html)

*Dept for Transport, Environment & the Regions v Mott MacDonald Ltd* - Court of Appeal - 27 July 2006
29.12.5 European Area of Justice - Rome II

A modified proposal for the Rome II Regulation was adopted in February (see the Europa website for further information: http://www.europa.eu.int/rapid/pressReleasesAction.do?reference=IP/06/168&format=HTML&aged=0&language=EN&guiLanguage=en.) and is part of ongoing efforts by the European Union to create a genuine European area of freedom and justice, in particular by establishing one comprehensive set of rules to cover all non-contractual cross border disputes including road traffic accidents (see InsideInsurance, Issue 15, Summer 2005: http://www.dlapiper.com/files/Publication/c27a5ecb-8ac6-454b-9a6aba40b9c21b31/Presentation/PublicationAttachment/c49245f4-2432-4bf2-addebb0af64865fd/InsideInsurance_summer05.pdf.)

Under Rome II, to pursue a claim, a UK claimant need only contact the UK Information Centre - the Motor Insurers Information Centre ("MIIC") upon his/her return, rather than having to face an unfamiliar system abroad.

The MIIC is responsible for keeping a register of information specified in the regulation and contains details of the insurers of all motor vehicles normally based in the UK. Every motor insurer is required to pass these details to the MIIC on a frequent basis. There is to be a crackdown on fleet and motor trade policy holders and their insurers for failing to provide information for this database and sanctions could be imposed on insurers if they fail to obtain the information from their policyholders.

Also on the agenda are small claims. In February, there was a unanimous agreement to raise the proposed damages ceiling of €2,000 to at least €5,000 (approximately £3,455) given the current value of goods and services. It was felt that raising the ceiling would contribute to a more than proportional reduction in costs. However, it is not yet known if the UK and Ireland will join the scheme.

The effectiveness of claims representatives in settling claims and insurance cover for legal expenses is also being considered. A consultation was launched to discover if mechanisms put in place by the Fourth Directive have been successful http://europa.eu.int/yourvoice/consultations. The consultation closed in June 2006 and further developments are awaited.

For further information, contact Carol Warmisham at mailto:carol.warmisham@dlapiper.com or on 0161 235 4434.

29.13 Occupier's liability

29.13.1 Liability of homeowner

Mr Garrett was doing some building works at his home. Mr Moon, employed as a delivery driver, delivered three and a half pallets of concrete blocks to Garrett. While unloading them, some blocks fell towards Moon. Understandably, Moon stepped out of the way. Moon fell and rolled into a pit two metres deep, suffering a serious back injury.

At first instance, the court found Garrett liable pursuant to the Occupiers' Liability Act 1957 ("1957 Act") but it declined to find that the Construction (Health, Safety
and Welfare) Regulations 1996 ("1996 Regulations") imposed any duty on him towards Moon. The Court also ordered Garrett to pay Moon's costs and Moon's employer's costs. (Moon's claim against his employer was dismissed.)

The Court of Appeal considered whether Garrett was liable under the 1957 Act and the 1996 regulations, and if he should pay the other parties' costs.

The court found that the correct question was "whether it was reasonably foreseeable that a man delivering blocks to the edge of the track, a few feet from this deep excavation, might slip, and if so whether it was reasonably foreseeable that in slipping he might fall into this pit."

The court found that such an accident was reasonably foreseeable. In a valuable warning to DIY-ers, the court then said "it is not surprising to find that the duty of an occupier who is carrying out extensive building works such as Mr Garrett was carrying out should be under a duty very similar to that which would be owed by a professional builder." The court found that, since it was reasonably foreseeable that Moon might fall, it followed Garrett was liable under the 1996 regulations.

As to costs, the court was unwilling to interfere with the first instance decision. Further, the court said that a Bullock or Sanderson order does not require there to be two "truly alternative" cases. The court sought to focus instead on the fact that Garrett had sought to blame Moon's employers. Therefore it was fairer for Garrett to pay their costs than for Moon to do so.

Garrett's appeal was dismissed and he was still to pay the other parties' costs. It is surprising that an apparently uninsured "man of straw", carrying out works at home was liable for another's employee. However, the extensive nature of the works perhaps holds the key to the decision. Household contents insurers will want to be clear as to the extent of cover available to their insured during construction works at the insured property.

See the Bailii website: http://www.bailii.org/ew/cases/EWCA/Civ/2006/1121.html for the full judgement.

For further information, please contact Alan Jacobs at mailto:alan.jacobs@dlapiper.com or on 0121 262 5743, or Sonja Dale at mailto:sonja.dale@dlapiper.com or on 0121 262 5690

*Moon v Garrett - Court of Appeal - 28 July 2006*

**30. INTELLECTUAL PROPERTY**

**30.1 Intellectual property**

**30.1.1 New law**

The regulations have made some changes to important aspects of IP damages law:

- They suggest that a damages claim can not only cover damages suffered by the rights holder but also any "unfair profits" made by the infringer. This could mean that a claimant need no longer elect for either an enquiry into damages or an account of profits.

- When awarding damages, the court has to take into account "elements other than economic factors, including the moral prejudice caused to the claimant by the infringement". Quite what "moral prejudice" means is unclear, but there is at least a suggestion that this would extend a possible damages claim beyond pure financial losses suffered by the rights holder in the UK.

- Section 68 of the Patents Act 1977 has been amended. Previously, if a rights owner did not register an instrument of assignment or an exclusive licence at the Patent Office within six months, he lost his right to damages or an account of profits for the period after the transaction took effect until the date the instrument was registered. This provision has now been amended so that the only sanction for non-registration is that the court shall not award to the claimant his costs and expenses in respect of any infringement that occurred after the instrument took effect but before it was registered. Again, it is unclear quite what this means; what are the costs and expenses that relate to infringements which occurred during that period, as opposed to those costs and expenses which relate to infringements which occurred outside this period? However, it seems clear that the bar on an order of damages or an account of profits in these circumstances has now gone. The equivalent amendment to section 25(4) of the Trade Marks Act 1994 has also been made by the regulations.

- There has also been a change as regards damages awarded on amended patents. Previously section 62 of the 1977 Act said that no damages should be awarded where an amendment to the patent has been allowed in infringement proceedings in respect of acts which occurred before the amendment was allowed unless the specification as published had been framed in good faith and with reasonable skill and care and the proceedings had been brought in good faith as well. The regulation has changed this, so that these are no longer mandatory conditions for an award of damages to be made, but merely relevant factors to be taken into account. An additional factor has to be taken into account in cases where there is a partial amendment - whether the infringer knew or had reasonable grounds for knowing that he was infringing the patent. Similar amendments have been made to section 63 of the Patents Act which relates to an award of damages in respect of a patent that has been held to be only partially valid.

Otherwise much of the Enforcement Directive is already established UK law although the following are possible further highlights:

- Regulation 3 implements article 13 of the Enforcement Directive. It sets out the grounds on which damages should be awarded against a person who knowingly infringes an intellectual property right.

- Regulation 4 implements article 8 of the Enforcement Directive in Scotland. It creates a new type of court order, for disclosure of information about infringing
goods and services. By reason of the House of Lords decision in *Norwich Pharmacal v Customs and Excise Commissioners* [1974] AC 133, no provision is necessary to implement this obligation in England and Wales or Northern Ireland.

### 30.1.2 Threats

The cause of action of groundless threats of infringement proceedings, here in the design right context, has now entered the world of the online auction. In response to the listing of a number of dirt bikes for sale on eBay, the proprietor of various registered community designs used eBay's "Vero" system to bring his registrations to eBay's attention and gave details of the listings. eBay subsequently removed the listings from its website and without checking the allegation of infringement. The company making the original eBay listings issued proceedings against the designs proprietor for groundless threats under the Community Design Regulations (SI 2005 No 2339) claiming an injunction to prevent further interference.

The court in *Quads 4 Kids v Campbell* [2006] EWHC 2482 (Ch) appears to have had some sympathy with eBay's position and felt that the scope of what amounts to an actionable threat may need to be increased to deal with these new means of potential abuse. It was clear that unsupported and unchallenged allegations of infringement of registered rights were an abuse.

In this particular case, it was not clear that the respondent would be in a position to satisfy any award of damages made against him and the court therefore thought it appropriate to grant an injunction preventing further interference with the applicant's sales through eBay.

In this case it is important to note the respondent made it clear he had no intention of starting proceedings against the applicant. It therefore demonstrates the need to tread carefully when relying on registered rights against a competitor and raising infringement allegations, whether they are made expressly or by implication.

### 30.1.3 Copyright

An attempt to include video arcade games within the scope of copyright protection was considered by the High Court in *Nova Productions Ltd v Mazooma Games Ltd & Ors* and *Nova Productions Ltd v Bell Fruit Games* [2006] EWCA Civ 1044, which held that the visual experience generated by a video game could not amount to a dramatic work for the purposes of the Copyright, Designs and Patents Act 1988 ("CDPA"). A video game was not a work of action intended to be, or capable of being, performed before an audience and so was not a dramatic work. Applying *Green v Broadcasting Corporation of New Zealand* [1989] RPC 700, it was held that there must be certainty in the subject matter of the copyright protected work in order to avoid injustice. The particular sequence of images displayed on the screen depended on the way in which the game was played by the user and this would vary from game to game. A video game did not possess sufficient unity to make it capable of performance. The fact that a video game might have a number of features claimed to constitute a "format" but which are unrelated to each other save as accessories to be used in the presentation of the game was held to be insufficient to establish dramatic work copyright.
A claim based on infringement of literary copyright also failed because it was common ground that the defendants had neither accessed nor copied the game's program code itself. All they had taken were some generalised ideas from the claimant's game and imitated these in their games' outputs (following Navitaire v Easyjet [2003] RPC 3). See also Council Directive 91/250/EEC (14 May 1991) on the legal protection of Computer Programs which did not provide protection for ideas underlying elements of a computer program.

The same principle applied in the high profile Baigent and Leigh v Random House Group Ltd [2006] EWHC 719 (Ch) where the High Court considered whether the central theme of the claimants' book "The Holy Blood and the Holy Grail" had been copied in Dan Brown's well-known book "The Da Vinci Code", published by the defendant, Random House, and whether this amounted to non-textual infringement. The Court held that a balance had to be made between the protection of the author's rights on one side and the allowance of literary development on the other. Although, copyright infringement was not restricted to copying the exact text in a piece of work, the court would not protect alleged copyright in a theme of a literary work which was at too extreme or general a level of abstraction.

Turning to the criminal provisions of the CDPA, in Gannon v F.A.C.T. (24 March 2006), the court heard an appeal against conviction for dishonestly receiving broadcasts of football matches.

The defendant, the proprietor a public house in Lancashire, had purchased a decoder and enabling card from a company called K.D.S, which enabled him to receive a satellite signal from a Greek broadcast originating from the UK.

Under section 297 CDPA:

"A person who dishonestly receives a programme included in a broadcasting service provided from a place in the United Kingdom with intent to avoid any payment of any charge applicable to the reception of the programme commits an offence".

The Crown Court held that the signal which was received by the decoder may have counted as a retransmission from Greece and not therefore a broadcast within the specific meaning of the section. It was also not satisfied that any "intent to avoid any payment of any charge " had been established as there was no evidence that an actual charge existed, since the rights to the "live" match broadcasts in the UK were not for sale - even if the defendant had asked UEFA if he could receive the signal, no price would have been offered by them. The decision should be treated with caution, however, since the Court did indicate that there had apparently been some unlawful use of IP rights which had not been identified and the success of the appeal may be in no small way due to the manner in which the case was prosecuted by FACT.

30.1.4 Designs : case law

Manufacturing spare parts can be a tricky business. Dyson Ltd -v- Qualtex (UK) Ltd [2006] EWCA Civ 166; [2006] RPC 31 (CA(Civ Div)) concerned "Pattern Parts" which are spare parts which do not originate from the manufacturer of the product but are made to reproduce the original parts. Qualtex, the manufacturer of the Pattern Parts, admitted copying but relied on "practically every point that might be a bar to design right" to defend Dyson's claim of design right infringement. The decision of
Excellence through know-how

the Court of Appeal is therefore long and complex but amounts to a fairly comprehensive review of this area of law and the "crude statute" which governs it. In general, it approved of the earlier decision of Mr Justice Mann in the High Court, dismissed Qualtex's appeal and upheld the original finding of UDR infringement. Some of the more significant points that arose are as follows:

- **UK unregistered design right ("UDR")** can subsist in the "design of any aspect of the shape or configuration of the whole or part of an article". This may cover aspects that have no practical significance. They do not need to be visually significant.

- The "must fit" exception removes UDR protection from parts of a design which enable it to be connected to or placed in, around or against another article so that either may perform its function. A part whose function was to make an article work more effectively or safely could fall within it. The exception may also cover parts which do not actually touch.

- The "must match" exception removes UDR protection from features that are dependent on the appearance of another article of which it is intended to form an integral part. Mr Justice Mann's interpretation was approved - this exception will apply where the overall design would be "radically different in appearance" if the spare part were not a particular shape. Accordingly if the manufacturer of the spare part enjoys design freedom, the exception will not apply.

- Surface decoration is excluded from UDR protection. It was held that this should not extend to surface features which have a significant function. It is not, however, limited to decoration that is applied to a pre-existing, previously undecorated, surface.

- UDR protects designs which are "original". The key question here is whether the designer used his own skill to create it or did he simply copy an earlier design, in which case UDR protection will not be available. Merely adding an old design on to an existing design is not enough in itself to create an original design.

- Even original designs will not be protected by UDR, however, if they are "commonplace" in the design field in question. The chances of an original design being commonplace are, however, low. Further, just because a design becomes well known, or even ubiquitous, does not mean that it becomes commonplace and falls out of UDR protection - the test is applied as at the date of creation.

The exclusion from design right protection for certain designs with a functional purpose was also considered by the Court of Appeal in *Landor & Hawa International Limited v Azure Design* [2006] EWCA Civ 1285, where the main issue was whether an "expander" section design for suitcases was a method or principle of construction. If it was, it would not attract UK or Community unregistered design right protection.

Lord Justice Neuberger giving the leading judgment of the Court of Appeal held that this exception to UDR protection should be construed narrowly. It does not apply merely because a design performs a functional purpose but will only apply if that purpose cannot be achieved by other means. If this were not so, purely aesthetic designs would be protected whereas designs which are both functional and aesthetic
may not be. Similar reasoning applies to the corresponding provisions in the Community Design Regulation (No 6/2002) in relation to Community unregistered design right.

The exclusion was considered again at first instance in Bailey (T/A Elite Angling Products) -v- Haynes (T/A Rags), Patents County Court, 2 October 2006, which concerned the design of fishing accessories. The claimant claimed UK and Community unregistered design right protection for a PVA micromesh to be used in a bait bag. Its complaint related to PVA micromesh material sold by the defendants.

The main points of the decision were:

- The creator of the claimant's design exercised a "rather small degree" of skill and judgment in creating it and did not merely copy antecedent material. This was sufficient for the design to be "original" and therefore attract UK unregistered design right. Further, as there was no evidence similar mesh had ever been made, it was certainly not commonplace. Similar findings were made in relation to the subsistence of Community unregistered design rights.

- The basic appearance of the design was created by a method of stitching used to create the mesh and in practice, its appearance would only slightly from product to product. Accordingly the method or principle of construction exclusion was engaged and the claimant's design would not be protected by UK unregistered design right. Thus this aspect of the claim failed.

The other head of claim was based on Community unregistered design right. This does not extend to "Features of appearance …dictated solely by technical function". The claimant's design was not the only design capable of achieving its intended function, but merely one such way, and as such was held not be caught by the exclusion. As with Landor & Hawa -v- Azure this exclusion was construed narrowly as applying to a design that is the only design by which the product in question could perform its function, ie where there is no design freedom. It follows, therefore, that the UK exclusion may well be broader that its EU counterpart.

A comparatively rare decision on Community registered design right infringement has been heard by the High Court (Procter and Gamble Company v Reckitt Benckiser (UK) Ltd [2006] EWHC 3154 (Ch)). Procter & Gamble's Community design for a package on which it based its air spray freshener 'Febreze' had been validly registered and infringed by Reckitt Benckiser’s packaging for its product "Air Wick Odour Stop".

A design may only be protected by Community registered design right to the extent that (i) it is new, and (ii) has "individual character". The latter is found to exist if the "overall impression" it produces on the informed user differs from that produced (on such a user) by any design made available to the public before the filing or priority date of the design for which registration is sought (article 6 Community Designs Regulation 6/2002/EC). The degree of freedom of the designer in developing the design is taken into account (article 6(2) CDR).

Any design which does not produce on the informed user a different overall impression is infringing (article 10(1)).
In identifying the nature of the informed user, Mr Justice Lewison followed the approach taken by Mr Justice Fysh in *Woodhouse UK v Architectural Lighting Systems* [2006] RPC 1 (see DLA Piper Annual Legal Review 2005).

Constraints on a designer's freedom could include things such as health and safety requirements or other regulatory requirements in the relevant design area. However, internal commercial constraints, such as a production line that was too expensive to change, could not be taken into account. The test was objective and applied to all designers; knowledge of the financial resources of an alleged infringer could not be attributed to the informed user.

Turning to "overall impression", the correct approach was to compare the relevant designs in respect of their various features individually and in respect of the weight (or importance) of the various features according to their influence on the overall impression (following *Eredu v Arrnet* (OHIM ref: ICD000000024, 27 April 2004)) and identify the similarities and differences. However, the overall impression was not a constant darting between one design and another, nor simply a catalogue (weighted or otherwise) of similarities and differences: The overall impression of a design was what stuck in the mind after it had been carefully viewed. The task of the informed user was to reach an overall impression of each of the two (or more) designs and then to ask whether those overall impressions differed.

On the interrelationship between validity and infringement, Mr Justice Lewison held that they were two sides of the same coin: the same test applied to each.

The comparison to be made to assess infringement was between the design as registered and only the comparable portion, not necessarily the whole, of the allegedly infringing product. So where eg the design of a chair back is registered, only the back and not, say, the legs of an allegedly infringing chair are relevant for the comparison.

Given the paucity of cases in this area, the decision is likely to be influential throughout the EU.

### 30.1.5 Registered Design Law Reforms

On 1 October 2006, certain changes were introduced to the procedure for obtaining a registered design by the Regulatory Reform (Registered Design) Order 2006. They bring the UK system more in line with the Community procedure. The main changes, which should make obtaining a UK registered design easier, are:

- new applications will no longer be examined for novelty and individual character (ie the registry will not compare it with earlier designs);

- multiple design applications are now allowed with consequent cost savings when registering a large number of designs;

- it will no longer be possible to withhold certain applications from public inspection although applicants will have the option of delaying publication for up to 12 months; and
• it will be easier to restore registrations that have lapsed through non-payment of the relevant fees.

30.2 Domain names

30.2.1 .eu domain name update

The .eu top level domain name registry opened on 7 December 2005 for Phase 1 applications. Following its launch, the European Registry of Internet Domain Names (EURid), the .eu domain name registry, was inundated with applications to register .eu domain names. Applications were processed on a first-come-first-served basis, within three set phases. Phase 2 opened on 7 February 2006, and this was followed by the landrush period for open registrations which began on 7 April 2006. It is now possible for anyone with the required local presence to apply for a .eu, without proof of prior rights. This has opened the floodgates for cybersquatters to try and profit from any available domain names.

To date, EURid has approved and activated over 2,378 million domain names. The country with the most interest in .eu domain names is Germany, from where over 740,000 applications have already been filed. Certain domain names proved to be very popular and subject to multiple applications. EURid has reported that the domain name that received the most applications is sex.eu with 281 applications. Over 80,000 sunrise applications were rejected by EURid, presumably as a result of incorrect supporting documentation being supplied by the applicants.

In cases where domain names have ended up in the wrong hands, the .eu Alternative Dispute Resolution ("ADR") is being managed by the Czech Arbitration Court. The court publishes its decisions on its website: [http://adr.eu/adr/decisions/index.php](http://adr.eu/adr/decisions/index.php)

30.2.2 Celebrity domain names: waynerooney.com

This year has seen yet more cases of cybersquatters registering domain names which reflect a celebrity’s name. In October, the World Intellectual Property Organisation ("WIPO") panel ordered the transfer of waynerooney.com to the Manchester United striker Wayne Rooney. To obtain an order that a domain name should be cancelled or transferred, a complainant must prove that:

• It has rights in a trade mark which is identical or confusingly similar to the domain name.

• The respondent has no rights or legitimate interests in the domain name.

• The domain name has been registered, and is being used, in bad faith.

In the case of waynerooney.com, the panel was satisfied that the respondent had registered the domain name in bad faith and had failed to produce any evidence to show his intentions for use of the domain name.

30.2.3 Launch of .mobi suffix

On 26 September, .mobi became available for general registration. This suffix is aimed at users accessing the Internet from mobile devices. With the widespread
growth of the Internet and mobile technology, brand owners should consider registering a .mobi domain name. The .mobi registry anticipates over a million .mobi registrations to be made within the registry's first year.

30.2.4 WIPO: domain name cases

WIPO's Arbitration and Mediation Center recently announced that it has handled over 25,000 domain name disputes since its inception in 1999. Domain name disputes for the following suffixes: .com; .net; .org; .info; .biz; .travel; .aero and .edu have been dealt with by WIPO and proceedings have been managed in 12 languages, namely Chinese, Dutch, English, French, German, Italian, Japanese, Korean, Norwegian, Portuguese, Russian and Spanish.

WIPO continues to remain an effective means of ADR, providing an efficient and fair service for all parties.

30.3 Patents

In the summer, the European Court of Justice (ECJ) handed down its eagerly awaited decisions in Primus v Roche (C-539/03) and GAT v LuK (C-4/03) (both 13 July 2006) and severely restricted the jurisdiction of the Dutch courts in hearing multiple EU patent infringement actions involving multinational defendants.

In Primus, the ECJ essentially affirmed the opinion of Advocate-General Léger (8 December 2005) that article 6(1) of the EEX Treaty (which states that one of a number of defendants can be sued in the courts of the place where any one of them is domiciled) cannot be used to bring a case in the court of a single Member State against defendants in different Member States for the alleged infringement in those other Member States of the relevant designated parts of a European patent; not even if the defendants belong to the same group of companies or if they acted on the basis of a common policy. The result is effectively game set and match against the existing Dutch practice of issuing cross-border decisions in proceedings against defendants in different Member States.

In GAT, the ECJ held that, under article 16(1) Brussels Convention on the Jurisdiction and Enforcement of Judgments in Civil and Commercial Matters (or the EEX Treaty), all proceedings relating to the validity of a patent are the exclusive preserve of the courts of the country in which that patent is registered, whether the issue of invalidity is raised by way of an original action or by way of a defence or counterclaim (the latter would usually be in an infringement action).

It follows that the use of the Dutch courts by forum-shopping claimants faced with European multinational infringers as a one-stop-shop for injunctive relief covering each state designated by a European patent is likely to be dramatically reduced. Instead, claimants will need to bring their actions in separate national courts.

Not to be outdone, Dutch courts have since granted injunctions covering both the Netherlands and Germany in kort geding (or preliminary proceedings), albeit against Dutch defendants. Although, the defendants raised invalidity defences, GAT was distinguished on the basis that in kort geding proceedings, no final assessment of the validity of a foreign patent is made (see Bettacare v H3, 21 September 2006; Van Kempen v Kuipers, 19 October 2006, both District Court of The Hague).
Another long-awaited decision, this time on the exclusion to patentability of business methods and computer programs (as such) under article 52(2) European Patent Convention raised - perhaps inevitably - more questions than it answered.

Giving the leading judgment in the Court of Appeal in the conjoined decisions of Aerotel v Telco and Macrossan’s Application (27 October 2006, please see http://www.bailii.org/ew/cases/EWCA/Civ/2006/1371.html), Lord Justice Jacob reviewed the existing case law of the European Patent Office and the English courts, grouping them into what he saw as three approaches: the contribution approach (please see Merrill Lynch's Application [1989] RPC 1 at first instance), the technical effect approach (the Court of Appeal in Merrill Lynch's Application [1989] RPC 561) and the "any hardware" approach (the more recent approach of the EPO since Hitachi [2004] T258/03). Lord Justice Jacob rejected out of hand the any hardware approach, which does not apply the exclusion to claims that involve the use of any hardware, as 'not intellectually honest'. However, he did little here to attempt to reconcile the approach with existing English case law, as Peter Prescott sitting as a Deputy High Court judge appeared to do in CFPH's Applications (2005) EWHC 1589 (Pat), (2006) RPC 5. One interpretation of the EPO's approach since Hitachi is that it would seem to be unnecessary to get bogged down in separate analysis under article 52(2), but instead deal with excluded matter by excluding it from the analysis under article 56 of novelty and inventive step. This was recognised by Mr Prescott in CFPH in his "little man test" - and was also the approach of the abandoned draft directive - but Lord Justice Jacob largely ignored CFPH in the judgment.

Lord Justice Jacob then seemingly got bogged down himself in distinguishing between the technical and contribution approaches as he saw them, even though they arguably lead to no real practical difference following application. The upshot was a reformulation of Merrill Lynch (CA):

- properly construe the claim;
- identify the actual contribution of the invention;
- ask whether the actual contribution falls solely within the excluded subject matter;
- check whether the actual or alleged contribution is actually technical in nature (if it is not technical, then that would cause it to be excluded in accordance with Merrill Lynch).

Turning to the Court of Appeal's application of its preferred principles to the facts of the Aerotel patent application, it perhaps unwittingly highlighted what has always been the real problem in this area - that whatever test you choose, it is the way you apply it that matters.

The heart of the Aerotel appeal is arguably the application of the new stage 2 to the facts of its telephone system: Lord Justice Jacob states:

"...the contribution is a new system. It is true that it could be implemented using conventional computers, but the key to it is a new physical combination of hardware."

UK patent agents may well be licking their lips at the opportunities that this presents: with a little creativity in the structure (particularly in terms of the block diagrams) of the computer systems claimed in the application as implementing the relevant computer program or business method, the exclusion to patentability might easily be avoided. In fact the Court of Appeal may unconsciously have introduced a "form over substance" loophole for the benefit
of patent applicants. In summary, the decision could usher in a quiet revolution in the number of UK patent applications that are granted in this field.

Finally, the Court of Appeal felt there was a need for clarification of the correct approach in applying article 52(2) and made suggestions for questions that might be asked of the European Patent Office Enlarged Board of Appeal. Readers are advised not to hold their breath.

At the tail end of the year, the Court of Appeal reined in the concept of sufficiency and also looked at "intermediate generalisations" in added matter. In deciding whether a patent application or specification discloses the invention sufficiently clearly and completely for it to be carried out by the person skilled in the art, the Court of Appeal in Halliburton Energy Services Inc v Smith International Inc [2006] EWCA Civ 1715 rejected the proposition that, provided only that the work needed of the skilled man in implementing the concept of the invention was not routine, it did not matter how much work (not itself related to the concept) was in fact required. Time spent by the skilled man doing the work had to come into the equation, since, if what was taught by the patent involved just too much to be reasonable allowing for all the circumstances (including the nature of the technical field), then the patent could not be regarded as "enabling".

But how do you decide when the work required to perform the invention is simply too much? Perhaps inevitably, this involves taking into account all the relevant factors including the nature of the invention, its field of technology, the width of the patent claim and whether it has functional limitations which would require too much work to explore.

What is now clear is that there is a limit to the amount of work that will be expected of the skilled person/team in implementing an invention for the purposes of sufficiency. While there is no clear empirical test to drawing the line, it should at least now be clear to litigants that the boundaries will only be stretched so far.

In LG Phillips LCD v Tatung [2006] EWCA Civ 1774, the Court of Appeal ruled that applicants seeking amendment of their patents (under section 75 Patents Act 1977) were not permitted to effect so-called "intermediate generalisations": to extract a feature (neither remarked on in the specification nor of significance to the skilled person) of one of the preferred embodiments of the invention and insert it into a claim while ignoring the other features of the embodiment. Such amendments would add matter contrary to section 76(3) PA77 (following EPO Enlarged Board of Appeal in G01/93 Advanced Semiconductor Products [1993] EPOR 97).

Where an amendment involves a disclaimer narrowing a claim, the disclaimer will not add matter, provided it is inserted into the claim in order to avoid an "accidental" anticipation, but it will add matter if inserted to avoid a "non-accidental" anticipation. According to the Enlarged Board of Appeal in G01/03 PPG/Disclaimer [2004] EPOR 331, an accidental anticipation involves a disclosure belonging to a remote technological field or one whose subject-matter suggested it would not help solve the problem addressed by the patent.

The Court of Appeal rejected the suggestion that the concept of intermediate generalisations was possibly illegitimate, given it was nowhere to be found in the EPC (or the PA77). It was clear that the Enlarged Board had developed the law on added matter in ways which could be said to involve superimposing a degree of policy over what had been perceived by the English courts as a relatively pure issue of principle.
30.4 Trade marks & passing off

30.4.1 No cause of action estoppel for matters heard at registry

L’Oréal was unsuccessful in opposing Special Effect Ltd's application to register "Special Effects" as a trade mark. Once the mark was registered, Special Effects Ltd started proceedings against L’Oréal for infringement by the use of its brand Special FX. L’Oréal contended that the mark Special Effects was invalid. Special Effects Ltd argued that L’Oréal was barred from challenging the validity of the mark on the grounds of estoppel and abuse of process, the validity of the mark having already been litigated before the registry. Even though the opposition was solely by L'Oréal SA, Special Effects Ltd contended that L'Oréal UK Ltd was also bound by the earlier decision.

The Chancellor of the High Court held that L'Oréal could not re-contest any of the issues it wanted to raise. In particular he held that (i) there was no real difference between the practice and procedure of the Trade Marks Registry in opposition proceedings and invalidity proceedings since the issues underlying the two sets of proceedings were identical; (ii) cause of action estoppel applied where a cause of action in the second action was identical to a cause of action in the first and (iii) L'Oréal could not rely on their own use of the SPECIAL FX brand before the date of application for "Special Effects", since that issue had been expressly raised, and dealt with, in the opposition proceedings. The Chancellor also held that it was just to bind both parties to the earlier decision. Companies in a group were to be regarded as privy to each other unless they demonstrate to the contrary; otherwise the principles of estoppel would be largely inoperable in relation to corporate structures.

The Court of Appeal has reversed the Chancellor's ruling, concluding that there was no cause of action estoppel. The cause of action before the registry was an opposition proceeding, while that before the High Court was a trade mark infringement proceeding in which the validity of the claimant's mark was put in issue.

Moreover, the co-existence of the provisions for opposition and for a declaration of invalidity had the result that the opposition proceedings were inherently not final for the purposes of issue estoppel. The fact that an unconnected third party could challenge the validity of the registration despite an unsuccessful opposition by another and that, if that challenge were successful, there would be nothing that would bind the unsuccessful opponent showed that the decision to register despite opposition was not a final decision so as to be capable of being the basis for an issue estoppel.

Given that the legislation did not preclude the same party from seeking a declaration of invalidity, having failed in opposition proceedings, the circumstances would have to be unusual to justify holding that a party who did take advantage of the second opportunity provided by the legislation was abusing the process of the court. On the facts of the case L'Oreal did not abuse the process of the court.
The Court of Appeal also held that it was unnecessary to decide whether the second defendant was bound as the privy of the first defendant. However, they thought that the Chancellor went further than was necessary for his decision.

Special Effects Ltd (Claimant/First Part 20 Defendant/Respondent) v (1) L'Oreal SA (2) L'Oreal (UK) Ltd (Defendants/Appellants) & Special Effects (A Firm) (Second Part 20 Defendant) & International Trademark Association (Intervener), Court of Appeal, 12 January 2007

30.4.2 O2's bubble trade marks

The claimants, O2 Holdings Ltd and O2 (UK) Ltd (collectively "O2") and defendant, Hutchison 3G UK Ltd ("H3G") both provide mobile telephone services. O2 was the registered proprietor of a number of trade marks, for telecommunications services and apparatus, including four trade marks consisting of bubbles.

In order to promote the launch of its new pay-as-you go service, H3G ran a series of advertisements on national television. The advertisements compared H3G's pay-as-you-go services to those of its competitors, including O2. The O2 comparative advertisement began with a stream of bubbles being dispersed and included an explicit reference to O2 in a voiceover. O2 argued that the comparative television advertisement infringed its four bubble trade marks. The trial judge, Mr Justice Lewison, held that although H3G's use of the bubble imagery fell within article 5(1)(b) of the Trade Marks Directive, the advertisement had complied with the Comparative Advertising Directive, and such compliance provided a defence under article 6(1)(b) of the Trade Marks Directive.

The Court of Appeal ruled that the case must be referred to the ECJ to decide the extent to which European law allows comparative advertising as it was unclear whether H3G's use of the bubble imagery in its comparative advertising campaign amounted to an infringement of O2's registered trade marks under either article 5(1)(a) or article 5(1)(b) of the Trade Marks Directive. Lord Justice Jacob's view was that it did not. It was also unclear whether the use of another's registered trade mark in comparative advertising had to be necessary or indispensable in order to comply with the Comparative Advertising Directive. Again, Lord Justice Jacob was of the view that it did not. The following questions would be referred to the ECJ:

- Where a defendant in the course of trade uses a sign in a context purely for the purpose of comparing the merits of his goods or services with those of the trade mark owner and in such a way that it cannot be suggested that the essential function of the trade mark (as an indication of origin) is in any way jeopardized, can his use fall within either article 5(1)(a) or (b) of the Trade Marks Directive?

- Where a defendant uses, in a comparative advertisement, the registered trade mark of another, in order to comply with the Comparative Advertising Directive, must that use be indispensable and if so what are the criteria by which indispensability is to be judged?
• In particular, if there is a requirement of indispensability, does that requirement preclude any use of a sign so similar to the registered trade mark as to be confusingly similar to it?

(1) *O2 Holdings Ltd (2) O2 (UK) Ltd v Hutchison 3G Ltd*, Court of Appeal, 5 December 2006

30.4.3 Risk of deception under article 3.1(g) of the Trade Marks Directive

The ECJ held that a trade mark corresponding to the name of a designer and first manufacturer of the goods bearing that mark (Elizabeth Emanuel) could not be refused registration on the ground that it would deceive the public, as the goodwill associated with that trade mark had been assigned together with the business making the goods to which the mark related.

Although the public interest ground which justifies the prohibition laid down by article 3(1)(g) must raise the question of the risk of confusion which such a trade mark may engender in the mind of the average consumer, nevertheless, the circumstances for refusing registration presupposes the existence of actual deceit or a sufficiently serious risk that the consumer will be deceived. In this case, the characteristics and qualities of that product remain guaranteed by the undertaking which now owned the trade mark thus preserving the essential function of the trade mark.

*Elizabeth Emanuel v Continental Shelf 128 Ltd*, Case C-259/04, European Court of Justice (Third Chamber), 30 March 2006

30.4.4 Smell-alike fragrances

This case was something of a pyrrhic victory for the claimants, who, while successful under section 10(3) Trade Marks Act 1994 in relation to two out of the five products that they complained of (neither of which were still produced) and under section 10(1) in relation to use of their word marks in product comparison lists, failed entirely under section 10(2).

Mr Justice Lewison held that signs incorporated within the defendants' "La Valeur" box and their "Pink Wonder" bottle, in their original incarnations, were sufficiently similar to certain of the claimants' marks incorporated within their products, "Tresor" and "Miracle", as was likely to establish a link in the mind of the average consumer sufficient to establish infringement under section 10(3). It was accepted by the defendants that the claimants "Tresor" and "Miracle" word marks enjoyed a reputation in the UK and the judge held that the "La Valeur" box and "Pink Wonder" bottle took unfair advantage of the reputation of the marks under section 10(3). However, none of the defendants' signs were sufficiently similar to any of the claimants' marks, so as to give rise to a likelihood of confusion sufficient to establish infringement under section 10(2).

The judgment raises a number of interesting points:

• How far in the EU does a trade mark have a legitimate function beyond guaranteeing trade origin, eg protecting "image" represented by the mark? Mr Justice Lewison felt that image protection was a legitimate function (citing
Case C-337 *Parfums Christian Dior SA v Evora BV*). How far is this view at odds with the Court of Appeal in *Arsenal v Reed* and *R v Johnstone*?

- The judge held that the level of similarity required to establish infringement under section 10(3) is lower than that under section 10(2). Should the judge have decided that there was a minimum level of similarity that needed to be reached before he could make any assessment under section 10(2) or 10(3)?

- The defendants unsuccessfully relied on section 10(6) (use in accordance with honest practices) in their defence to the claim under section 10(1). Mr Justice Lewison held (as he did in the 02 "bubbles" case) that the section 10(6) defence was the same as that under the Comparative Advertising Directive and that consequently the defence fails if the defendant is found liable under the "unfair advantage" limb of section 10(3).

The claim in passing off also failed.

*L'Oreal SA and others v Bellure NV and others*, Chancery Division, 4 October 2006

30.4.5 **ECJ dismisses Picasso estate's appeal against registration of PICARO**

The ECJ has dismissed the Picasso estate's appeal against the decision to allow the registration of the word sign PICARO as a CTM by Daimler Chrysler in Class 12 (Vehicles). The basis of the Picasso estate's challenge was that a likelihood of confusion existed under article 8(1)(b) of regulation No 40/94 as it had a CTM "PICASSO," also registered in class 12.

The CFI had been entitled to conclude that the relevant public would inevitably see the word mark "PICASSO" as a reference to the painter, and that rich conceptual reference would greatly reduce the resonance with which the sign was endowed as a mark of motor vehicles. Moreover, the CFI had rightly considered that the sign "PICASSO" was devoid of any distinctive character with respect to motor vehicles. Further, as the average consumer would purchase a vehicle only after a particularly careful examination, such a fact might reduce the likelihood of confusion between marks relating to such goods at the crucial moment when the choice between those goods was made.

The ECJ dismissed the Picasso estate's argument that the CFI had misapplied article 8(1)(b). The Picasso estate claimed that the CFI did not take into account the rule in *Arsenal Football Club*, which states that the mark must be protected against possible confusion, not only at the time of purchase of the product, but also before or after such a purchase. In view of the nature, price and highly technological character of the goods concerned, the average consumer would display a particularly high level of attention at the time of purchase.

*Ruiz-Picasso and others v Office for Harmonisation in the Internal Market (Trade Marks and Designs*, Case C-361/04 P, European Court of Justice (First Chamber), 12 January 2006
30.4.6 Court of Appeal upholds High Court decision on Philips electric shaver mark

In October 2004, Remington Consumer Products Limited (Remington) won the latest leg of UK litigation before Lord Justice Rimer in the High Court, by successfully invalidating the UK trade mark registration relied upon by Koninklijke Philips Electronics N.V. (Philips) in the dispute between the parties over Philips' trade mark registrations. The Philips Mark is a two dimensional picture of the shape of the top portion of a Philips three headed rotary electric shaver. The trade mark consisted of three elements, "the cloverleaf design" (consisting of three shaving foils), "the raised rim" and "the lower residual areas of the face plate".

The Court of Appeal upheld the judgement of Lord Justice Rimer. The whole of the face plate of the razor, including the cloverleaf design, contributed to the overall technical objective of giving the user a smooth, effective and comfortable shave. The court concluded that the Mark was in substance functional and the registration invalid. The court appeared to take no notice of the variety of shapes and configurations open to other competitors to use. This would indicate that any shape which has a functional object or element will be refused registration as a trade mark regardless of any aesthetic characteristics attaching to its components.

Koninklijke Philips Electronics NV v (1) Remington Consumer Products Ltd (2) Rayovac Europe Ltd, Court of Appeal, 26/1/2006

30.4.7 UK to end relative grounds for refusal

Following a Patent Office consultation paper published in February 2006 on how the practice of relative grounds examination should evolve, it was decided that there will be no more examination on relative grounds. The official search will be used to notify both the applicant and owner of the earlier trade mark, in order to settle potential disputes as early as possible before a significant amount of time and money is invested in a new mark. A further consultation process will follow in respect of the procedural issues relating to this option, particularly the circumstances in which owners of earlier trade marks will be notified of later conflicting marks. It is anticipated that the process will be completed and implemented in October 2007.

The change will adversely affect small and medium sized enterprises as it will cause a substantial increase in the burden on existing trade mark owners to police and enforce their own marks.

31. INTERNATIONAL TRADE

See also COMPETITION, section 9.

31.1 Revival of Doha round of WTO talks

The Doha round of WTO talks was inaugurated in November 2001 to deepen the liberalisation of goods and services and to create a fair system of trade, particularly in relation to agricultural products, for the benefit of developing countries. In July 2006, the talks collapsed. This was largely due to an impasse over the removal of market distorting farm subsidies among the EU, India and Brazil and Asia Pacific Economic Cooperation ("APEC") members, the US, Australia and Japan. After months of deadlock, the issues are again receiving attention. Although it is by no means certain that the negotiations will be properly

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resumed, an APEC leaders' meeting opened in November, amid mounting calls for their revival. The EU has confirmed its full commitment to the Doha Development Agenda and Brazil too is pressing for a new round of negotiations. If the negotiations do not resume while the US president still exercises his Trade Promotion Authority (by which he is allowed by Congress to exercise unfettered negotiating authority until July 2007), the talks will not be resumed again until the US's next election cycle in 2010. It remains to be seen whether a new round of negotiations will achieve a successful outcome.

31.2 Bilateral free trade agreements and partnership and cooperation agreements

Bilateral free trade agreements provide effective alternative channels for achieving free trade and investment commitments on a more detailed, wide ranging and speedy basis. The European Commission has long been negotiating bilateral free trade frameworks with a number of key trade partners, in particular, ASEAN, GCC and Mercosur. On 4 October 2006, the European Commission adopted a new strategy to integrate trade policy into the EU's competitiveness and economic reform agenda. The policy review (Global Europe: Competing in the World) sets out a strategy for opening new trade markets abroad for EU companies and ensuring that European companies are able to compete fairly in those markets. It also commits Europe to ensuring its own markets remain open. As part of the strategy, the Commission will propose a new generation of bilateral free trade agreements with key partners ("Partnership and Cooperation Agreements") to build on WTO rules by tackling issues which are not suited to multilateral discussion and by preparing the ground for the next level of multilateral liberalisation. The key economic criteria for new free trade agreements will be market potential and, thus, the Commission is targeting in particular China and markets of Asia.

31.3 Anti-dumping

Dumping is illegal in international trade law and is often rooted in state intervention in free and fair competition. European Community rules on antidumping are targeted at cheap or below cost imports which cause significant injury to producers within the Community. A finding of anti-dumping can result in the imposition of hefty duties.

The ideal situation for countries who export cheap goods to the EU is to be recognised by the EU as having Market Economy Status ("MES"). This enables them to benefit from reductions in antidumping duties and avoid the application of the "analogue country" procedures for determining the costs of production of the goods in question.

While in December 2005, the Ukraine was granted MES by the EU, the controversy over China's longstanding application for MES continues. The situation has been aggravated by concerns over China's dumping of leather shoes into the EU and the consequential imposition of anti-dumping duties on certain leather shoe imports from China to the EU. In the meantime, China's present economy-in-transition status will last until it either complies with the EU's various requirements for full market economy status or until 2016 when it will automatically receive MES under the terms of its WTO accession in 2001.

In June 2006, Commissioner Mandelson announced a review of antidumping and EU trade defence instruments generally. It is believed that this will not be a wholesale review, but rather that it will address failings relative to labour intensive products such as textiles and shoes. The best practice which has been established for sectors such as steel is likely to remain.
31.4 Exports: customs security programme

The EU has introduced a number of measures to tighten security around goods crossing international borders. These will result in faster and better targeted checks and controls.

Three major changes to the customs code have been made:

- traders must now provide customs authorities with information on goods prior to import or export from the EU;
- reliable traders will be afforded trade facilitation measures; and
- a mechanism for setting uniform Community risk-selection criteria for controls supported by computerised systems has been introduced. The EU Customs Security Programme ("CSP") covers activities supporting the development and implementation of these security measures. The CSP aims to introduce proper security controls and work in close cooperation with the EU's major trading partners to secure international supply chains. It will also work towards providing compliant traders with channels to secure their part of the international supply chains. Central to the CSP is the creation of the Authorised Economic Operator ("AEO") concept which may be granted by member states to any economic operator that meets common criteria relating to operators' control systems, financial solvency and compliance record. AEOs will benefit from simplifications provided for in customs rules.

32. INTERNET AND ELECTRONIC COMMERCE

See also COMMERCIAL, section 5.

32.1 VAT and eCommerce Directive (2002/38/EC)

On 28 November the European Council concluded that the effect of the VAT and eCommerce Directive (which brings supplies of electronic services over the Internet made by non-EU-based suppliers within the ambit of VAT regimes of the member states) should be extended until 31 December 2008. Delays in the progress of substantive proposals to amend the VAT regime prompted this latest move. The Council proposes to finalise the new package of VAT measures by June 2007.

32.2 ICSTIS Code of Practice now applies to information society services

The 11th Edition of the ICSTIS Code of Practice which comes into effect on 4 January 2007 will bring information-society service providers (ie businesses which market or sell goods or services on the Internet or using interactive TV or phone texting) within its scope for the first time. It will also clarify its compatibility with the E-Commerce Directive.
32.3 Liability of internet service providers ("ISPs") for defamation

The UK courts have clarified in the case of *Bunt v Tilley, Hancox, Stevens, AOL, Tiscali, BT* [2006, EWHC 407, QB, 10 March] the following in relation to the liability of ISPs for defamatory content published on their networks:

- to succeed in an action for defamation against ISPs, claimants need to prove awareness by the ISP of the defamatory content (ie that the ISPs are responsible for publication). Assuming editorial responsibility could be enough;
- ISPs are not publishers if performing merely "passive" roles in facilitating internet postings;
- ISPs have no obligation to act as "gatekeepers" to their conduits;
- on the facts, the ISPs would also have been able to reply on the "mere conduit", "caching" and "hosting" defences under the e-Commerce Regulations.

32.4 Legal effect of email signatures

The case of *Mehta v J Pereira Fernandes SA* [2006] EWHC 813 CH, 7 April 2006 clarified:

- the automatic insertion of a person's email address after a document has been transmitted doesn't constitute a binding signature;
- for an email signature to be binding, positive conduct indicating an authenticating intention must be shown;
- it was suggested that typing a name in the body of an email would suffice to constitute a binding signature. In this respect, the case raises more questions than it answers. On this analysis, an automatic email signature might be construed as indicating an authenticating intention.

32.5 Distance selling


32.6 Communications Act 2003 (Maximum Penalty for Persistent Misuse of Network or Service) Order 2006

With effect from 6 April 2006, the maximum penalty that Office of Communications can impose under section 130 of the Communications Act 2003 in respect of the persistent misuse of electronic communications networks or electronic communications services was raised from £5,000 to £50,000.
32.7 Code of Practice for Traders on Price Indications

The DTI has revised its Code of Practice on Price Indications to include specific guidelines for internet price promotions. Further information together with a copy of the revised code is available on the DTI web site.


33. LITIGATION: SCOTLAND

For LITIGATION: ENGLAND, see section 34.

33.1 Courts update

33.1.1 Modernising civil business in Glasgow Sheriff Court

Glasgow Sheriff Court is reputed to be the busiest court in Europe. In 2006, it sought to take advantage of developments in technology in order to streamline civil business and produce efficiencies. Extending principles which have worked well in 'commercial actions' parties may now:

- email the Sheriff in relation to the disposal of non-contentious hearings;
- use simple word processing techniques in applications to amend their court pleadings; and
- where an action has settled advise the Sheriff by email thereby avoiding the need for parties to appear at the court hearing.

These changes should bring about time savings in litigation conducted at the court.

33.1.2 ADR and mediation

The Sheriff Court Rules Council conducted a consultation in 2006 to consider what the function of the Sheriff Court should be in relation to the use by parties of ADR procedures. In particular it was considered whether the court should encourage or facilitate parties to use such procedures and if so at what stage in proceedings. The consultation concluded in September and it may pave the way to an increased role for mediation within the Sheriff Court.

In a separate development in June 2006, pilot in-court mediation projects were initiated in Glasgow and Aberdeen Sheriff Courts. These pilots are available for higher value claims in addition to smaller claims and they make provision for payment by the users and for the remuneration of the mediators. Claims with a value of less than £750 are free for the user but a sliding scale of charges is applied for claims with larger values.

For further information, see http://www.catalystmediation.co.uk/sheriff/default.asp
33.1.3 The Court of Session’s power to make orders about its own procedure

There has been confusion on this issue over the last twelve months. In *Tonner v Reiach and Hall*, decided in August 2005, it was held that the Court of Session did not have the power to make orders about its own procedure. This decision meant that the court could not throw out an action for want of prosecution. However, in December 2005, in the case of *Mckie and Others v Macrae and Others*, Lord Glennie decided the same point the other way. He held that the Court of Session had such a power and could throw out a claim where there had been extraordinary delay. This issue should be resolved soon as an appeal to the Inner House of the Court of Session in the *Tonner* case was heard in November 2006. The judgment is awaited.

For further information, see the judgments in the two cases at the Scottish Court Service website:


33.1.4 Security for expenses and legal expenses insurance

In Scotland, if a party to a litigation is concerned about the solvency of the opposing party, they may ask the court to order that party to lodge ‘caution’ for expenses. ‘Caution’ is simply a sum of money lodged in court by one party by way of security for the other party’s costs. In 2006, the Court of Session considered such an application in the case of *Monarch Energy Limited v Powerglen Retail Ltd.* In particular it considered whether the existence of a legal expenses insurance policy would avoid the need for a party to make any further payment into court. Lord Drummond Young held that the existence of legal expenses insurance cover was relevant however the specific terms of the policy in question were not sufficient to provide adequate security in that particular case.

For further information, see the judgment at the Scottish Court Service website:

http://www.bailii.org/scot/cases/ScotCS/2006/CSOH_102.html

33.1.5 Scope of summary decree

‘Summary decree’ will be a familiar concept to those who use the Scottish courts frequently. It is a mechanism which allows a court to find in favour of the party bringing the action, at an early stage in proceedings, if it considers that the party defending the action has no true defence to the action. The concept came before the House of Lords this year in the Scottish case of *Henderson v 3052775 Nova Scotia Limited*. In that case, the House of Lords allowed an appeal against a summary decree granted by the Scottish courts and gave some guidance as to how such applications should be considered by the court in future. The Law Lords considered that:

- the rule allowing summary decree must not create injustice for a defender by denying them a chance to prove what might amount to a defence;
• a judge considering an application for summary decree can consider facts in documents, articles and affidavits and not just what is said in the note of defence lodged at court by the defender; and

• before granting summary decree the court should be satisfied that the defender's case must fail.

This decision may have the effect of reducing the number of applications for summary decree in future.

For further information, see the House of Lords' judgment:

http://www.publications.parliament.uk/pa/ld200506/ldjudgmt/jd060510/hend-1.htm

33.1.6 Tribunal, Courts and Enforcement Bill

This Bill seeks to amend the minimum eligibility requirements for judicial appointments with the aim of increasing the diversity of the judiciary. It is intended that certain provisions will apply in Scotland.

For further information, see the text of the Bill at:


33.2 Companies Act 2006

This Act received royal assent on 8 November 2006. It represents the largest reform of company law in over 20 years. The major changes which may have an impact on litigation in Scotland are in relation to: (1) the codification of directors duties; (2) the extension of rights of shareholders to take action against directors; and (3) changes to the provisions in respect of auditors. The Act will come into force gradually over the next 2 years.

For further information, see paragraph 7.1 and:

http://www.opsi.gov.uk/legislation/whatsnew.htm

33.3 Enforcement

33.3.1 Bankruptcy and Diligence etc (Scotland) Act 2007

This Bill was introduced in November 2005 and was passed by the Scottish Parliament on 30 November 2006. Royal assent was granted on 16 January 2007. It aims to modernise the law of personal bankruptcy and diligence to strike a better balance between the rights of creditors and debtors; to modernise the law of floating charges and to create a Scottish Civil Enforcement Commission to regulate officers of court, who enforce court rulings on diligence. Amongst the specific provisions are:

• Raising the limit for sequestration from £1500 to £3000;

• automatic bankruptcy period reduced from 3 years to 1 year;
• creation of Land Attachment as a new form of diligence in respect of debts in excess of £3,000;

• creation of a Scottish Civil Enforcement Commission and the abolition of Sheriff Officers;

• introduction of bankruptcy restriction orders to impose restrictions on debtors after the conclusion of a sequestrian.

For further information, visit the Scottish Parliament website at: http://www.scottish.parliament.uk/business/bills/50-bankruptcyDiligence/index.htm

33.3.2 Competency of sequestration

In this unusual 2006 case, the Trustee in Sequestration of an entity known as 'HB Engineering' sought a finding from the court that that entity and the defender, Mr Butler, were one and the same. The defender was a sole trader who used the trading style 'HB Engineering'. In the absence of such an order the Trustee was unable to sequestrate the personal estate of the Mr Butler. The defender admitted that he was the true debtor in respect of the debt upon which sequestration was granted but argued that the Trustee's case was incompetent as he was trying to correct an inaccuracy in designation in the original petition. The court held that the action was not incompetent given the defender's admission.

Accountant in Bankruptcy v Butler

For further information, see http://www.scotcourts.gov.uk/opinions/A1709_04.html

33.4 Evidence

33.4.1 The status of the 'best evidence rule' in Scotland

The 'best evidence rule' is one that is often quoted in law schools around the country. The rule is to the effect that the best evidence available must be presented to the court and secondary evidence should not be allowed where primary evidence is available. The best evidence rule came into focus in 2006 in a Court of Session action. In that case, one party sought to describe in court the footwear that she was wearing at the time of an accident but was unable to produce in court the footwear in question as it had been destroyed. The other party objected to the oral evidence being heard arguing that this contravened the 'best evidence rule'. Their position was that if the footwear itself couldn’t be produced (the best evidence), then a verbal description (secondary evidence) wasn’t acceptable. Lord Macphail in the Court of Session held that a verbal description was allowable in the circumstances. He said that there was no overarching 'best evidence rule' in Scotland. Evidence is admissible in the Scottish courts so long as it is sufficiently relevant to the issue in dispute and is not infringed by any of the 'exclusionary rules' of Scots law (eg these are the textbook rules such as the exclusion of hearsay, in so far as it has not been abolished).

Margaret Haddow v Glasgow City Council
33.5 Expenses: negotiating costs

Usually at the end of a court action the successful party will be awarded costs. An Account of Expenses will then be prepared by that party’s Law Accountant and if it is not capable of agreement the Auditor of Court will assess it at a hearing called a ‘taxation’. A taxation is in itself expensive and usually parties will try to negotiate and agree the costs in advance. In a Court of Session decision in 2006, Lady Smith considered a change in that procedure. She suggested that the unsuccessful party in the court action could make an offer in respect of the successful party’s costs in advance of the taxation. If the offer is not accepted by the successful party and the Auditor subsequently fails to award more than the sum offered she considered that the successful party should then bear the costs associated with the taxation. If this procedure is implemented in practice it will require the successful party to give serious consideration to any offer made by the unsuccessful party in advance of a taxation.

*McFarlane v Scottish Borders Council*

For more information, see the Scottish Court Service website http://www.scotcourts.gov.uk/opinions/2006CSOH96A.html

33.6 Legal Profession and Legal Aid (Scotland) Act 2007

This Bill was introduced to the Scottish Parliament on 1 March 2006. It aims to: establish a Scottish Legal Complaints Commission; to make provision as regards complaints against members of the legal profession in Scotland and other matters concerning the regulation of the profession and to make provision in connection with the Scottish Legal Aid Fund, including a register of advisors in connection with advice and assistance. This Bill was passed on 14 December 2006 and now awaits Royal Assent.

For further information, see:


33.7 Defamation

Civil jury defamation cases are highly unusual in Scotland and 2006 saw four of them, the most high profile of which was the case of *Thomas Sheridan v News Group Newspapers Ltd*. The case was of note for a number of reasons but in particular, because the pursuer was successful even though for a significant portion of the trial he conducted the case without legal representation. The split jury decision is currently under appeal.
34. LITIGATION: ENGLAND

For LITIGATION: SCOTLAND, see section 33.

34.1 Admissions

34.1.1 Legal status

What is the legal status of an admission made before proceedings have started? Does a defendant need permission from the court to withdraw an admission made pursuant to the pre-action protocols?

The Court of Appeal held that a party's case will not have been formulated until the claim form or the particulars of claim are prepared and it would not be meaningful to describe someone as a party until legal proceedings have been commenced. Accordingly a defendant does not need to apply under Part 14 for permission to withdraw the admission nor can a claimant rely upon Part 14 in order to obtain judgment.

This judgment initially appears to downgrade the significance of the pre-action protocols and the pre-action stage. However, if an admission is made it is still open to a claimant, as was the case here, to seek summary judgment on the basis of the admission made and a party should still think very carefully before admitting anything that it may later regret.

Jane Sowerby v Elspeth Charlton [2005] EWCA Civ 1610, 21 December 2005, CA

34.1.2 More on legal status

Following publication of the Sowerby case (above), the defendant here made an application to appeal a circuit judge's decision which had been made before Sowerby, and where the judge had refused to allow the defendant to withdraw its admission and had entered summary judgment against the defendant.

The claimant tried to demonstrate that the defendant's withdrawal of its pre-action admission was an abuse of process or would be likely to obstruct the just disposal of the case. However, this argument failed and the Court of Appeal held that it had to follow Sowerby and allowed the defendant's appeal.

The Court of Appeal here stressed that there would be force in giving the status of an admission of liability in response to a pre-action letter greater effect than it at present enjoys, in order to lead to more certainty and to avoid delay, expense and worry. Accordingly, although the position is that pre-action admissions can be used as evidence, but not as a basis for judgment, we may yet see changes to the CPR which increase the status of the pre-action admission.

Stoke on Trent Council (appellant) v Walley (respondent) [2006] EWCA Civ 1137, 31 July 2006, CA

The Civil Procedure Rules Committee which considers amendments to the CPR are looking into the question of Admissions.
34.2 ADR

On 6 April 2006, the pre-action protocols were amended substantially to further encourage litigants to consider methods of alternative dispute resolution. There is more information about the different forms of ADR emphasizing that litigation should be the last resort and that claims should not be issued prematurely. Parties are warned that if the protocol is not followed then the court must have regard to such conduct when determining costs.

To view the changes to the practice directions, see the DCA website: http://www.dca.gov.uk/civil/procrules_fin/contents/frontmatter/pd_update41_changes_preview.pdf

34.3 Appeals

34.3.1 Inherent jurisdiction

The Court of Appeal has an implicit jurisdiction to correct wrong decisions to ensure that there is public confidence in the administration of justice. This jurisdiction can only be exercised where it is clearly established that a significant injustice has probably occurred and that there is no effective alternative remedy. This implicit jurisdiction has been enshrined in CPR 52.17 which provides that the Court of Appeal will not re-open a final determination of any appeal unless:

- it is necessary to do so in order to avoid real injustice;
- the circumstances are exceptional and make it appropriate to re-open the appeal; and
- there is no alternative effective remedy.

The Department for Environment Food and Rural Affairs, acting by its executive, the rural payment agency (the agency) claimed that payments were owed by Mr and Mrs Feakins for the export of sheep under a system operated by the European Community. The agency obtained summary judgment and also successfully resisted an appeal in the Court of Appeal in October 2001. During the Court of Appeal hearing, an expert purported to explain the repayment system operated under the European Community. It transpired that this evidence was misleading. The evidence failed to give an accurate account of the system adopted at the time and did not disclose documents which would have shown that the agency had initially indicated that the exported sheep were exempt. This led the Court of Appeal to reach an erroneous conclusion and, accordingly, Mr and Mrs Feakins were able to re-open the appeal so that justice could be achieved.

The Court of Appeal praised the Feakins solicitor, remarking that he was the hero in this tale, particularly as he had shown how good sense, patience and an absence of aggression may eventually be rewarded.
This case demonstrates that, even where there has been a final determination of an appeal, the Court of Appeal can still re-open the matter if a serious injustice has occurred.

*Mr and Mrs Feakins v The Department for Environment Food and Rural Affairs (acting by its executive, the rural payment agency)* [2006] EWCA Civ 699, 8 June 2006, CA

34.3.2 Amendments to the CPR

CPR Part 27 was amended this year to ensure that the small claims track costs regime applies to appeals from cases allocated to that track.

CPR Part 52 on appeals was also amended to state that, where the Court of Appeal refuses permission to appeal without a hearing, it may, if it considers the application to be totally without merit, make an order that the person seeking permission may not request the decision to be reconsidered at a hearing.

CPR Part 52.4 (2) (b) was amended to increase the time limit from 14 days to 21 days for filing of the appellant's notice to seek permission to appeal.

34.3.3 Permission

A party needs permission to appeal against a judgment. From whom should this permission be sought? Part 52.3 (2) of the Civil Procedure Rules provides that an application for permission to appeal may be made:

- to the lower court at the hearing at which the decision to be appealed was made; or

- to the appeal court in an appeal notice.

The claimant did not apply for permission to appeal on the day judgment was delivered because it had decided, at that stage, not to seek to appeal. It then changed its mind.

The question the court considered was, to whom should the application for permission to appeal be made, given that no application was made at the time of the hearing? The claimant decided to make the application to the trial judge. The judge concluded that when judgment was given, the claimant could have applied for an adjournment of the hearing so as to enable it to make an application for permission to appeal. Since that hearing was over, the judge declared that it was no longer open to him to grant permission. As the claimant neither applied for permission to appeal nor sought an adjournment of the application for permission to appeal, the claimant had to apply to the appeal court.
The judge also considered to whom an application for an extension of time for filing an appellant's notice should be made. The judge declared that the trial judge had the power to extend time and the only question was for how long the extension should be. Bearing in mind the complexity of the matter and that it was far from a run of the mill case, the judge wanted to give the claimant sufficient time to produce a useful, fully reasoned and informative notice in order to assist the Lord Justice. He also reasoned that the defendant would not suffer any prejudice as a result.

_Balmoral Group Ltd v Borealis (UK) Ltd, Borealis AS and Borealis A/S_ [2006] EWHC 2228, 23 August 2006

### 34.4 Case management

#### 34.4.1 Notification to the court

The claimant obtained judgment against the second defendant for over £640,000 and then successfully obtained permission to enforce the judgment by way of a charging order over the second defendant's property. In December 2002, in response to the application for a charging order, the second defendant applied to set aside the judgment. Subsequently there was enormous delay but matters were eventually brought to a head when the claimant applied to strike out the application to set aside judgment in order to make the charging order final.

The judge was concerned that the court had failed actively to manage the case and found that both parties had a duty to prompt the court. Overall, the court came to the conclusion that the second defendant's failure to help the court to further the overriding objective by dealing with her application expeditiously was far greater than that of the claimant. The real reason for making the application to set aside judgment was to frustrate enforcement. If there had been a meritorious defence, she would have applied to set aside the charging order immediately. The judge therefore struck out the defendant's application to set aside and made the charging order final.

_Peter Nolan v Stephen Devonport (deceased) and Gillian Devonport_ [2006] EWHC 2025, 21 July 2006

#### 34.4.2 Relief from sanction

The CPR provides a procedural code with time limits, sanctions for failure to comply with time limits and the ability to obtain relief from those sanctions. What is the procedure for applying for relief? Does a party always have to complete and submit an application notice in order to obtain relief from those sanctions? Can a party apply for relief at a hearing even though no application notice has been submitted?

The claimant made an unsuccessful claim for summary judgment for payment for accountancy work. It subsequently applied for permission to appeal. The judge ordered that the claimant lodge a transcript of the judgment by 31 January 2006. The judge then extended the deadline to 7 February, but ordered that if the claimant was in default, the application for permission should be refused. Through no fault of the claimant or its lawyers, the transcript was not lodged until 8 February, after the deadline had expired.
At the hearing of the application for permission to appeal and the appeal itself the defendant argued that, since the transcript had not been lodged in time, the claimant was in default and therefore permission had already been refused. Even though the claimant had not submitted an application notice, the judge decided to grant an extension, heard the substantive application, allowed the appeal and gave summary judgment to the claimant.

The defendant subsequently appealed to the Court of Appeal and asserted that, where a sanction has been imposed for failure to comply with an order, an application for relief must be made. Unless and until an application is made, the court has no jurisdiction to grant the relief. As the claimant did not apply for relief, the sanction remained in effect and the judge could not grant permission to appeal.

The Court of Appeal was not impressed by the defendant's argument, and found that the defendant's interpretation of the CPR was perverse and flew in the face of the overriding objective of dealing with cases justly. When extending time, the court is not restricted to waiting for an application to be made. In any event, the CPR expressly provides (in the practice direction to CPR 23 paragraph 3 (4)) that the court has a general power to dispense with an application notice. At the hearing, the judge chose not to hear the claimant’s submissions on the application because, having heard the defendant's submissions, he decided to grant the extension.

This judgment demonstrates that, where the court takes the view that relief from sanctions ought to be made, it does not have to wait for an application notice to be completed.

Keen Phillips (a firm) v Field [2006] EWCA Civ 1524, 26 October 2006, CA

34.5 Costs

34.5.1 Staff costs

Here the court decided that the cost of wasted time spent on the investigation and/or mitigation of a tort (in this case a conspiracy) is recoverable notwithstanding that no additional expenditure loss, or loss of revenue or profit is recoverable. This is subject to the proviso that it has to be demonstrated with sufficient certainty that the wasted time was indeed spent on investigating and/or mitigating the relevant tort. It must be shown that there has been some significant disruption to the business; in other words that staff have been significantly diverted from their usual activities. Otherwise, the alleged wasted expenditure on wages cannot be said to be "directly attributable" to the tort.


34.5.2 Non party costs

There have been a number of cases recently on the ability to recover costs from a non-party. Usually the party seeking those costs has to establish that the non-party has caused or been responsible for the litigation and should therefore indemnify the successful party for the costs he has incurred. This is known as causation.
The courts have now stated that it cannot be said that causation is a pre-requisite for an order for costs against a non-party. Causation will often be a vital factor, but there may be cases where it is just to make an order for costs against a non-party who cannot be said to have caused the costs in question.

Costs orders against non-parties are exceptional in that they are outside the run of cases where parties bring or defend claims for their own benefit and at their own expense. The ultimate question is whether it is just to make an order against a non-party. Here the court decided, given all the circumstances, that it was just to make an order against the non-party.

This case has extended the ability of courts to make costs orders against non-parties by holding that there does not necessarily have to be any causation. This case remains an exceptional case and it is likely that only in very limited circumstances will an order for costs be made against a third party who has not been responsible for incurring any of the costs.

_Total Spares and Supplies Limited and another v Antares SRL and others_ [2006] EWHC 1537, 27 July 2006

See also, paragraph 29.4 for further information and cases on costs.

### 34.6 Damages

#### 34.6.1 Calculation

The Court of Appeal gave guidance on how to assess the damages payable when valuing confidential information which had been misused.

A partnership was dissolved and customer information contained in a card index was taken by one of the former partners and used in a new venture. One of the former partners who was not involved in the new venture (the claimant) brought proceedings for damages for the misuse of the confidential information against the other partners (the defendants) who had set up this new venture. The judge concluded that the card index belonged to the former partnership. The bone of contention was how to measure the loss suffered by the claimant.

The claimant argued that the method of valuing the card index was to value it as part of the assets of a going concern and by reference to the trading results of the new venture. The defendant argued that the correct way to assess the value of the index was to ascertain the price at which it could have been sold by the former partnership on the open market under the circumstances that existed at that time.

The Court of Appeal concluded (with Lord Justice Arden dissenting) that the claimant's method of valuing the index was likely to lead to a result that did not properly reflect the value of the index and introduced a substantial measure of hindsight. It proceeded on the assumption that the former partnership was a well established and stable business capable of being valued as a going concern. As two of the partners were not willing to continue the former partnership, it could not continue in business nor be sold as a going concern. The only asset of any significance was the card index. The value of the index depended on what a purchaser in the open market would be prepared to pay for it in light of the...
information then available. Accordingly, a fresh inquiry should take place. However, bearing in mind the costs that had already stacked up, the court urged the parties to engage in mediation before spending a further fortune.

Jane Margaret Gorne v Alec Vernon Scales and others [2006] EWCA Civ 311, 29 March 2006, CA

See also, paragraph 29.6 for further information and cases on damages.

34.7 Disclosure

34.7.1 Pre-action disclosure

Pre-action disclosure was heralded as one of the great reforms introduced by the CPR. However, the courts have been keen to demonstrate that only those applications falling strictly within the rule will be allowed.

The patent court stated that, to allow pre-action disclosure (CPR 31.16) to become a means of examining a competitor's otherwise secret designs on the basis that some kind of infringement might have occurred cannot be permissible, unless there is at least a clear and convincing evidential basis for the belief that acts of infringement may have taken place and the court can be satisfied that the pre-action disclosure sought is highly focused. Otherwise, the potential for abuse is obvious. The court concluded that this was a speculative claim which lacked focus and was based on uncorroborated statements of impression.

The applicant suggested that, in order to meet the objections in relation to confidentiality, an independent expert could be appointed who could compare designs and drawings and produce a list of similarities which might be the product of copying. However, the court stated that this would result in the court relying on the expert to make a judgment about the issue of infringement without the court being seized of the material or having the benefit of the parties' observations on it. This would introduce a quite different procedure which would be outside the scope of rule 31.16.

BSW Limited v Balltec Limited [2006] EWHC 822 (Ch), 11 April 2006

34.7.2 Pre-action disclosure ordered

Total E & P Soudan SA (Total) had entered into with the Republic of Sudan in 1980, to conduct petroleum exploration and operations within an area known as Block B. Civil war broke out, but eventually on 9 January 2005, a peace agreement was brokered. In the meantime White Nile, a company registered in Guernsey, but whose place of business was in London announced on 16 February 2005 that it had concluded an agreement with the government of Southern Sudan (and its national oil company) to acquire a 60% interest in Block Ba which is a sub-part of Block B. Total claimed that they had exclusive rights to Block B and that the first and second respondents (the founders, directors and shareholders of White Nile) had acted in a way that appeared wholly inconsistent with Total's rights and economic interests.
Total, in its application for pre-action disclosure, sought to inspect documents that were provided as part of White Nile's admission to the Alternative Investment Market ("AIM") in respect of any documents concerning meetings between White Nile and the Southern Sudanese regime in relation to Block Ba.

The respondents refused to provide these documents on the basis that the proposed claim was not justiciable in this jurisdiction and they called for judicial restraint. The court decided that it was difficult to see what sensitivities could be infringed or diplomatic embarrassment caused by being required to produce documents which were not confidential and which had for the most part been (or arguably ought already to have been) made available in London via the AIM admission. The court was not prepared to adjourn the application pending a challenge to the jurisdiction given that most of the documents had, or ought to have been, made available for public inspection in any case.

The judge decided that a complete picture should be revealed. Given that most of the documents had been publicly available, this decision was perhaps not surprising. However, the grant of disclosure in respect of those documents that were not publicly available is perhaps more controversial.


34.7.3 Waiver of privilege

When a party decides to disclose a limited amount of privileged material, it runs the risk that the other side will claim that it has waived privilege in respect of all privileged documents. Here the court gave guidance on how much documentation should be disclosed in these circumstances.

The claimant had disclosed some documentation concerning the legal advice it had received. The defendant then applied for disclosure of all documentation relating to the legal advice given to the claimant. The court explained that the relevant process should be to identify the "transaction" in respect of which disclosure has been made. That transaction may be identifiable simply from the nature of the disclosure made, for example, advice given by counsel on a single occasion. However, it may be apparent from that material or from other available material that the transaction is wider than that which is immediately apparent. If it does, then the whole of the wider transaction must be disclosed. When that has been done, further disclosure will be necessary in order to avoid unfairness or misunderstanding of what has been disclosed.

In this case, the court decided that the "transaction" in question was the advice given by counsel and by solicitors on the occasion in question and accordingly there was no reason to suppose that there had been some form of illegitimate partial disclosure. However, where the lawyers had qualified, extended or amplified the original advice, the other side were entitled to see that documentation as well.
This case emphasises the importance of exercising caution in deciding to disclose any privileged material.


34.7.4 Privilege

Due to the reduction in the availability of legal aid and the advent of conditional fee arrangements, after the event legal expenses insurance (ATE) was introduced. ATE provides protection against the costs of bringing or defending legal action. In this case, NIG underwrote ATE insurance in connection with a litigation funding scheme operated by the first defendant, The Accident Group Limited (TAG). An ATE policy would not be issued unless it passed a vetting process by the second defendant solicitors and later by another firm of solicitors drawn from a panel. It transpired that many more indemnity claims were made on the policies than had been expected. The claimant alleged that the second defendant and the panel solicitors had failed to vet and monitor the claims properly.

The Panel solicitors claimed that the documents in their possession were privileged and so could not be produced in the litigation. The court reviewed the documentation in question:

- the court considered the documents that were created prior to the issue of ATE insurance. Did litigation privilege apply? Litigation privilege extends to documents produced during the course of adversarial (as opposed to inquisitorial or investigative) litigation, or when such litigation is in contemplation. The court had to consider the purpose of the person that directed the creation of the document. The dominant purpose here was to make a decision on whether the ATE policy would be issued and the potential claim funded. If the policy was not issued there would be no litigation. A subsidiary reason for producing the documents was the potential litigation but it was not uppermost in the minds of NIG or TAG;

- could legal advice privilege apply? This privilege only applies to communications between a solicitor and his client. Even if these documents were privileged, the privilege was in favour of NIG not the individual TAG claimants, since the communications were for the benefit of NIG;

- the court considered the documents that were created after the agreement to provide ATE. The court found that these documents were subject to legal professional privilege;

- in any event, NIG had a contractual right to obtain access to the first and second category of documents. The policy included a contractual right to demand that the TAG claimant give it access to documents. The insured could not use litigation privilege to prevent the insurer using his contractual right of access to the documents;

- did common interest privilege apply? This applies where a communication is produced by or at the instigation of one party for the purpose of obtaining legal
advice to assist in the conduct of the litigation, then a second party that has a common interest in the subject matter of the communication or the litigation can assert a right of privilege over that communication as against a third party. Could NIG rely on common interest as a sword to seek production of these documents? The court decided that the relationship between NIG and the claimants was one that could give rise to a common interest and they had a common interest in the documents. Accordingly NIG could seek production of these documents.

Winterthur Swiss Insurance Company v AG Manchester Limited (In Liquidation) [2006] EWHC 839, 12 April 2006

34.7.5 Disclosure against non parties

An application which was originally sensible may no longer be appropriate if circumstances change.

Proceedings were issued by the Secretary of State for Transport for alleged defects against AMEC and Pell Frischmann Consultants in respect of a project to widen the M6 for a mighty £37,000,000 plus interest. AMEC was engaged to carry out the project and Pell Frischmann were the engineers on the project. AMEC eventually dropped out of the litigation as they exercised their contractual rights to require the claim by the Secretary of State to be referred to arbitration. Pell Frischmann subsequently applied for disclosure against AMEC on the basis that AMEC was a non-party. It was then agreed between AMEC and the Secretary of State for Transport that matters should be streamlined so that the appropriate forum for the dispute was litigation and not arbitration. Despite being informed about this change, Pell Frischmann continued with their application for non-party disclosure against AMEC.

The judge concluded that the application was well-founded when issued but, since the decision to resume litigation was made, the position had now been transformed. The whole disclosure process must now be managed in an orderly manner in the context of the emergent multi-party litigation and therefore the application against AMEC for non-party disclosure was untenable and should be dismissed.

This case serves as a useful reminder to parties to constantly review their litigation strategy.

The Secretary of State for Transport v Pell Frischmann Consultants Limited [2006] EWHC 2756, 23 October 2006

34.8 Enforcement

34.8.1 Tribunals, Courts and Enforcement Bill (draft)

This 250 plus page Bill covers a broad range of issues. In summary it proposes to:

- streamline the methods by which control can be taken of goods when enforcing judgments and orders;
- improve the attachment of earnings method of enforcement;

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• remove the restriction on obtaining a charging order if an instalment order is in place;

• allow the court to request information in relation to a judgment debtor who has failed to assist with the enforcement of a judgment from the Department for Work and Pensions, Her Majesty's Revenue & Customs and banks and credit reference agencies. Such information will include name, address, date of birth, national insurance number and the name and address of the debtor's employer;

• abolish the common law right of distress for rent and introduce a modified "out of court" regime for recovering rent arrears under leases of commercial premises;

• expand the eligibility criteria for judicial appointments (so that, for example, legal executives can be appointed to the Bench);

• reform the tribunals system; and make changes to debt management and relief schemes for debtors.

34.8.2 Enforcement of judgments

The European Commission has launched a consultation paper on improving methods of enforcement of monetary claims in Europe. The Green Paper proposes the creation of a European system for the attachment of bank accounts. This would allow a creditor to secure a sum of money due to (or claimed by) him by preventing the removal or transfer of funds held to the credit of the debtor in one or several bank accounts within the European Union. It would have protective effect only ie it would restrict the debtor's funds to a bank account without transferring them to a creditor. A new and self-standing European procedure would be available. The creditor would have to demonstrate urgency, have a justifiable claim and be able to provide security to protect the debtor against any loss or damage were the order to be set aside.

Parties are invited to submit comments by 31 March 2007.

34.9 Evidence

34.9.1 Similar fact

In what circumstances can a party rely on evidence of similar circumstances or similar facts to help prove its claim?

In this case, the defendant, a Greek shipping family, alleged that the claimant, JP Morgan had provided investment advice which they had relied upon. Unfortunately, their investments suffered substantial losses of over US $200m. JP Morgan denied that they had provided any investment advice and maintained that the defendant was sophisticated and knowledgeable in relation to debt securities.

The Greek shipping family alleged that the claimant had not only provided advice to them, but had also recommended that other Greek shipping families invest in similar derivatives, which demonstrated that there was an advisory relationship. It was this secondary evidence that was in contention.
A two-stage test was set out in the House of Lords’ case of O’Brien v Chief Constable of South Wales for determining whether secondary evidence is admissible. First, the court has to assess whether the proposed evidence is potentially probative of one or more issues in the current litigation i.e., will it help prove anything? If it is, it will be legally admissible. Secondly, if it is legally admissible, are there good grounds upon which a court should decline to admit it in the exercise of its case management powers?

The Court of Appeal stated that the relationship of JP Morgan with other Greek shipping families taken on its own could not prove anything about the relationship between the claimant and the defendant, but it might explain, illuminate or put in context evidence about the relationship that would otherwise be ambiguous or difficult to understand. Depending on its context, the secondary evidence of the other Greek shipping families was potentially relevant to the contested issues and passed the first test. However, in this case, there was already an abundance of evidence including 1,055 transcripts of telephone calls from which it ought to be possible to draw conclusions.

If all the evidence provided a clear answer, the secondary evidence would be irrelevant. The secondary evidence would only be an extra burden on the trial, it was not obvious that it would assist and therefore it did not pass the second test.


34.9.2 US legal proceedings

When can a witness be asked to give evidence here in England in respect of US legal proceedings?

This case concerned proceedings brought in Kansas against a number of tobacco companies for alleged price fixing. The Kansas action was one of a number of similar proceedings that had been brought in the US.

A request was made under the Evidence (Proceedings in other Jurisdictions) Act 1975 to examine an individual who used to work for BATCo, but who now lived in England. The court summarised the general principles which apply to such requests:

• the court only has jurisdiction in accordance with the provisions of the Act;

• section 2(3) of the Act allows the court to make any such orders as could be obtained in civil proceedings in the English court;

• the approach of the court is to seek to assist the foreign court wherever appropriate;

• if the request does not comply with the Act, the court will be prepared to make an order subject to limitations or conditions;

• once a court has jurisdiction to make the order, it has a discretion whether or not to do so;
• a court will not make the order if the request is mainly of an investigatory nature (even though the witness may be able to give some relevant and admissible evidence);

• a court will not make the order if it would be unfairly oppressive or there is some other powerful reason not to do so;

• the court can make an order subject to conditions or limitations designed to give the witness adequate protection; and

• if the conditions or limitations amount to a rewriting of the letter of request, it will not be appropriate for a court to make the order.

In this case, the judge noted that the request was drafted in strikingly wide terms. It was unrestricted in terms of subject matter, the dates were wide ranging and the request was far wider than the significance of the testimony could possibly justify. The court considered whether the request could be modified or limited but, as the questioning was mainly of an investigatory nature, it decided that the request should not be granted. Although the court would have preferred to assist the Kansas court, it was not willing to agree to this request.

*Daric Smith v Phillip Morris Companies Inc and others* [2006] EWHC 916, 27 April 2006

34.9.3 Spyware

If "Spyware" has been installed on a computer what can be done? What if it has been installed remotely from another jurisdiction? Can you start proceedings in the English court and how much evidence do you need to gather upfront?

For the facts, see paragraph 26.5.

Proving not only that hacking has taken place, but exactly who executed or commissioned the exercise, is frequently fraught with difficulty. Unfortunately, the claimant's task was made even harder in this case as a result of one critical mistake. When the claimant discovered that the "Spyware" had been installed on its server, it immediately disabled it, thereby destroying potentially significant evidence which could have been preserved if an expert had been called in before any steps were taken.

It is important to note from this that, if a party suspects that its server has been accessed without authorisation, it should not touch the computer equipment, not even to turn it on or off. Expert legal and information technology advice is required from the outset.

*Ashton Investments Ltd & Anor v OJSC Russian Aluminium RUSAL & ors* [2006] EWHC 2545, 18 October 2006
34.9.4 Videolink

A witness is now able to give evidence via a video link, rather than having to stand in a witness box. The CPR gives the court a wide discretion and highlights the considerable savings in time and costs that a video link can provide. However, examining a witness via a video link is not as satisfactory as direct cross-examination. There can also be logistical difficulties, particularly where the witness needs to look at photographs and extracts from videos and DVDs, and there is the added complication of needing to ensure that the respective bundles are compatible.

The claimant, who had resided abroad for about 20 years, did not want to come here to give evidence in the trial of his claim for alleged major defects in a large house that had been built in Jersey. He asserted that there was a real risk that he would be liable to pay capital gains tax of about £50m if he came here to give evidence.

The judge was not particularly impressed with the application, bearing in mind that the claimant wanted to use the justice system provided by the UK for its citizens, but did not want to contribute to the costs of that system by paying UK taxes. However, the judge found that he was bound by the House of Lords judgment in *Polanski v Conde Nast Publications Ltd* 2005 where, despite the claimant being a fugitive from justice, the House of Lords had allowed Mr Polanski to give his evidence via a video link. Such permission was given on the basis that a fugitive from justice is entitled to invoke the assistance of the court in protection of his civil rights as long as the administration of justice is not brought into disrepute.

The judge made the following points:

- there are often logistical difficulties and there are always ways of getting round them;

- the claimant's own evidence would not be of critical importance to the trial. The vital issues were more to do with the expert evidence;

- the claimant would be prejudiced if the order were not made as there would be a real risk, rather than a fanciful risk, that the claimant may become liable to pay substantial capital gains tax. This was not the appropriate forum to determine the CGT liability. The claimant had received specialist advice that there was such a risk. If the claimant did not come here, then there would be no risk. HMRC would be very interested in the claimant's tax status and the sums involved were very large.

The judge therefore decided to grant the application. As this was similar to Mr Polanski's position, but the issue in hand was not as serious as Mr Polanski's misdemeanours, it would have been surprising if the application had been refused.

*Ian McGlinn v Waltham Contractors Ltd and others* [2006] EWHC 2322 (TCC), 15 September 2006
34.10 Experts

34.10.1 Conflict of interest

What if the expert has a conflict of interest such as a financial interest, a personal connection or an obligation as a member or officer of a body? Does the expert have an obligation to disclose this?

Here, the Court of Appeal stated that an expert should produce his CV when he issues his report and that the CV should detail any employment or activity which raises a possible conflict of interest.

In this case, the expert had failed to disclose that he was a member of the Cases Committee of the Medical Defence Union (which is responsible for insuring medical practitioners in relation to clinical negligence claims). As long as he was a member of the committee and the committee had any responsibility for this case, he was in principle subject to a conflicting duty as a member of that committee. The Court of Appeal decided that this information should have been available to the court and to the other side in the interests of transparency and of deflecting suspicion. As it turned out, he ceased to be a member of the committee before the trial and so his interest became immaterial. Therefore, the judgment was not set aside on the ground that he did not disclose his potential conflict of interest.

The court suggested that the Civil Procedure Rules Committee should give consideration to whether an expert should make a statement at the end of his report:

- that he has no conflict of interest of any kind, other than any which he has disclosed in his report;
- that he does not consider that any interest which he has disclosed affects his suitability as an expert witness on any issue on which he has given evidence; and
- that he will advise the party by whom he is instructed if, between the date of his report and the trial, there is any change in circumstances which affects the position set out above.

Such a statement would remind both the expert and the party calling him of the need to inform the other parties and the court of any possible conflict of interest.

Arpad Toth v David Michael Jarman [2006] EWCA Civ 1028, 19 July 2006, CA

34.10.2 Experts meeting

The court has the power to direct that discussions between experts from each side should take place. If, after the experts' meeting has taken place, the expert completely changes his mind, can a further expert be appointed?

The court ruled that the mere fact that an expert has changed or modified his opinion following an experts' meeting cannot by itself be a reason to allow a party who is disappointed with the change or modification of opinion to adduce evidence from another expert. Although the CPR does not rule out the ability to call a further expert, this will rarely be appropriate.
The court concluded that the claimant had a sense of grievance because the judge had frequently interrupted the claimant's counsel and had given the impression that he thought the claim was exaggerated. This was apparently based on his own experience of backache (which he had suffered for 40 years) rather than the claimant's own evidence. For this additional and exceptional reason it was appropriate to consider the claimant's application afresh.

The judge commented that it would have been helpful if the claimant had found out why the expert had changed his mind. He suggested that, when making such a request, parties should in the future make appropriate enquiries of the expert. Nevertheless, bearing in mind the special nature of this case, the judge decided that the claimant would have an understandable sense of grievance if she was not allowed to call a further expert and should, therefore, be given leave to do so.

This case establishes that a good reason will be needed for a court to allow an expert to be replaced in circumstances where an expert has changed his mind following an experts' meeting. To prevent or minimise the potential for such problems arising, an agreed detailed agenda of any item for discussion at an experts' meeting should be prepared in advance and circulated to all.


34.10.3 Experts immunity

Witnesses cannot be prosecuted for the evidence they give in court so as to encourage honest and well-meaning people to assist the legal justice system, even if dishonest and malicious persons may on occasion benefit from this immunity. The question explored here was whether immunity from prosecution extended to protect experts from disciplinary, regulatory or fitness to practice proceedings? The Court of Appeal confirmed that it did not.

Earlier this year, the Administrative Court concluded that the immunity should extend to disciplinary proceedings and so Professor Roy Meadow (who had given expert evidence in the criminal trial of Sally Clark for murder) would be immune from disciplinary proceedings by the GMC. The Court of Appeal disagreed. It concluded that it would be wrong to extend the immunity from suit so as to limit the powers of disciplinary proceedings. The purpose of such disciplinary bodies is to regulate the profession or occupation concerned for the benefit of the public. If the conduct or evidence of an expert witness at, or in connection with, a trial raises questions as to the fitness of an expert to practise in his particular field, the regulatory authorities should be entitled (and may be bound) to investigate the matter for the protection of the public.

The General Medical Council v Professor Sir Roy Meadow with Her Majesty's Attorney General [2006] EWCA Civ 1390, CA

34.10.4 Filing - electronic and document management

It is proposed that the civil courts introduce a web-based service for documents to be filed with the court (and between parties) electronically without the need for users to have specialist software, for users to complete forms online, for some of the data to be automatically uploaded into case management systems and to remove the need for
Excellence through know-how

a paper case file. A phased implementation over a number of years is anticipated. However, it is not likely to start before 2009.

34.11 Freezing orders

34.11.1 Worldwide

A freezing order is a temporary order which freezes a defendant's assets up to the value of a claim and guards, so far as possible, against the risk that the defendant will dispose of his assets before a judgment is satisfied. The aim is to ensure that a claimant does not end up with a worthless judgment. This order can extend to assets wherever they are in the world (hence, a worldwide freezing order ("WFO")). Usually, the WFO will contain an undertaking that the party who seeks the order will not enforce it in another jurisdiction without the court's permission.

For the first time, the Court of Appeal has given guidance on considering an application to enforce a WFO:

- Guideline 1: The grant of permission should be just and convenient for the purpose of ensuring the effectiveness of the WFO and, in addition, should not be oppressive to the parties to the English proceedings or to any third parties.

- Guideline 2: All the relevant circumstances and options need to be considered. In particular, consideration should be given to granting relief on terms. Consideration should also be given to the proportionality of the steps proposed to be taken abroad and to the form of any order.

- Guideline 3: The interests of the applicant should be balanced against the interests of the other parties to the proceedings and any new party likely to be joined to the foreign proceedings.

- Guideline 4: Permission should not normally be given in terms that would enable the applicant to obtain relief in the foreign proceedings which is superior to the relief given by the WFO.

- Guideline 5: The evidence in support of the application for permission should contain all the information (so far as it can reasonably be obtained in the time available) necessary to allow the judge to reach an informed decision. It should include evidence as to the applicable law and practice in the foreign court, evidence as to the nature of the proposed proceedings to be commenced, evidence as to the assets believed to be located in the jurisdiction of the foreign court and the names of the parties by whom such assets are held.

- Guideline 6: The applicant must show that there is a real prospect that assets which fall within the ambit of the WFO are located within the jurisdiction of the foreign court in question.

- Guideline 7: There must be evidence of a risk of dissipation of the assets in question.
• Guideline 8: Normally, the application should be made on notice to the respondent but in cases of urgency where it is just to do so, the permission may be given without notice to the other party. However, that party should be given the earliest practicable opportunity of having the matter reconsidered by the court at a hearing of which he is given notice.

On the facts of this case, the claimant had discharged the onus of showing that there was a real prospect that the defendant had assets in Switzerland and, moreover, in the light of the history of this matter, it was reasonable and proportionate for them to seek to enforce the WFO in Switzerland in order to safeguard their rights under the WFO.

_Ddadourian Group Int Inc v Simms & Ors_ [2006] EWCA Civ 399, 11 April 2006, CA

34.11.2 Duty of care

Does a bank owe a duty of care to the party which has obtained a freezing order to take reasonable care to comply with the order? The House of Lords unanimously held that banks do not owe any such duty.

Freezing orders affecting two customers were served by the claimants on the bank. Within about two hours the bank, acting on the instruction of the two customers, paid approximately £1.24m and £1m out of the accounts. Part of the problem was that instructions were given electronically to the payment centres and thus bypassed the branches where the accounts were held.

Previous case law has established three broad approaches when considering whether to extend a duty of care into a new area of conduct:

• whether there has been an assumption of responsibility;

• whether the three-fold test of foreseeability, proximity, and "fairness, justice and reasonableness" has been satisfied; and

• whether the alleged duty would represent an incremental development to previous cases.

The judges all decided that there was no assumption of responsibility. The claimants had not relied on the bank as they did not adopt a particular course of action in the expectation that the bank would comply with the orders. The claimants had already taken the only option available to them. In any event, the freezing order regime already imposes the sanction of contempt for non-compliance. There is no requirement for any additional civil liability. Civil liability could expose banks to large liabilities for what could be relatively small failings. Whilst banks might be able to protect themselves through new systems or insurance, other third parties who are not accustomed to receiving freezing orders could find themselves facing disproportionate liability if a new duty of care was imposed.
The Lords considered the merits and origins of the three approaches, but none of them concluded that any of the possible approaches was either inconsistent with the others or was not a useful guide. The law therefore remains unchanged by this decision.

*Her Majesty's Commissioners of Customs & Excise v Barclays Bank Plc [2006]*
UKHL 28, 21 June 2006, HOL

34.11.3 Third parties

HM Revenue & Customs ("Customs") brought a winding-up petition for over £35m against C&E Enterprises UK Limited ("C&E") in respect of a large scale VAT missing trader and/or carousel fraud. The respondents included the director and person in control of C&E, a company called Trade Eazy Limited which had significant dealings with C&E and the directors and shareholders of Trade Eazy. Customs alleged, (although the allegation has yet to be tested), that the respondents were not only aware of the intentional fraud on Customs, but participated in the fraud. Customs alleged that the director and controller of C&E acted in breach of trust and fiduciary trust to C&E and that the other respondents dishonestly assisted him.

Customs applied for a freezing order against the respondents who were effectively third parties as the respondents' liability was to C&E and/or its Liquidator, not to Customs. The current freezing order jurisdiction restricts orders against third parties to those who are holding or are in control of assets beneficially belonging to the defendant. However, the judge decided that this was unduly restrictive and unjust. He rejected the argument that the court had no jurisdiction to grant a freezing order against the respondents in this case.

Having decided that he had the jurisdiction, he then examined whether, applying his discretion, he should make the order. The usual course of action in these circumstances (as acknowledged by Customs) was to appoint a provisional liquidator prior to the advertisement of the winding-up petition who could apply for a freezing order. This had not been done because the director and controller of C&E had disappeared together (or so it was anticipated) with any surviving books and records. This made the appointment of a provisional liquidator seem rather a waste of time and costs because he would not have had the usual advantages of inspecting the company's books and interviewing its office holders.

The judge stated that there were powerful reasons why a provisional liquidator should have been appointed. Generally, a freezing order necessitates a commitment to proceed diligently with the establishment of the claim. In the present context, the person to resolve the litigation is the office holder, not the petitioning creditor. Further, the office holder, as guardian of the interests of the company's stakeholders, is best placed to make an independent judgment as to the wisdom of bringing proceedings against third parties. The freezing order will always be designed to temporarily hold the fort until the office holder decides to apply for a freezing injunction.

The judge proposed therefore to discharge the freezing order, but bearing in mind that the hearing of the application to wind up the company would be heard the following week, he acknowledged that it would have been a waste of costs to appoint a provisional liquidator for just one week. However, he made it clear that creditors...
should not expect to be able to obtain freezing orders against potential judgment debtors (where usually a provisional liquidator could be appointed) save in entirely exceptional circumstances. The judge could not envisage what those circumstances might be.

This case potentially broadens the grounds on which a freezing order can be made against a third party but it is clear that creditors will not be able to obtain freezing orders against a third party when a provisional liquidator could be appointed.


### 34.12 Telephone hearings

The Department for Constitutional Affairs published its responses to its consultation paper on telephone hearings. 91% of those responding to the paper welcomed the intention to extend the general scope of hearings that could be dealt with by telephone and were broadly supportive of the intention to roll it out to civil courts nationwide, although there was almost universal agreement that telephone hearings were unsuitable for litigants in person and that telephone hearings which were estimated to last more than 30 minutes would be unsuitable, as they were invariably more complex.

### 34.13 Injunctions

When can you obtain an injunction?

The claimant operated customer service handling such as opening and closing accounts, billing customers, collecting revenue and managing enquiries and complaints on behalf of Powergen, the defendant. The arrangement was the subject of a Master Services Agreement ("MSA"). Powergen was dissatisfied with the service it received from the claimant and served notice of termination of the MSA. The claimant applied for an interim injunction restraining the defendant from acting on its notice of termination or from taking any steps to prevent or hinder it from performing its obligations under the MSA.

The court concluded that it was not appropriate to grant an injunction which would have the effect of compelling the parties to work together. There was already a dispute and uncertainty as to what was required of both sides in order to make the arrangements work. In the light of this, it would impose an intolerable burden upon the employees of Powergen simply to expect them to make the arrangements work in circumstances where it would be unclear to them whether they were in fact doing all that was required if sanctions were to be avoided.

This was a situation in which injunctive relief was inappropriate and unworkable.

**Vertex Data Science Limited v Powergen Retail Limited** [2006] EWHC 11340, 9 June 2006

### 34.14 Judge's role

With the introduction of the CPR a judge's role tends to be much more proactive and interventionist than in the past. However, it remains the case that a judge who can observe the demeanour of a witness while he or she is being examined by counsel has much more opportunity to form a just appreciation of that witness than a judge who conducts the examination.
In this case, the judge's constant and frequently contentious interventions during the oral evidence served to cloud his judgment to a point where he was unable to subject the oral evidence to proper scrutiny and evaluation. From the judgment, it was difficult to see what (if any) assistance the judge derived from the oral evidence which he heard, as opposed to the documentary evidence and witness statements. The manner in which the judge conducted himself led to a failure to discharge his judicial function. He allowed himself to play a substantial part in the interrogation of the witnesses which meant that he took on a quasi-inquisitorial role entirely at odds with the adversarial system that operates in our justice system.

Accordingly, the Court of Appeal ordered a retrial.

The Mayor and Burgesses of the London Borough of Southwark v Maamefowaa Kofi-Adu [2006] EWCA Civ 281, 23 March 2006, CA

34.15 Judgments

34.15.1 Register

From 6 April 2006, High Court judgments are now registered in the Register of Judgments, Orders and Fines.

This means that a prospective claimant will now be able to find out whether a prospective defendant has any High Court judgments registered against it and so will have more information to assess the prospects of recovery against that defendant. Previously only County Court judgments were registered.

In addition, information on the register will be available to credit reference agencies and lenders. Only judgments for payments of money will be registered. Judgments will be automatically entered in the register on entry of a judgment in default. The register will not apply to any judgment in family proceedings, the Administrative Court, the Technology and Construction Court or any judgment subject to appeal until that appeal has been determined.

34.15.2 European Payment Order

The European Parliament has agreed to introduce a European Payment Order. The aim of the Payment Order is to make it easier to obtain judgments on uncontested claims, by providing a uniform EU wide procedure and ensuring that these judgments will be automatically recognised throughout the EU. It is anticipated that businesses across the EU will benefit from this procedure.

34.16 Jurisdiction

34.16.1 Denmark

Council Regulation No 44/2001 on jurisdiction and the recognition and enforcement of judgments in civil and commercial matters ("Brussels Regulation") currently does not apply to Denmark. Neither does regulation No 1348/2000 on the service of judicial and extrajudicial documents in civil or commercial matters. However, an agreement has now been negotiated between the European Community and Denmark.
in order to extend these regulations to Denmark so as to achieve a uniform application and interpretation.

34.16.2 Tort

Council regulation 44/2001 sets out the rules on jurisdiction for EU member states. Article 2 states that persons domiciled in a member state shall, whatever their nationality, be sued in the courts of that member state. Article 5 is an exception to that rule and provides that a person domiciled in a member state may, in matters relating to tort, delict or quasi delict, be sued in the courts of the place where the harmful event occurred or might occur.

In *Handelskwekerij GJ Bier BV v Mines de Potasse d' Alsace SA* (a 1976 case), the ECJ explained that the expression "place where the harmful event occurred" means that the claimant has the option to either sue in the place where the damage occurred or the place of the event giving rise to it.

In this case the defendant, who was domiciled in Portugal, had produced a certificate for aircraft engine maintenance work on a second-hand helicopter. The claimant alleged that it had relied on this statement and claimed damages for the tort of negligent misrepresentation. The claimant, based in England, issued proceedings here and argued that the certificate was issued under a system in which any maintenance company would know that its certificate would be recognised and relied on internationally. The defendant argued that England was not the appropriate jurisdiction.

The court concluded that the place where the damage occurred is not the place where a claimant simply suffers financial loss. It is necessary to see where the event giving rise to the damage produced its "initial, "direct", "immediate", or "physical" harmful effect. The domestic court should examine with particular care any assertion that the place where the damage occurred was the place where the claimant is domiciled. However, the court found that the initial and direct damage occurred when the certificates were received and relied on by the claimant in England. This was the place where significant damage was done to the immediate victim of the harmful event and therefore the place where the damage occurred. Accordingly, England was the correct jurisdiction for the dispute to be heard.


34.16.3 Judgment recognition

Article 33 of Council regulation (EC) No.44/2001 on jurisdiction and the recognition and enforcement of judgments in civil and commercial matters ("Judgments Regulation") provides that a judgment given in a Member State shall be recognised in other Member States without any special procedure being required. When, however, will the courts refuse to recognise an EU judgment?

Article 34.2 of the Judgments Regulation states that a judgment shall not be recognised if:

- the judgment was given in default of appearance; and
• the defendant was not served with the document which instituted the proceedings or with an equivalent document in sufficient time and in such a way as to enable him to arrange his defence; and

• the defendant must fail to commence proceedings to challenge the judgment when it was possible for him to do so.

The English courts were asked to recognise a Greek judgment against Mr Tavoulareas pursuant to the Judgments Regulation. Mr Tavoulareas relied on article 34.2. The court concluded that Mr Tavoulareas had not appeared during the trial. The attempts to serve Mr Tavoulareas with the Greek proceedings through the medium of the Greek Public Prosecutor had failed. Further, Mr Tavoulareas had filed an appeal in Greece challenging the Greek judgment within the required time.

Accordingly, all the conditions of article 34.2 had been satisfied and the Greek judgment would not be recognised.

*Peter Tavoulareas v George Tsavliris and others* [2006] EWHC 414, 9 March 2006

34.16.4 Jurisdiction clause

In what circumstances can you successfully challenge a jurisdiction clause and when can you obtain an anti-suit injunction preventing a case from proceeding in another country?

This case concerned a shipment of printing machinery from Hamburg in Germany to Cartagena in Colombia. Contrary to instructions, the cargo had been stowed on deck rather than under deck. Following bad weather, the goods were a constructive total loss. The bill of lading was expressly subject to English law and English jurisdiction. The defendant cargo insurers issued proceedings in the Colombian courts and the claimant ship owners brought proceedings here. The defendant challenged the English jurisdiction arguing that, under Colombian law, parties cannot agree a choice of foreign law and jurisdiction and any such term is void and contrary to public policy.

Since there was an express jurisdiction clause, the court stated that only in exceptional cases would an English court not exercise its jurisdiction. This was not an exceptional case. The court found that it was undesirable that there should be two sets of proceedings in two different jurisdictions with different laws being applied and therefore the potential for different outcomes. The only sensible course, therefore, was to grant an anti-suit injunction in order to support the express terms of the bargain made between the parties. As this was an order directed against the parties and not the Colombian courts, the English court stated for the record than no discourtesy was intended to the Colombian courts.

*Horn Linie GmbH & Co v (1) Panamericana Formas E Impresos (2) Ace Seguros SA* [2006] EWHC 373, 6 March 2006
34.17 Limitation

34.17.1 Acknowledgment of debt

This case concerned itself with the interplay between section 29(5) of the Limitation Act 1980 ("Act") and the rules concerning the non-admissibility of without prejudice communications.

Section 29(5) of the Act provides that, if within the limitation period a debtor acknowledges a debt, this will have the effect of extending the limitation period for bringing a claim. The right of action will be treated as having accrued on the date that the acknowledgment is made.

In this case letters were written on the debtor's behalf to Bradford & Bingley plc ("B&B") which acknowledged the debt by referring to it as the "outstanding balance owed to you" and the "outstanding amount". Neither letter was marked without prejudice. The debtor argued that these letters were inadmissible as evidence as they were written as part of a negotiation with a view to getting the creditor to give the debtor more time to pay, or to accept a lesser amount. They were implicitly without prejudice.

The Law Lords all agreed that the words used amounted to an acknowledgment under section 29(5). They also agreed that the letters were admissible, though they reached this conclusion via different routes.

Lord Hoffman concluded that, in so far as the without prejudice rule is based on general public policy (and not an agreement of the parties), it does not apply at all to the use of a statement as an acknowledgment for the purposes of section 29(5) and is therefore admissible.

Lord Hope of Craighead and Lord Mance held that neither letter made an offer of the kind that would attract without prejudice privilege on public policy grounds.

Lord Brown (with whom Lord Walker of Gestinghope agreed) held that the without prejudice rule had no application to apparently open communications designed only to discuss the repayment of an admitted liability, rather than to negotiate and compromise a disputed liability. Some acknowledgments might attract without prejudice privilege but only where the extent of the liability is genuinely in dispute and the parties are trying to settle that difference.

All were in agreement that B&B's claim was not statute barred.

*Bradford & Bingley plc v Rashid* [2006] UKHL 37, 12 July 2006, HOL

34.17.2 Proceedings brought

Proceedings start on the date entered on the claim form by the court, but is this also the date when the claim is "brought" for the purposes of establishing whether a claim has been issued within the limitation period?

In this case, the limitation period expired on 5 November 2004. The solicitor attended the court office on 4 November 2004 with a letter stating that it enclosed the
claim form and the court issue fee. The court clerk stamped the letter to record the fact that the letter and its enclosures had been received on 4 November. However, due to industrial action, the claim form was not issued and dated until 8 November, after the expiry of the limitation period. Had the proceedings been brought in time?

The Practice Direction on service in accordance with CPR Part 7 provides:

"Procedings are started when the court issues a claim form at the request of the claimant, but where the claim form as issued was received in the court office on a date earlier than the date on which it was issued by the court, the claim is brought for the purposes of the Limitation Act 1980 and any other relevant statutes on that earlier date."

Surprisingly there is no prior authority on this point. The Court of Appeal held that, as contemplated by the Practice Direction, a claim is brought when the claimant's request for the issue of a claim form (together with the court fee) is delivered to the court office. The claimant is given the full period of limitation in which to bring the claim and does not take the risk that the court will fail to process it in time. The date of issue of the claim form only fixes the time within which the proceedings must be served. Although the defendant will not be able to see when the request to issue the claim form was received, if it is outside the limitation period, he can make enquiries to discover the date of receipt. Accordingly, the claim had been brought within the limitation period.

This case clarifies the meaning of when proceedings are "brought" for limitation purposes and brings some relief to parties which have ensured that the claim form was received by the court within the relevant limitation period, but for whatever reason the claim form was not issued until after the expiry of the limitation period. It also serves as a useful reminder that, if close to the expiry of the limitation period, it is of paramount importance to establish and record the date on which the claim form is received by the court.

*St Helens Metropolitan Borough Council v Barnes* [2006] EWCA 1372, 25 October 2006, CA

See, also, paragraph 29.11 for further information and cases on limitation.

34.18 Part 36

The response to the consultation on proposed changes to CPR Part 36 were published. The aim of the proposals was to ease the burden on certain categories of defendant (those that are "good for the money") by allowing them to make written offers to settle without requiring them to make a payment into court (in line with *The Trustees of Stokes Pension Fund v Western Power Distribution*. There was broad support for a change to this effect.

Other proposals were greeted as follows:

- the proposal to allow unaccepted offers and payments to be withdrawn after the time limit for acceptance has expired received a mixed response with a small majority in favour;
- responses to the proposal to allow parties to accept offers outside the initial time limit without requiring the court's permission were closely balanced;
most were against requiring a party refusing an offer to give reasons;

views were closely balanced as to whether a defendant should be entitled to indemnity costs and enhanced interest where a claimant fails to beat the defendant's Part 36 payment at trial (some respondents felt this would put additional pressure on claimants to settle early when faced with an unfair offer and the Senior Costs judge considered it would be unfair to treat those claimants who had rejected a defendant's offer more harshly than those that had failed in their claims altogether).

The Civil Procedure Rules Committee is currently considering the comments made and anticipates making changes to the rules to come into force in April 2007 with payments into court being abolished.

34.19 Partnerships

The procedures to be adopted when claims are brought by or against a partnership were amended to include new rules for acknowledging service. The practice direction relating to enforcement of judgments now has provisions against partnerships including against limited partners and partners who reside out of the jurisdiction. There is also a provision to require partners to produce a partnership membership statement disclosing the names of the partners at the date the cause of action is alleged to have arisen. Where a partnership has a name, claims by and against the partnership should be brought in that name and individuals trading under a name other than their may be sued in that name.

34.20 Security for costs

34.20.1 Sudan

In this case, the defendant successfully demonstrated that, if it successfully defended the action, the claimant might not be in a position to pay the defendant's costs or that any costs award might be difficult to enforce as the claimants were resident in Sudan. The court ordered the claimant to make a payment into court in the sum of £375,000 as security for the defendants' cost up to completion of the disclosure process. The claim itself was for an alleged libel in respect of a book called "Slave" published by the first defendant and co-authored by the second defendant. The book purported to be an account of a Sudanese woman's life which included her time working for the claimants, a former Sudanese ambassador and press attaché and his wife. The accuracy of the book's content was fiercely disputed.

The claimants appealed. The Court of Appeal decided that there was no evidence which compelled the court to find the claimants' case highly likely to succeed at trial. In deciding that the enforcement of a costs order would be impractical in Sudan, there was no breach of international comity. The judge was therefore entitled to order security for costs. The judge found that he had not been provided with a full and candid account of the claimants' actual and potential means and, in this situation, he had to set a suitable sum in the exercise of his discretion. The appeal was unsuccessful.
This decision reinforces the position that, where a claimant resides in a jurisdiction in which it would be difficult to enforce any costs order, the court will be inclined to grant an order for security covering the various stages of the litigation process.

*Al-Koronky & Anor v Time-Life Entertainment Group Limited & Anor* [2006] EWCA Civ 1123, 28 July 2006, CA

34.20.2 Unless orders on security for costs applications

Where a claim has a good chance of success but the claimant has limited funds, the courts are reluctant to make an order for security if it would stifle a genuine claim. The court can also take into account the claimant's ability to raise money from others such as family, friends and colleagues when deciding whether to make an order for security.

Here the claimant was ordered to pay £125,000 into court by 25 August 2005, failing which the claim would be struck out. He had limited funds, but his father-in-law was King Michael of Romania. The Senior Master gave the claimant permission to appeal, but limited it to the issue of whether the claimant could oppose the order for security on the basis that it would stifle a genuine claim in circumstances where his relations, friends and others with whom he worked appeared to have substantial funds.

The claimant applied to stay the order pending the appeal, but the Senior Master refused. The claimant then applied to a vacation judge for a stay pending the appeal. He was again refused. The security was not provided and the claim was struck out on 26 August. Eventually, in December, King Michael provided the funds and the claimant wrote to the defendant offering to provide the security. The defendant refused this offer. The appeal went to a judge who was not prepared to set aside the default judgment, although he indicated that the sum to be paid into court should have been £80,000.

The claimant subsequently appealed to the Court of Appeal. The court decided that the decision to make the order for security subject to an unless order as a first order, although common practice, was somewhat strange. Further, to bring the sanction into play before the appeal had even been heard seemed unfair and inappropriate. If a claimant could, within a short period of time, come to the court with the right sum, then the court should be willing to grant the relief and set aside the default judgment. It would be a different story if the claimant had deliberately refused to obey the order. Accordingly, the appeal was allowed and the claim was reinstated on the payment into court of £80,000.

As a result of this decision, it is likely that a claimant will have a greater prospect of persuading a court not to make unless orders as its first order on a successful application for security and/or of persuading a court to provide a more generous amount of time to pay. If a claimant then produces the money after the unless order has come into effect, a court may be more willing to set the default judgment aside (although if the claimant has deliberately refused to comply with the order a court is still unlikely to do so).

*Radu v Houston & Anor* [2006] EWCA Civ 1575, 22 November 2006, CA
34.20.3 Settlement

What impact does a drop hands offer made by one party have on the question of costs? During the conduct of the case the defendant had made an offer suggesting that both parties should walk away from the court proceedings and be responsible for their own costs.

The claim itself was for £7.75m, being the alleged costs of buying a right which the claimant alleged was negligently omitted by the defendant from documentation under which the claimant purchased Fulham Football Club. The court declared that the defendant had been negligent but they were not liable for the loss claimed. There had been an additional claim for £100,000 for professional fees in sorting out the negligence claim and the court allowed only £6,750 of that claim.

Looking at the whole claim in context, the court had to decide as a starting point which party had been successful. It concluded that it was the defendant, bearing in mind that the claimant had recovered a very small part of a subsidiary part of the claim.

The court then had to determine the effects of the drop hands offer. Usually the court would compare the amount of the offer with the final amount determined. The court decided that the costs and effort put into the whole action should be equally split between the issues of liability and quantum. Although the defendants were the successful party, the court decided to make an order to reflect the fact that each party had won and lost on a substantial part of the claim and that the costs were roughly equal and were likely to have been incurred in similar proportions. The court therefore decided to net the two orders off, one against the other, with the result that there would be no order as to costs. This resulted in the same position as the drop hands offer. The court stated that the drop hands offer was an offer that the claimant should have accepted and therefore the defendant was entitled to its costs from the date the offer ought to have been accepted.

This case shows that every offer made must be taken seriously as it could have a significant impact on the costs a party is able to recover.


34.21 Service

34.21.1 Solicitors' authorisation and extensions of time

- If a defendant gives his solicitor's address to the other side for service of proceedings do those solicitors have to confirm that they are authorised to accept service? No, it will be effective service if the claimant nominates a firm of solicitors and the claimant serves the claim form on those nominated solicitors.

- Where a claimant does not know if the defendant has a solicitor acting or he knows that he has a solicitor but is told that solicitor is not authorised to accept service then no solicitor is authorised to accept service.
• “Usual or last known address” cannot include an address where the defendant has never resided. If, however, the claimant belief is reasonable this may be a ground for extending time for service of the claim form.

• An application for an extension of time is made when it is issued, not when it is heard.

• If there is no reason or only a weak reason for extending time, the court is unlikely to extend time.

• An application for an extension of time for service of the claim form may be made without notice. This means that either party can apply to have it set aside varied or stayed rather than having to appeal. However it will generally be an abuse of process for the applicant to apply to set it aside unless there is fresh material. Where the application is made shortly before the four month deadline for service of the claim form and the limitation period has expired, it is of critical importance that such applications are dealt with by an urgent hearing rather than be disposed of on paper. Owing to time constraints this may not always be possible, but then consideration should be given to hearing the application by telephone.

• An application to dispense with service should only be granted if the claimant had attempted to serve by one of the methods permitted or had served in time in a manner which involved only a minor departure from the permitted methods of service.

• A party that waits until the last minute to serve takes a great risk.

*Collier v Williams* [2006] EWCA Civ 20, 25 January 2006

34.21.2 Not served

In this case, final judgment had been entered even though the defendant had never been served with the claim form. Rather surprisingly, there is no clear provision in the CPR dealing with this situation.

The court urged the Rules Committee (who are responsible for updating the CPR) to consider this, but in the meantime they gave the following guidance:

• if the defendant can show that he has not been served (or is not deemed to have been served) with the claim form at all, he would normally be entitled to an order setting the judgment aside and to his costs of making the application;

• if, when the claimant is served with an application to set aside such a judgment, he believes that he can show that the defendant has no real prospect of successfully defending the claim, he may apply to the court for orders dispensing with service of the claim form, permission to apply for summary judgment immediately and for summary judgment on his claim;

• if such an application and cross-application are made, the court should make such order as it considers just; and
• if the claimant can show that the defendant has been guilty of inexcusable delay since learning that the judgment has been entered against him, the court is entitled to make no order on the defendant's application for that reason. The judgment would then stand (subject to any direction made to the court, whether in relation to statutory interest accruing on the judgment or otherwise).

This case concerned a possession action where proceedings had not been served on the defendant, but judgment had been entered against it. The court held that it was entitled to have the judgment set aside so that the whole matter could be determined at trial.


34.21.3 Dispensing with service

Service of any court documents (in particular the claim form) must be done in accordance with the CPR.

In this case, the claimants waited until the last day before the limitation period expired and then attempted to serve the defendant. First, the claim form was sent by fax to the defendant's legal department, despite the fact that the defendant had not given written confirmation that they would be willing to accept service by electronic means - a requirement of the rules. Secondly, the claim form was couriered to solicitors who had acted for the defendant, but who had not confirmed that they were authorised to accept service on behalf of their client - again, a requirement of the rules.

The claimant applied to the court to dispense with service. The Court of Appeal refused to do so. The Court of Appeal confirmed that it requires an exceptional case for the court to exercise its power to dispense with service where the time limit for service of a claim form has expired. The claimant could have served the claim form on the defendant by courier, but failed to do so. There was nothing exceptional about the facts and it was not even a case where there has been a minor departure from the permitted methods of service or there had been an ineffective attempt to serve by a permitted method within the time limit.

This case demonstrates that the courts are eager to ensure that claimants adhere strictly to the rules of service in order to create certainty and to avoid inconsistencies.

_Nutifafa Kuenyehia v International Hospitals Group Limited_ [2006] EWCA Civ 21, CA

34.21.4 Retrospective permission to serve out of the jurisdiction

On what the basis will the court grant retrospective permission to serve out of the jurisdiction when the limitation period has expired? The claimant had served a claim form on the Norwegian defendant under an Inheritance Act claim in circumstances where he should have applied for permission to serve out of the jurisdiction.
The court examined the factors against granting the application:

- the need to seek permission to serve out of the jurisdiction is a serious and important procedural requirement;

- the grant of retrospective permission is something the court will only ever give sparingly and after very serious consideration;

- the need to seek retrospective permission was caused by a mistake of the lawyers who did not realise that permission was required;

- had immediate steps been taken to serve the claim form, the defect may have come to the lawyer's attention within the limitation period; and

- if permission was granted, the defendant would lose the right to insist that the claim under the Inheritance Act was now statute barred. However, the Inheritance Act itself provided for permission to commence a fresh claim out of time and it is likely that, given the circumstances, permission would be granted.

The court then examined the factors in favour of granting the application:

- the claimant had an arguable case that ought to be tried. The claim could not be compromised as the claimant was seeking a transfer of his deceased wife's share in the house, where he had lived for many years. He was in poor health and would find it difficult to relocate;

- a money remedy against his solicitors would not be a satisfactory substitute for a successful claim; and

- to refuse permission would elevate the need to discipline lawyers above the need to do justice between the parties.

The judge therefore granted the application for retrospective permission. This case should not be seen as a change in the courts' position on limitation. Instead, it highlights flexibility of the CPR in adapting to individual requirements.

_Nesheim v Kosa [2006] EWHC 2710, 4 October 2006_

34.21.5 CPR

The Civil Procedure Rules Committee is looking at the service rules.

34.21.6 Small claims procedure

The Department for Constitutional Affairs published the government's response to the Constitutional Affairs Select Committee's report on small claims.

The government accepted that there is a need to enhance IT facilities. A number of IT initiatives are being considered including more web-based systems for navigating through the process, electronic filing and document management systems. The government were also aware of the frustration felt by litigants who obtained judgment only to find that a debtor either would not or could not pay. The
government is exploring information sharing initiatives giving the courts the opportunity to request information from the Department for Work and Pensions and HM Revenue & Customs.

The government also commented on the European Small Claims Procedure, agreeing that it is to be welcomed but should be limited to cross-border cases.

34.22 Statement of case

On 2 October, all statements of case became available to non-parties. The previous rules were worded so that, if a non-party wanted access to a statement of case other than a claim form, it had to make an application to the court. It was expected that, if a request was made for access to statements of case in respect of any proceedings issued before 2 October, the court file would be given to the Master or District Judge for further consideration. At the eleventh hour this decision was reversed so that if a party wished to restrict access it had to make an application to the court. The Law Society intervened and obtained an urgent, but temporary injunction to prevent the Court Service from releasing copies of documents filed before 2 October 2006.

Subsequently, the case was settled and a new rule was introduced on 18 December so that any statement of case filed before 2 October will not be available to the public unless an application is made for access. Any statement of case filed after 2 October will, however, be available to non-parties.

34.23 Summary judgment

34.23.1 Good faith

Part 24 of the Civil Procedure Rules creates a procedure, available on the application of either party or at the court's own volition, to deal with weak or hopeless cases. The objective is simply to enable cases which have no real prospect of success to be disposed of summarily without trial.

A court will be wary of hearing facts which are apparently credible against facts from the other side which are also apparently credible unless there is some inherent improbability in what is being asserted or some extraneous evidence which would contradict it. To identify the truth between them is the function of the trial judge and a court faced with an application for summary judgment will not conduct a mini-trial. Where there is clearly conflicting evidence, this can often be the downfall of an application for summary judgment.
In this case, the defendant argued on appeal that the judge should not have given summary judgment when it involved a finding of a lack of good faith. The Court of Appeal noted that the judge had been well aware that the conclusion that a party has not acted in good faith ought generally to be reached at trial. However, the seriousness of the allegation did not oblige the court to automatically dismiss the application. It was a factor to be borne in mind. Reaching a decision where such an allegation was made will depend on the circumstances of each case and the judge had reached his conclusion on the quality of the evidence that had been adduced. The defendant's appeal was therefore dismissed.

_Wrexham Association Football Club Ltd v Crucialmove Ltd_ [2006] EWCA Civ 237, 14 March 2006, CA

34.23.2 Fraud

In cases where fraud is alleged, it is notoriously difficult to succeed because a judge will find it difficult to make a finding of fraud without examining all the facts.

This case concerned the privatisation of the State Oil Company of Azerbaijan. The Azeri government issued vouchers for the purpose of subscribing to shares in the company. A Mr Kozeny introduced the claimant investors to the voucher markets. However, the privatisation never went ahead and the claimants lost their investment. The claimants then asserted that options had not been purchased from the Azeri government, but from companies controlled by Mr Kozeny. The claimants issued proceedings for deceit and fraudulent misrepresentation. It also transpired that Mr Kozeny had allegedly bribed the Azeri officials to ensure he could continue to buy vouchers and options.

The defendants applied for summary judgment on the basis that there was no misrepresentation that induced the claimants to enter into the contract because they were aware of the illegality of the arrangement from the beginning and therefore the agreement was unenforceable. Even if the claimant was unaware of, or turned a blind eye to, the corruption they were aware that Mr Kozeny had access to government officials over and above other investors which rendered the agreement contrary to public policy.

Despite going through the issues in depth, the judge concluded that he was unable to give summary judgment. The mere fact that Mr Kozeny had good relations with the Azeri government could not of itself render the agreement contrary to public policy. There would need to be something more. The agreements between the claimant and the defendant were not in themselves contracts to exact payment for the use of personal influence on government officials and the judge could not say at this stage of the proceedings that they were entering into arrangements which involved improper influence on the government. This could only be decided after the evidence has been considered.
This case once again demonstrates that in a complex matter it can be difficult to obtain summary judgment. As the judge himself concluded, this case joins the long list of "heroic" attempts to achieve summary disposal, but fails because the court cannot determine enough at this stage. The court concluded that the case ought to go to trial so that all the evidence could be considered.

Marlwood Commercial Inc v Kozeny and others [2006] EWHC 872, 28 April 2006

34.24 Time

How should you agree an extension of time for a deadline arising under the CPR or imposed by the court? Do you agree it orally with the other side? Do you write to the other side to confirm any agreement? Do you expect the other side to write to you in similar terms?

CPR 2.11 provides:

"Unless these Rules or a practice direction provides otherwise or the court orders otherwise, the time specified by a Rule or by the court for a person to do any act may be varied by the written agreement of the parties."

The Court of Appeal made it clear that this means exactly what it says. The Court of Appeal confirmed that, whilst it is permissible for parties to agree with each other to extend the four month deadline in CPR 7.5 for service of claim forms once issued (and indeed to extend many other time limits or deadlines), there must be an agreement in writing for the extension to be effective.

A written agreement does not include the following:

- an oral agreement;
- an oral agreement recorded by one or both parties in a file note (whether or not the respective file notes each record the same detail);
- a written communication sent by one party to the other recording an oral agreement which is not expressly agreed and accepted in writing by the other party; and
- an exchange of written communications which both record the same oral agreement but do not expressly refer to each other by way of acceptance.

Furthermore, where a party has (purportedly) agreed an extension of time without a written agreement, it will not be able to argue that the other party is estopped from denying the oral agreement.

To agree an effective extension of time, there must be an agreement in writing which could include:

- one document signed by all relevant parties; or
- an exchange of written communications where one party sets out the agreement and the other side expressly confirms that agreement.

Ian Thomas v The Home Office [2006] EWCA Civ 1355, 19 October 2006, CA
After the claimant's witnesses have given evidence, it is usually then the turn of the defendant to call its witnesses. This case considered the circumstances in which a defendant is entitled to claim that it has no case to answer (in that the claimant has not proved its case and that the defendant does not therefore need to call any witnesses).

The Court of Appeal confirmed that rarely, if ever, should a judge trying a civil case without a jury entertain a submission of no case to answer. Almost without exception the dangers and difficulties involved will outweigh any supposed advantages. The claimant is simultaneously being deprived of the opportunity of making a weak case stronger by eliciting favourable evidence from the defendant's witnesses and of the opportunity of inviting the court to draw adverse inferences from the defendant's failure to give evidence. In this case, as the judge had agreed to the defendant's submission, the procedural irregularity had caused injustice which deprived the claimant of an opportunity that should have been open to her to strengthen her case in one way or another. The Court of Appeal therefore directed a retrial before a different judge.

An application by a defendant in a civil case that it has no case to answer is most unusual and will rarely be successful.

*Neina Graham v Chorley Borough Council* [2006] EWCA Civ 92, 21 February 2006, CA

As is well known, the Liquidators of BCCI SA (the Liquidators) brought a claim alleging that the Bank of England had acted in a knowingly unlawful way in its supervisory regulation of the activities of BCCI SA in the UK between 1980 and 1991. They further alleged that at least 42 of the Bank's officials had been dishonest. The Liquidators abandoned their claim last year.

Here the Bank applied for indemnity costs and for the exoneration of the Bank's officials. The Liquidators agreed to pay the Bank's indemnity costs and so argued that the judge no longer had jurisdiction to make any orders. The judge gave his response to that application and took the opportunity to heavily criticise the Liquidators' legal team and case. He made the following points:

- the judge had been so concerned about the case that he had consulted the Lord Chief Justice, (then Lord Woolf) about it. He had told the Lord Chief Justice that it was a farce and that it had the capacity to damage the reputation of the legal system but, on the basis that the Liquidators had an eminent legal team, he had concluded that there was nothing he could do;
- there was a myriad of hopeless inconsistencies and implausibilities in the Liquidators' case;
- there was a desire not to abandon any point, however bad, in an effort to keep the show on the road for long enough to cross examine the Bank's witnesses. Some of the case was simply incoherent. The Liquidators never grappled with the fact that the logic of their case compelled them to attribute to perfectly decent people trying to do their job ever more disgraceful and dishonest conduct, such as would not be ordinarily contemplated by perfectly decent people;
• the two leading counsel for the Liquidators made diametrically opposed submissions on the principal legal issue;

• some of the issues left an unpleasant taste in the mouth, not just because of their gravity, but because even when a lack of foundation had been exposed, the Liquidators refused to abandon it;

• the structure upon which some of the allegations were hung was unsound. It was a structure built on occasion not even on sand, but rather air;

• counsel's sustained rudeness to his opponent was inappropriate and distracting and the judge conceded that he should have been more successful in controlling it, but even the Liquidators' counsel's colleagues could not do so; and

• the way the public relations campaign had been run allowed a wholly distorted picture of the Bank's conduct to be painted. With the benefit of hindsight, the extracts supplied to the press were a cynical and grotesque operation. The public relations campaign was designed to put pressure on the Bank to capitulate.

Accordingly, the Bank's entitlement to indemnity costs could not be more clearly made out and he was entitled to make an order for indemnity costs. Further, the Bank's officials should be exonerated of the grave allegations made against them.


### 35. MERGERS AND ACQUISITIONS/CORPORATE ACTIVITY

#### 35.1 Takeovers Directive implementation: interim regulations

The Companies Act 2006 (*"2006 Act"*) contains provisions implementing the Takeovers Directive in the UK. Since the implementation date of the Takeovers Directive was 20 May 2006 and the 2006 Act was not finalised at that stage, the Takeovers Directive was implemented on an interim basis pursuant to the Takeovers Directive (Interim Implementation) Regulations 2006 (*"Interim Regulations"*). The Interim Regulations will apply only until the takeover-related provisions of the 2006 Act come into force. This was proposed to be from 6 April 2007. However, the first commencement order implementing certain provisions of the 2006 Act (see paragraph 7.1) remained silent Thus the current two track regime remains in place until further notice (see below). The Interim Regulations:

35.1.1 apply only to transactions governed by the Takeovers Directive. In the UK, these are, in the main, takeovers of officially listed companies but not takeovers of unlisted, AIM or PLUS companies;

35.1.2 place the Takeover Panel (*"Panel"*) on a statutory footing (ie giving it statutory powers to make and enforce its rules) in relation to transactions to which the Takeovers Directive applies. In addition, those parts of the Takeover Code (*"Code"*) which were amended or adopted in order to implement the Takeovers Directive (see paragraph 35.2) also operate on a statutory basis in relation to such transactions;
35.1.3 introduce a new criminal offence in respect of bid documentation that fails to comply with relevant Code provisions - again this applies only to transactions governed by the Takeovers Directive;

35.1.4 set a revised procedure for the exercise of squeeze-out and sell-out rights on a takeover that is governed by the Takeovers Directive; and

35.1.5 list the information that the Takeovers Directive requires to be included in the directors' report of an officially listed company (this requirement applies in respect of financial years beginning on or after 20 May 2006).

Takeover transactions outside the scope of the Interim Regulations continue to be regulated by the Panel and the Code. In addition the existing minority sweep up provisions in sections 428-430F of the Companies Act 1985 continue to apply to such transactions. Therefore, until the relevant provisions of the 2006 Act come into force, a "two-track" takeover regime operates in the UK.

35.2 Takeovers Directive implementation: Code amendments

On 21 April 2006, the Code Committee published response statement (RS 2005/5) (http://www.thetakeoverpanel.org.uk/new/consultation/DATA/RS200505.pdf) "The Implementation of the Takeovers Directive" detailing its proposed amendments to the Code to implement the Takeover Directive and the related provisions of the (then) Company Law Reform Bill (now the 2006 Act). The amendments put forward in the response statement were as substantially proposed in the initial 2005 consultation paper. As the Code is currently broadly compliant with the requirements of the Takeovers Directive, fundamental changes were not made. Some of the key amendments include:

35.2.1 additional disclosures in relation to strategy and employees (Rules 24 and 25): a bidder will be required to provide details in the offer document with regard to:

- the bidder's strategic plans for the target;
- the likely repercussions of those strategic plans on employment and on the locations of the target's places of business; and
- its intentions regarding the continued employment of the employees and senior management of the target, including any material change in the conditions of employment. These disclosures must also be made by the bidder about itself, if affected by the offer;

35.2.2 "making available" offer and response documents to employees (rule 30): the audience for announcements and offer/response documents will be wider and will include not only target shareholders but also both the bidder's and the target's employees or employee representatives, to whom the relevant announcement/document must be made "readily available";

35.2.3 as a basic principle, overseas (ie non-EEA) shareholders/employees of target should not be treated differently to UK/EEA target shareholders and the various Code requirements with respect to the provision of information or the making of documents available to such shareholders/employees should be complied with (rule 30.3).
However, certain dispensations have been introduced where there is a "significant risk" of civil, regulatory or criminal exposure for the bidder or target;

35.2.4 the definition of persons "acting in concert" is being widened in line with the Takeovers Directive definition. It catches both persons who seek to obtain or consolidate control of the target and those who wish to frustrate an offer for the target. In addition, the definition no longer requires "active" co-operation between parties and is not limited to parties co-operating by the acquisition of shares by any of them. There is a specific carve-out covering shareholders who give irrevocable undertakings in certain circumstances. The Panel considers that these changes merely reflect its current practice and should not therefore have a major impact;

35.2.5 the residency test for UK registered companies whose securities are traded on a regulated market (ie the Official List) in the UK has been removed. Therefore, the Code will apply to such companies irrespective of where their place of central management is. The residency test will continue to apply to other companies subject to the Code (including AIM companies and certain private companies);

35.2.6 in the context of take privates (rule 16), the Panel will now require shareholder consent in all cases where management remain financially involved in the target business not just where the bidder and management hold more than 5% of the target's share capital.

35.2.7 circulation of announcements by target (rule 2.6): both announcements which start the offer period (eg a "talks" announcement) and a Rule 2.5 announcement will need to be circulated by the target to its shareholders - at the moment the obligation only applies to the announcement which starts the offer period;

35.2.8 the cash confirmation statement (rule 24.7) must now be included in both the Rule 2.5 announcement and the offer document itself. Conditional forms of cash confirmation statements in exceptional circumstances will no longer be permitted;

35.2.9 Rule 21 on frustrating action has been widened - shareholder consent to frustrating action may be required in more instances than was the case previously;

35.2.10 the General Principles underpinning the Code are being replaced with those contained in the Takeovers Directive. Although these are in many ways similar to the current General Principles, there are some differences in emphasis. However, the Panel do not expect that the revised General Principles will result in major changes to current practice; and

35.2.11 there are a number of changes proposed to the rule 9 mandatory bid provisions to implement the Takeovers Directive. These changes chiefly concern the calculation of the offer price, carve outs from the rule 9 obligation and the types of securities that must be included in a rule 9 offer.

A new edition of the Code, incorporating the changes (as well as those in RS 2005/4, RS 2005/3 and RS 2006/1 - see below) was published on 20 May 2006 (being the implementation deadline for the Takeovers Directive). The revised Code therefore came into effect and was applied from that date applying to all bids that are regulated by the Code (ie to Official List, AIM and other UK public companies).
35.3 Code: miscellaneous minor amendments

On 10 February 2006, the Code Committee issued a consultation paper (PCP 2006/1) "Miscellaneous Code Amendments" seeking comments on various minor amendments to the Code (http://www.thetakeoverpanel.org.uk/new/consultation/DATA//PCP200601.pdf). Whilst the number of amendments proposed affected 30 rules, in most cases they did not impact on the substance of the relevant rules. Indeed, the changes related mostly to terminology used in other regulations to which the Code refers. As a follow up, on 21 April 2006, the Code Committee published response statement (RS 2006/1) "Miscellaneous Code Amendments" (http://www.thetakeoverpanel.org.uk/new/consultation/DATA/RS200503.pdf), setting out its response. The final amendments to the Code were substantially as proposed. A new edition of the Code incorporating the changes, (as well as the changes set out in RS 2005/3, RS 2005/4 and RS 2005/5 - see above and below), was published on 20 May 2006, and came into effect from that date.

35.4 Code: dealings in derivatives and options

On 21 April 2006, the Code Committee published response statement (RS 2005/3) "Dealings in Derivatives and Options" setting out its response to issues raised in two consultation papers relating to dealings in derivatives and options (http://www.thetakeoverpanel.org.uk/new/consultation/DATA/RS200503.pdf). The final rule amendments were substantially as proposed.

In essence, with effect from 20 May 2006, the Code now treats dealings in derivatives and (put and call) options that are referenced to shares as being equivalent to dealings in the underlying shares themselves. This has a particular impact on rule 5 (which generally prohibits acquisitions of over 30% of target) and rule 9 (which determines when a mandatory offer must be made). Derivative and options transactions are now taken into account when determining whether Rule 5 has been breached and whether the mandatory offer obligations under rule 9 have been triggered. Dealings in derivatives and options may also have an impact on the price at which an offer is required to be made (relevant to rules 6, 9 and 11). These provisions are complex and in practice are most likely to be relevant to investment banks/brokers who regularly deal in derivatives and options rather than corporates or their directors who for the most part may not.

The Code Committee has stated that it proposes to undertake a review of the operation of the new regime relating to dealings and derivatives and options in June 2007.

35.5 Code: disclosure of dealings in offer period

On 22 May 2006, the Panel published a revised summary of the provisions of Rule 8 reflecting changes made to the Takeover Code as of 20 May 2006 (http://www.thetakeoverpanel.org.uk/new/codesars/DATA/Rule8Summary.pdf). By way of background, Rule 8 concerns disclosure of dealings during the offer period. The summary of the principal provisions of Rule 8 were given in prescriptive form, with the Panel indicating that it would normally be acceptable for the purposes of:

35.5.1 rule 2.4(a) (announcement of possible offer);
35.5.2 rule 2.5(b)(ix) (announcement of firm intention to make an offer);
35.5.3 rule 2.6 (obligation offeree/offeree to circulate announcements); and
35.5.4 rule 24.2(d)(xiii) (financial and other information on the offeree, offeror and the offer).

The Panel stated that any **material** variation from the form of wording given in the Summary should be **specifically agreed** with the Panel in advance. Note, however, that the Panel clarified that, where it has been announced that an offer or possible offer is or is likely to be solely in cash, there is no requirement to disclose dealings in relevant securities (see further Note 2 to rule 8 of the Code).

### 35.6 Code: abolition of Substantial Acquisition Rules ("SARs")

On 21 April 2006, the Code Committee published response statement (RS 2005/4) "Abolition of the SARs" ([http://www.thetakeoverpanel.org.uk/new/consultation/DATA//RS200504.pdf](http://www.thetakeoverpanel.org.uk/new/consultation/DATA//RS200504.pdf)). The Code Committee confirmed it had decided to abolish the SARs (which restrict the speed at which a person may increase his holding of shares from 15% to 30% of a relevant company's share capital) and to retain the rules relating to tender offers (as proposed in the original consultation paper). The new edition of the Code incorporating the changes (as well as the changes set out in RS 2005/3, RS 2005/5 and RS 2006/1 - see above), were published on 20 May 2006, when the revised Code came into effect.

### 35.7 Practice statement: clarification of "acting in concert" definition

On 22 August 2006, the Panel published a practice statement (No 16) to clarify Note 5 on the definition of "acting in concert" in relation to standstill agreements ([http://www.thetakeoverpanel.org.uk/new/practiceStatements/DATA//PS16.pdf](http://www.thetakeoverpanel.org.uk/new/practiceStatements/DATA//PS16.pdf)). The Panel stated that it will not normally consider a concert party to exist between the parties to a standstill agreement provided that the agreement does not in anyway restrict any of them from either (i) accepting an offer for the company's shares at any stage, or (ii) agreeing to accept any offer for the company's shares - either before or after announcement of the offer.

This principle would also normally apply to standstill agreements to which the company's financial or nominated adviser/sponsor/underwriter - rather than the company itself (and/or its directors) - was a party. For example, where an agreement is entered into at the time of an equity offering with a view to ensuring an orderly aftermarket in the company's shares. The Panel made it clear that where parties enter into a standstill agreement to which neither the company (and/or its directors) nor its nominated adviser/sponsor/underwriter is a party - or in any other cases of doubt - the Panel should be consulted in advance. An example would be a standstill agreement between two shareholders. This practice statement supersedes the statement on standstill agreements contained in the Panel's 1995-1996 Annual Report.

### 35.8 Notice of warranty claim case

In *John Forrest & others v (1) John Glasser and (2) John Whitley* [2006] EWCA Civ 1086, the Court of Appeal was asked to give a proper interpretation of a time bar clause in a share subscription and acquisition agreement concerning a breach of warranty.

The appellant in this case was an investment syndicate who were appealing against the High Court's decision concerning their failure to bring a claim under the warranties within the remits of the time bar clause in the subscription and acquisition agreements. The company in question had gone into liquidation. In acquiring further shares after the initial subscription, the investment syndicate had been given various warranties including in relation to the company's management accounts.
The Court of Appeal was asked to assess (i) a contractual time bar clause (that "...any Claim under the Warranties which shall not have been notified in writing to the Company on or before the third anniversary of the Completion Date...shall be deemed to have been waived") and (ii) a notification clause relating to the requirements for such notice (stating "without prejudice" to the time bar clause that the purchasers must notify the warrantors of the claim "...in writing as soon as reasonably practicable after...becom[ing] aware of a Claim...such notification to be in sufficient detail to...identify the Claim..."). Correspondence concerning problems with the management accounts had passed between the parties prior to the expiry of the warranty time limit, but the letter notifying the claim did not incorporate or refer to this preceding correspondence. The warrantors argued that the notice was inadequate as it did not contain sufficient details of the claim.

The Court of Appeal held that a bald notice of claim (ie that a demand for damages for breach of warranty was being made) was sufficient to satisfy the time bar clause and that the notification clause imposed a separate and independent contractual obligation on the purchasers - this was made particularly clear by the use of the phrase "without prejudice". The Court of Appeal also stated (obiter) that even if it had found that the notice of claim was insufficient (and thus particulars of the claim were required), the antecedent correspondence made it plain what claim was being asserted (because the correspondence cited three specific discrepancies in the management accounts) - against that background, any reasonable recipient of the notice would have understood the purchasers were notifying a claim under the management accounts warranty clause.

35.9 Expert determination clause case

In *Brian George Kennedy v DSG Retail Ltd* [2006] QBD (Comm) (20/03/2006), the High Court examined the construction of an expert determination clause for earn out purposes in a share purchase agreement.

A share purchase agreement contained an earn out clause which specified a procedure for resolving disagreements in the earnings before interest, tax, depreciation and authorisation ("EBITDA") statement. Two years after completion, the vendor gave notice referring issues to expert determination under the agreement, and the notice also referred to the draft EBITDA statement. The purchaser, as entitled, then gave notice of other matters to be referred to expert determination. The vendor sought a declaration that the purchaser could not ask the expert to examine figures/contentions that were *not* in the draft EBITDA statement.

The High Court found that where the parties had devised a detailed procedure in the agreement for resolving issues by a chosen expert, the commercial approach was to allow them to get on with it. The drafting of the agreement allowed the parties to make written submissions to the expert, once the expert determination process had started, as they thought "reasonably fit". The court felt these submissions should therefore not be limited to any one earlier statement (ie the draft EBITDA). It helped that the agreement gave the expert a discretion to take the initiative in obtaining facts relevant to the dispute.

Thus where a contract is prescriptive in expert determination processes (eg earn-outs, completion accounts etc) the court have confirmed that they will not impose their own interpretation.
36. **OUTSOURCING**

36.1 **Injunctive relief inappropriate and unworkable in relation to complex outsourcing contract**

The decision of Mr Justice Tomlinson in this case is essential reading for lawyers dealing with complex outsourcing or services contracts because it comments on when injunctive relief is appropriate in respect of a complex outsourcing arrangement, how the dispute resolution clause worked in the contract, how the service obligations operated together, and the impact of not having specific obligations of co-operation between the customer and the supplier in relation to the specific services being provided.

For the facts and the decision, see paragraph 34.13.

*Vertex Data Science Limited v Powergen Retail Limited [2006] EWHC 1340 (Comm)*

9 June 2006, Mr Justice Tomlinson

36.2 **TUPE 2006**

The new Transfer of Undertakings (Protection of Employment) Regulations 2006 which came into force in the UK on 6 April 2006 apply where services are outsourced. For further information, see paragraph 17.11.

36.3 **MiFID (Markets in Financial Instruments Directive)**

Paragraph 20.5 sets out the detail on MiFID. MiFID will affect not just those firms currently covered by the Investment Services Directive (which MiFID replaces) but other organisations including outsourcing companies who may provide the financial services caught by MiFID on behalf of their financial services customer. While any new outsourcing contracts will need to be drawn up in the context of the new regulation, the FSA "Planning for MiFID" guidance states that "firms will need to ensure that all existing outsourced arrangements meet the relevant requirements as finally agreed". If this is taken literally, it could mean that affected firms with existing outsourcing contracts will need to implement a number of complicated contract changes to meet the new requirements and potentially foot the bill for such changes.

The FSA will have the power to veto any potential outsourcing arrangements if the outsourcing company (whether in the EU or in a third country) cannot provide equivalent protection to its financial services customer in complying with the requirements of MiFID.

36.4 **Data protection**

A good practice note was published by the Information Commissioner's Office in April 2006 on how to deal with data protection in the context of outsourcing transactions. Despite being written for small and medium sized businesses, the good practice is useful to all outsourcing, offshoring or BPO contracts. For further information, see paragraph 15.4.
37. PARTNERSHIP

37.1 Share of profits of firm not required for partnership

It is possible for a person to be a partner in a firm even when they are salaried and do not participate in the profits of the firm (Robert Heywood Ogden Lees v (1) M Young Legal Associates Ltd (2) Zahid (3) Samera Sharif and (5) Zahid Bashir [2006] EWCA Civ 613).

Here, an individual had asked to join a firm of solicitors to ensure that the practice would comply with the Solicitors Practice Rules 1990 (ie to have at least one principal who was qualified to supervise legal work). When a creditor sued the firm, the individual claimed not to be jointly liable due to the fact he was not a partner. However, regardless of provisions for payment to him of a fixed annual sum (ie a salary) and despite him having made no contribution to the firm’s capital, the Court of Appeal held he was a partner. The Partnership Act 1890 was wide enough to render the recipient of the payment of a fixed sum a partner where it could be shown that (i) there was a business, (ii) it was being carried on with a view to profit, and (iii) the person carrying on the business was doing so in common with another or others. The need for the practice to comply with the Solicitors Practice Rules was determinative - the firm could only legally practice as a law firm if he was a partner.

37.2 Duty of disclosure during negotiations for entry into partnership

In (1) Michael Ambrose Conlon and (2) Roger Harris v Paul Francis Simms [2006] EWHC 401 (Ch), the court considered two aspects of the Partnership Act 1890. Firstly, whether breach of the duty of good faith among partners (specifically where the issue is non-disclosure) gives rise to an action for damages. Secondly, whether the duty of good faith between those already in the partnership extends to persons negotiating entry into it.

In this case a solicitor fraudulently failed to disclose his previous misconduct to another solicitor when negotiating entry into partnership with him. The Office of the Supervision of Solicitors had commenced an investigation into various banking transactions in which he was involved which, after he became a partner, resulted in his suspension by the Law Society and subsequent removal from the Solicitors’ Roll.

The court at first instance found that although the dishonest partner had made untrue representations to the claimant partner, the statements had not been made in respect of the future profitability of the firm. Therefore, on the facts, the claimant partner had not been induced into entering into the partnership as a result of those representations. However, partners owe a duty of good faith to their co-partners in all partnership dealings, and the dishonest partner should have disclosed all material matters when negotiating entry (ie a positive duty). The dishonest partner had failed to disclose his dishonesty. The non-disclosure was not based on a genuine belief of his innocence, but had been fraudulent. In failing to do so, the claimant partner was fraudulently induced into entering into the partnership agreement. (Indeed, the claimant partner claimed that had he known of the dishonesty, he would have had nothing to do with the dishonest partner). He was therefore entitled to be awarded damages for fraudulent misrepresentation.

This case shows that, whilst non-disclosure will not always give a right to an action in damages, where there is a duty to disclose (and the failure to disclose is fraudulent), this amounts to an act of deceit leading to a right to claim damages. In his judgment, the judge stated that "in such cases, the non-disclosure assumes the character of fraudulent
concealment, or amounts to fraudulent misrepresentation, or is otherwise founded on, or characterised and accompanied by fraud”.

(Note that on appeal in December 2006 (BLD 2012064480), their Lordships ordered a retrial of the case on a technicality (relating to abuse of process). However, the findings on the principle of "caveat emptor" not applying to the forming of a partnership as more particularly set out above were not questioned.)

37.3 Partnerships (Restriction on Contributions to a Trade) Regulations 2006

The Partnerships (Restriction on Contributions to a Trade) Regulations 2006 came into force on 22 June 2006 relating to anti-avoidance schemes involving firm-related losses. The regulations restrict the extent to which partners can make use of "sideways loss relief", the process by which an individual sets off their share of a partnership's trading losses against their other income or gains. For more information, consult the explanatory notes which accompany the regulations (http://www.opsi.gov.uk/si/si2006/20061639.htm).

37.4 Partnership law: government statement on reform proposals

By way of background, the Law Commission and Scottish Law Commission published a report (Law Com No 283; Scot Law Com No 192) in November 2003 on Partnership Law (for further information please see http://www.lawcom.gov.uk/docs/le283.pdf) which recommended the first statutory changes to partnership law in nearly a century. It recommended replacing the existing Partnerships Act 1890 and the Limited Partnership Act 1907 with a new Partnerships Act, a draft of which was annexed to the report. The Bill did not deal with partnership tax or insolvency matters. The Department of Trade and Industry ("DTI") consulted on the economic benefits of the Law Commissions' proposals during 2004 (http://www.dti.gov.uk/files/file23033.pdf and http://www.dti.gov.uk/files/file32328.pdf).

In July 2006, the government announced its decision to implement the limited partnership law reforms recommended by the Law Commissions' report, but not the general partnership recommendations (http://www.dti.gov.uk/files/file32331.doc). The recommendations in respect of limited partnership law include the following:

- weaving limited partnerships into the general law of partnership;
- a requirement for limited partnerships to disclose their limited liability status;
- default in registration formalities be the responsibility of the general partner;
- registration of a limited partnership should be conclusive as to its existence;
- the liability of a limited partner be limited to the amount of capital actually registered;
- the inclusion in the legislation of guidance on the activities which a limited partner may undertake without losing limited liability status;
- the Registrar of Companies be empowered to de-register defunct limited partnerships; and
- separate legal personality for limited partnerships but with provision for limited partnerships without legal personality (for tax reasons).
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Respondents to the DTI consultation cited the following benefits:

• it would be advantageous for limited partnerships to be able to elect for aggregate or entity status (ie partnerships as currently formed under the Limited Partnerships Act 1907 or with legal personality);

• the proposed changes would be likely to deliver significant benefits and increased legal certainty to fund sponsors and investors; and

• clarification of the current uncertainty which exists for limited partnerships, particularly relating to the extent of the limited partners' involvement in the business, should increase the attractiveness of the vehicle for investment purposes

The government proposes to take forward the reforms to limited partnership law when Parliamentary time allows, and to publish a consultation document containing draft clauses shortly

37.5 Claims against partnerships

See paragraph 34.19 for procedures to be adopted when claims are brought by or against a partnership.

38. PENSIONS

2006 has seen a large number of changes in the pension arena: "A-Day" and the introduction of pensions tax "simplification" on 6 April; a further seven codes of practice from the Pensions Regulator; the advent of age discrimination; and the introduction of a new member nominated trustee regime. Many other detailed changes have occurred or are due to take place over the next 12 months, which substantially affect the day to day operation of both occupational and personal pension schemes and the commercial activity of employers who operate them!

38.1 "A-Day": pensions tax "simplification"

The single tax regime for all pension schemes, replacing the former array of eight different tax regimes introduced in the Finance Act 2004, came into effect on 6 April 2006, "A-Day". The old "Revenue Limits" ceased to apply, although interim provisions enable them to continue to be used by schemes for a number of years.

As a result, in the first part of the year, many schemes were busy introducing A-Day amendments, either by a full review of their scheme documentation or by a simple interim amendment to be followed by a rule consolidation.

The key elements include:

• a Lifetime Allowance ("LTA") of £1.5m for tax advantaged pension savings;

• an Annual Allowance ("AA") for tax relief on contributions or benefit accrual of 100% of UK earnings, up to a maximum of £215,000;

• a maximum tax free lump sum of 25% of the value of a member's pension benefit (up to the LTA);
a tax charge of 25% if the LTA is exceeded;

income tax charged at the member's marginal rate on the value of any benefit accrual exceeding the AA (except in the year that the benefits are taken in full);

the ability to take funds above the LTA as lump sums, subject to a tax charge of 55%;

a new minimum early retirement age of 55 from 2010 (with protection for those members who have a right on 6 April 2006 to retire earlier and where the applicable scheme rules contained such a right on 10 December 2003);

transitional arrangements to protect members' benefits accrued and contributions made before A-Day;

concurrency - the facility to join any number and type of pension schemes simultaneously;

the replacement of the discretionary Inland Revenue approval of occupational pension schemes by a new system of registration of schemes with The Pensions Regulator; and

HMRC's prohibition on taking AVCs as a lump sum has disappeared as a result of the Pensions Act 2004, and schemes are now no longer required to provide an AVC facility.

Protection

Members can protect their pre A-Day rights from the LTA charge by registering those rights with HMRC within three years of A-Day. Members with benefits in excess of the LTA (either at A-Day or at some anticipated point in the future) can protect their rights by applying for one of the following:

primary protection, where the member remains in pensionable service but a higher personal LTA is set (benefits must exceed LTA at A-Day); and

enhanced protection, where accrual of benefits is prohibited after A-Day but the LTA is increased to the level of benefits (no need for benefits to exceed the LTA at A-Day).

Trustees must now also ensure that members benefits are put into payment by the day before the member's 75th birthday and may not pay capital sums on death on or after the member's 75th birthday. Pensions may be either unsecured (before age 75 only) or secured by an annuity, through a self administered pension scheme or alternatively by secured income - the latter option is intended to address the objections of some religious groups to mortality pooling.

The prohibition on taking pension benefits while continuing to work has been removed; this means that retirement benefits may now be put into payment once a member reaches minimum pension age, even if the member is still in service with the employer and benefits may be brought into payment in tranches - this is designed to encourage older workers to continue in employment, while lessening the sudden impact of retirement on income and lifestyle. Many employers are allowing employees to work part-time while drawing a pension in the run up to full retirement. DTI guidance on the new age discrimination legislation (see paragraph 38.2) appeared initially to suggest that employers were required to offer flexible
retirement to their employees in order to avoid falling foul of age discrimination legislation. However, the DTI is undertaking further consultation on flexible retirement after a significant amount of pensions industry feedback and now plans to issue further guidance on this in due course. We will issue an update on the outcome of this process in due course.

38.2 Age discrimination

The much-heralded age discrimination provisions finally came into force in relation to pensions on 1 December 2006. Originally planned to be introduced on 1 October 2006, a last minute reprieve gave an extra two months to pension scheme trustees and employers to review their existing arrangements for age discriminatory practices. The final regulations were published a few days before the deadline and DWP/DTI guidance was not available until afterwards. As a result, employers and trustees have struggled to understand the new requirements and to know what actions are needed.

Essentially, from 1 December 2006 it is unlawful for trustees or employers to discriminate (directly or indirectly) against a member or prospective member of a pension scheme on the basis of age, except in relation to rights accrued or benefits payable in respect of periods of service completed before that date (regulation 11(1) of the Age Discrimination Regulations). Every pension scheme is now treated as including a "non-discrimination rule" and all provisions of a scheme will have effect subject to that rule (schedule 2, paragraph 2). The regulations also level up any discriminatory rules within a scheme.

Originally, it was envisaged there would be a blanket exemption from the age discrimination requirements for pensions; however, schedule 2 of the regulations instead sets out a series of exemptions which are not prevented by the regulations and which may continue without revision. In addition, the regulations provide that discriminatory practices will be permitted if they can be objectively justified ie shown to be a "proportionate means of achieving a legitimate aim". DWP/DTI guidance further clarifies objective justification. With reference to a "proportionate means of achieving a legitimate aim", this guidance suggests that factors that may be taken into account by employers include: business needs, efficiency, reducing staff turnover/staff retention, incentivising and rewarding staff. Cost on its own is not a sufficient reason to objectively justify a discriminatory measure, but a matrix of factors that includes cost is more likely to be acceptable. In terms of proportionality, it will need to be shown that the requirement in question actually contributes to the pursuit of the legitimate aim; that the legitimate aim being pursued has been appropriately weighed up against the discriminatory effects and that the legitimate aim cannot be achieved using any less discriminatory measure.

Trustees and employers should therefore identify rules or practices which appear to be directly or indirectly discriminatory on the grounds of age and then consider whether that rule or practice falls within the exemptions set out in schedule 2 of the regulations and if not, whether it can be objectively justified.

The list of exemptions which apply to occupational pension schemes (as well as further exemptions that apply to personal schemes) includes, for example:

- minimum or maximum ages for admission to a scheme (including different ages for admission of different groups or categories of worker) - but not the requirement to cease active membership at a particular age;

- the use of age criteria in actuarial calculations;

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equal rates of contributions to money purchase schemes, irrespective of age (despite inequality in the emerging benefits);

age related contributions to money purchase schemes (subject to the further requirement that the aim is to achieve “more nearly equal benefits”. Much debate has taken place as to what this means and how many bands of age related contributions would be necessary to satisfy the test);

the closure of a scheme to future joiners.

If a scheme's power of amendment is not wide enough to allow trustees to make the necessary alterations to ensure compliance with the non discrimination rule, the regulations provide that the trustees may make the required amendments by resolution, subject to the employer's consent. This power also applies if the scheme procedure for making the necessary amendments is unduly complex or protracted or involves any consents which cannot be obtained or which can only be obtained with undue delay or difficulty (again subject to employer consent).

Common problem areas for employers currently include whether or not to allow flexible retirement together with continued accrual for employees who remain in service after normal retirement date and how many age related contribution bands are required to achieve "more nearly equal" benefits. The revised DTI/DWP guidance for example states that two bands may be acceptable provided they achieve "more nearly equal" benefits on retirement. However, it is hoped that actuarial guidance will become available once widespread age discrimination reviews have taken place and settled case law is also available.

38.3 Consultation of employers

A further complication is the impact of the new requirement to consult introduced by the Occupational and Personal Pension Schemes (Consultation by Employers and Miscellaneous Amendments) Regulations 2006. This requires an employer to consult with its employees where it proposes to introduce one of the "listed changes" set out in the Consultation Regulations. These changes include, for example, switching from DB to DC benefits, closing a scheme to new entrants or closing a scheme to future accrual. The application of the Consultation Regulations is staggered, however, and applies to employers with 150 or more employees from 6 April 2006; 100 or more employees from 6 April 2007; and 50 or more employees from 6 April 2008. Consultation must last at least 60 days.

38.4 Codes of Practice

38.4.1 Funding Defined Benefits

The first Code to come into force in 2006 was the Code of Practice on Funding Defined Benefits, which came into effect in February 2006. These requirements apply to the trustees of most private sector funded occupational schemes providing defined benefits and deal with how schemes implement scheme specific funding under the Pensions Act 2004. A key element of this Code is the requirement to adopt a statement of funding principles, specific to the circumstances of each scheme, setting out how the new statutory funding objective will be met. Schemes must undergo periodic actuarial valuations as well as interim annual actuarial reports and trustees must agree a schedule of contributions with the scheme's principal employer.
Trustees must now set a funding target by reference to the scheme's own circumstances including its liabilities, membership profile and the strength of the employer covenant. This should be at least 100% funded on a PPF basis. A recovery plan will need to be put in place if the funding target is not met usually involving a deficit recovery period of no more than 10 years (three to five years is becoming common place). This represents a big change for most schemes and employers are facing increased contributions as a result.

38.4.2 Trustee knowledge and understanding

The Code of Practice on Trustee Knowledge and Understanding came into force in May 2006. This Code requires trustees to have sufficient knowledge and understanding to enable them to be "conversant" with their scheme - via its governing documentation and to enjoy increased confidence in their ability to carry out their roles. This will inevitably mean being familiar with trustee powers as well as duties and responsibilities under an occupational pension scheme. Trustees should understand how their own scheme operates and in the case of defined benefit schemes, the significance of the employer covenant, which will need to be assessed when considering future funding and agreeing the schedule of contributions and will usually also need to be examined by trustees when approached by an employer in relation to corporate transactions. Trustees must ensure they understand any professional advice they are given and should enter into discussion with their advisers, participating fully in decision making. The Regulator anticipates that trustees should be able to question or even challenge advice, when the need arises - this will also include being able to identify when they need particular specialist advice and when to consider reselection of advisers.

Conflicts of interest have also been put in the spotlight - trustees should identify any potential conflicts in a timely manner and be able to deal with them appropriately. The Pensions Regulator expects trustees to deal with conflicts of interest proactively, which will usually involve putting in place conflict policies and procedures for dealing with conflicts as they arise. Many schemes have now adopted conflict policies alongside risk registers in their annual business plans. These policies may set out when it is appropriate for a trustee to be absent from meetings/votes or when to step down.

Trustees are expected to select a learning regime delivered with the precise needs of the individual trustee in mind. The Pensions Regulator has introduced an online e-learning training programme for trustees, with modules available on the majority of hot topics for occupational pension scheme trustees.

38.4.3 Code of practice on internal controls

This Code sets out the Pensions Regulator's expectations of how occupational pension schemes should satisfy the legal requirement to have adequate internal controls in place and came into effect in November 2006. The Code provides guidelines on how to implement adequate internal controls, although it does not provide a prescriptive list of internal controls. Rather, it suggests a high level, risk-based approach, which trustees may follow when assessing the adequacy of their internal controls environment. The Regulator expects trustees to adopt policies which enable focus on the key risks requiring these controls as not all risks have the same potential impact or the same likelihood of materialising. Smaller schemes may
require less formalised controls than more complex larger schemes, but regardless of size, key risk areas will need to be adequately controlled. Many schemes are now setting up a risk register detailing regular tasks for mitigating risk, admin procedures and regular review.

38.4.4 Member nominated trustees and directors

The Pensions Act 2004 introduced a new simplified MNT regime, with details in regulations issued in 2006. The Pensions Regulator’s Code of Practice on MNT/MNDs - Putting Arrangements in Place came into force in November 2006. The principal change, brought in by the Pensions Act 2004, is the removal of the employer "opt-out", now making it mandatory for all affected schemes to have member nominated trustees (or member nominated trustee directors) representing one third of the trustee body. However, the level of prescription on selection processes for MNTs is reduced so that the focus is on the outcome to be achieved and not on a detailed process that schemes must follow to achieve that outcome.

Existing "opt-outs" may continue to run until the earlier of their expiry date or 31 October 2007, although MNTs or MNDs may continue in office until their term of office expires.

Trustees must ensure that within a reasonable period arrangements are in place to provide for at least one third of the trustees to be member nominated trustees. The trustees are themselves responsible for ensuring that these arrangements are implemented. In complying with these requirements, the trustees should adopt principals of proportionality, fairness and transparency. The arrangements must include the nomination process, a selection process and must comply with other statutory requirements.

The nomination process must now include all active members of the scheme and all pensioner members of the scheme. The selection of MNTs, however, must merely involve some or all of the members of the scheme. This allows trustees to adopt a selection panel where they believe it appropriate, while for some schemes, constituencies may be appropriate with each site for example appointing a trustee.

The Pensions Act 2004 has left room for the Secretary of State to amend the legislation to provide for a minimum of one half of the trustee body to be MNTs.

38.4.5 Other Codes coming into force in 2006

The Pensions Regulator also issued the following Codes in 2006:

- Early leavers - reasonable periods
- Reporting late payment of contributions to occupational money purchase schemes
- Reporting late payment of contributions to personal pensions.

A consultation report was published in May 2006 in relation to the Code of Practice on Modification of Subsisting Rights and the final Code is expected early 2007.
38.5 Moral hazard provisions and clearance: update

The Pensions Regulator was established in 2005 with wide powers to make a participating employer (or any person "connected or associated" with it) take responsibility for its under-funded final salary pension scheme via the "moral hazard provisions" in the Pensions Act 2004, allowing it to issue contribution notices or financial support directions. These powers are effective from 27 April 2004 and there is a six year look back period. However, in order that corporate activity could continue, there is a clearance procedure, whereby parties can apply to the Pensions Regulator for a statement that these powers will not be exercised in relation to the events in question. Although this process is voluntary, the Pensions Regulator has reported it received over 330 applications in its first year of operation.

Companies may apply for clearance for any transaction which could have a financially detrimental impact on an occupational final salary pension scheme within its group, including refinancing, granting security over company assets, corporate restructuring, converting unsecured debt to secured debt and dividend payments. These are known as Type A transactions.

It has become apparent that, in order to obtain clearance, the Pensions Regulator will generally require an employer to make an immediate payment to the pension scheme to eliminate at least half of any FRS17 deficit with the remainder of the FRS17 deficit being repaid over three to five years. The Regulator does expect trustees to take independent financial advice and to negotiate with the employer and in some circumstances, trustees may obtain a parent company guarantee or some form of additional security such as a charge over land.

To date, the Pensions Regulator has not exercised its powers to issue either a financial support direction or contribution notice, although it has put Sea Containers on notice that it may use the powers to require the Sea Containers group to pay $254m into its UK pension schemes. The move is against the background of Sea Containers sheltering in US chapter 11 bankruptcy protection and moves by the company to treat its UK pension scheme shortfall in line with other creditors.

The Pensions Regulator aims to be "responsive to commercial timescales" and estimates that the majority of applications are dealt with in under four weeks. However, the timescale for obtaining clearance can depend on the stage at which the trustees become involved in a transaction, which is likely to have an impact on the occupational pension scheme - ideally, the trustees should be involved as early on in the deal as possible, to give the employer and trustees the maximum amount of time to arrive at an agreed proposal to put forward to the Regulator, in applying for clearance. Since the introduction of the Regulator's moral hazard powers, pensions negotiations are now a significant part of the deal process and timetables should be adjusted to include clearance application negotiations.

38.6 Changes to pensions disclosures in accounts

See paragraph 19.8.
39. PLANNING

39.1 Mezzanine floors: the Welsh loophole

Owners and occupiers of retail property will be aware that the construction of a mezzanine of 200m² or more now requires planning permission in England. However, due to devolution of power, Wales is not yet affected as the National Assembly for Wales has yet to pass the relevant statutory instrument. As a result there may be opportunities for retail floor area increases through the installation of mezzanines for property in Wales, at least until March 2007 when the relevant Welsh legislation is expected to come into force. At present Scotland is unaffected by the mezzanine legislation.

39.2 Changes to the Use Classes Order

Further changes have been made to the Town and Country Planning (Use Classes) Order 1987 ("Use Classes Order"), to deal with changes of use affecting casinos. Casinos previously fell within class D2 (assembly and leisure) of the Use Classes Order. Previously use class D2 included use as:

- a cinema;
- a concert hall;
- a bingo hall or casino;
- a dance hall;
- a swimming bath, skating rink, gymnasium or area for other indoor or outdoor sports or recreations, not involving motorised vehicles or firearms.

A use can be changed to any other use within the same use class without an express grant of planning permission. Formerly the use of a cinema or gym, for example, could be changed to a casino without the need for express planning permission and vice versa.

However, following the Gambling Act 2005, there was concern that the number of existing D2 uses wishing to change to casinos would increase and it was considered that further regulation through the planning system was required. As a result, the Town and Country Planning (Use Classes) (Amendment) (England) Order 2006, which came into force on 6 April 2006, removed casinos from class D2.

Uses which are not specified as being within a particular use class in the Use Classes Order are known as sui generis and planning permission will almost always be required to change to or from this unless otherwise specified. In view of this change, local planning authorities will therefore now require a planning application for any premises, including existing D2 premises, to undergo a material change of use to a casino.

As the government's concern is only about existing D2 uses changing to casinos and not with casinos changing to other D2 uses, a further statutory instrument has been issued to amend the Town and Country Planning (General Permitted Development) Order 1995 ("GPDO"). The GPDO permits certain changes of use between different use classes without the need for planning permission. The GPDO has been amended by the Town and Country Planning (General Permitted Development) (Amendment) (England) Order 2006, to make any change...
from a casino to any use still falling within class D2 permitted development. As a result, a casino can still change to a cinema or a gym without needing planning permission for the change of use.

39.3 New Planning Policy Statements and Circulars

39.3.1 Planning Policy Statement 3: Housing

PPS3 was published at the end of November replacing PPG3 with a new national policy framework for planning for housing at the local and regional levels. It provides an enabling framework for local planning authorities, working with their stakeholders, including developers, to deliver both the right quantity of housing to address need and demand in their areas, and the right quality and mix of housing for their communities.

See the following link for a full copy of PPS3:


39.3.2 Planning Policy Statement 25: Development and Flood Risk

Planning Policy Statement 25 which replaces Planning Policy Guidance Note 25: Development and Flood Risk (published July 2001) was published on 7 December 2006 and sets out government policy on development and flood risk. Its aims are to ensure that flood risk is taken into account at all stages in the planning process to avoid inappropriate development in areas at risk of flooding, and to direct development away from areas of highest risk. Where new development is, exceptionally, necessary in such areas, policy aims to make it safe, without increasing flood risk elsewhere, and, where possible, reducing flood risk overall.

See the following link for a full copy of PPS25:


39.3.3 Minerals Policy Statement 1: Planning and Minerals

Minerals Policy Statement 1 (MPS1) replaces MPG1: General considerations and the development plan system with an overarching planning policy document for all minerals in England. It provides advice and guidance to planning authorities and the minerals industry to ensure that the needs of society and the economy for minerals is managed in an integrated way against its impact on the environment and communities.

See the following link for a full copy of MPS1:

39.3.4 Circular 01/06 (ODPM): Planning for Gypsy and Traveller Caravan Sites

This Circular provides updated guidance on the planning aspects of finding sites for Gypsies and Travellers and how local authorities and Gypsies and Travellers can work together to achieve that aim. This replaces Circular 01/94: Gypsy Sites and Planning

See the following link for a full copy of the circular:


39.3.5 Circular 01/06 (Communities and Local Government): Guidance on Changes to the Development Control System

This Circular contains guidance on changes to the development control system implemented by the commencement of provisions in the Planning and Compulsory Purchase Act 2004 and changes to the General Development Procedure Order.

See the following link for a full copy of the circular:


39.3.6 Circular 02/06 (ODPM): Changes to Planning Regulations for Casinos

This Circular offers guidance on the changes to planning regulations (the Use Classes Order 1987 and the General Permitted Development Order 1995) regarding casinos.

See the following link for a full copy of the circular:


39.3.7 Circular 02/06 (Communities and Local Government): Crown Application of the Planning Acts

This Circular contains guidance on Crown development following the commencement of Part 7 of chapter 1 of the Planning and Compulsory Purchase Act 2004, which ends the Crown's immunity from the planning system by applying the planning Acts to the Crown.

See the following link for a full copy of the circular:


39.3.8 Circular 04/06 (ODPM): Planning Inquiries into Major Infrastructure Projects: Economic Impact Reports

This Circular offers guidance on the preparation of economic impact reports for major infrastructure projects.
See the following link for a full copy of the circular:


39.3.9 Circular 04/06 (Communities and Local Government): The Town and Country Planning (Flooding)(England) Direction 2007

This circular sets out the provisions of the Town and Country Planning (Flooding)(England) Direction 2007.

See the following link for a full copy of the circular:


39.4 Planning gain supplement

Kate Barker's Review of Housing Supply (March 2004) led to a government consultation on a planning gain supplement ("PGS") intended to capture a proportion of the increase in value achieved by landowners as a consequence of the grant of planning permission. In his pre-budget report on 6 December 2006 Chancellor Gordon Brown announced that there would be a further consultation on PGS to ascertain whether a workable and effective approach could be found (this consultation has already commenced with a return date of 28 February 2007) and that a workable and effective approach would not be introduced earlier than 2009.

See the following link for a full copy of the consultation:


39.5 Challenge to Environmental Impact Assessment ("EIA")

In European cases C-290/03 (R v London Borough of Bromley, ex parte Barker) and C-508/03 (Commission v UK), the ECJ held that the UK had incorrectly transposed the requirements of the EIA Directive into national law by virtue of the fact that under the EIA Regulations an assessment as to whether an EIA is required should be carried out at the outline planning permission stage and not at the reserved matters stage. The ECJ stated that articles 2(1) and 4(2) of the EIA Directive must be interpreted as requiring an EIA to be carried out at the reserved matters stage if it becomes apparent at that stage that the project is likely to have significant effects on the environment by virtue of its nature, size or location.

As a result the Department for Communities and Local Government ("DCLG") issued interim guidance to LPAs regarding the need for Environmental Impact Assessments at the reserved matters stage of the planning process. In a judgment handed down on 6 December 2006 in R (on the application of Barker) v Bromley London Borough Council [2006] UKHL 52 the House of Lords agreed with the ECJ and it is expected that further guidance will be issued by the DCLG shortly.
Barker Report on the planning system

The final report and recommendations of the Barker Review of Land Use Planning was published on 5 December 2006.

The report's terms of reference were:

"To consider how, in the context of globalisation, and building on the reforms already put in place in England, planning policy and procedures can better deliver economic growth and prosperity alongside other sustainable development goals. In particular to assess:

- ways of further improving the efficiency and speed of the system;
- ways of increasing the flexibility, transparency and predictability that enterprise requires
- the relationship between planning and productivity, and how the outcomes of the planning system can better deliver its sustainable economic objectives; and
- the relationship between economic and other sustainable development goals in the delivery of sustainable communities."

The report makes a number of recommendations that include:

- streamlining policy;
- updating PPS4;
- new systems for dealing with major infrastructure projects;
- a positive planning culture;
- enhanced fiscal incentives to ensure efficient use of urban land;
- a review of green belt boundaries;
- more risk based and proportionate approach to regulation;
- removal of need for planning permission for minor commercial developments;
- supporting town centre first policy without having to demonstrate need;
- measures to allow local authorities to share in benefits of economic growth;
- a reduction in the number of Secretary of State "call ins";
- ensuring planning resources are sufficient, with links to improved performance;
- more efficient processing of applications;
- a faster appeals system;
• improved skills and higher profile for the Chief Planner.

The government has indicated that a white paper will be issued in the New Year as a response to these recommendations.

A full copy of the report can be found at:

mmendations_id1504876.pdf

40. PRODUCT LIABILITY

40.1 Skov Æg v Bilka Lavprisvarehus and others (case C-402/03)

A decision of the ECJ in January 2006 on the EU Product Liability Directive (85/374/EEC) carries a stage further existing case-law which has emphasized that the purpose of that directive is the total harmonisation of the law of the member states governing strict liability for defective products. It holds that the terms of the directive precludes national rules under which a supplier other than a producer is answerable for the no-fault liability which the directive establishes and imposes on the producer, other than in the specific cases mentioned in Article 3 of the directive. The exceptions in article 3 apply where the supplier is an "own-brander" or an importer, or where the producer or importer cannot be identified and the supplier has failed to notify the injured party within a reasonable time of the identity of the producer or the person who supplied him with the product.

The case also casts some doubt on whether national provisions such as the statutory provisions in the Sale of Goods Act which impose strict liability on suppliers can continue to be enforced in circumstances where a consumer is given a remedy against the producer under the directive. While the case may not in fact have such quite drastic implications, it highlights the importance of bringing product liability proceedings against the producer where the directive applies and not simply relying on the remedies against the retailer under sale of goods law.

The case involved litigation in Denmark resulting from the salmonella poisoning suffered by two consumers who had eaten eggs purchased from a retailer. The consumers successfully sued the retailer from whom the eggs were purchased, who in turn successfully sought compensation in the same proceedings from the producer, on the basis of Danish statutory provisions which purported to implement the Product Liability Directive but also maintained pre-existing Danish case law. This case law, in addition to imposing strict liability on producers, made suppliers answerable to consumers for the liability of economic operators further up the production and distribution chain. Both the producer and the retailer appealed on the basis that the Danish law did not faithfully transpose the directive. The Danish appeals court referred the matter to the ECJ for a preliminary ruling.

The ECJ referred to previous case law which had concluded that the purpose of the directive was the total harmonisation of the law on product liability, and having decided that suppliers were only intended to be liable on the basis of strict liability in a few precisely defined circumstances, held that suppliers could not be held liable on that basis in any other circumstances.

Although Article 13 of the directive provides that the directive is not to affect any rights which an injured person may have according to the rules of contractual or non-contractual
liability, or a special liability system existing at the moment of the adoption of the directive, that Article was interpreted restrictively by the ECJ. The operative part of the court's judgment has been interpreted by commentators as meaning that national laws in these categories can only be upheld where they are based on fault, as opposed to the strict liability provisions of the directive.

The court refused to take into account minutes of discussion in the Council of Ministers according to which the relevant articles in the directive were not considered to prevent member states from laying down national rules regarding liability for intermediaries. The court also refused to accept arguments that the effect of this interpretation of the directive was to reduce consumer protection, by limiting the scope of the remedies available to producers.

On the face of it, the decision has adverse implications for the UK because, under English law, contractual obligations, including those under statutory provisions such as the Sale of Goods Act, are regarded as being based on strict liability. This means that the key question in deciding whether a contractor is in breach is simply whether he has failed to deliver on what he has promised. If he has so failed, it is not generally relevant whether or not that was due to his fault. This is contrary to the position in most continental systems, where the starting point is that contractual liability is in principle based on fault. However, in practice the differences in that respect are not as great as might appear, because this is only the starting point, and in many cases liability is also for practical purposes strict. Nevertheless, if article 13 only applied to fault-based liability rules, as commentators on the case seem to imply, it would mean that the rules of the Sale of Goods Act could not be used to provide consumers with an additional remedy against retailers in any case where the directive applied.

However, buried in the text of the Skov Åeg judgment is the suggestion that Article 13 does not solely apply to preserve the position of national rules based on fault, but also those based on breach of warranty. It can be argued that this is indeed the basis of the liability, under the provisions of the Sale of Goods Act, of a retailer who has supplied a defective product, and therefore the separate remedy against retailers in the UK is preserved.

Undoubtedly the Danish statutory provisions invited the criticism of the court, because they essentially sought to impose the identical liability as the producer incurs under the directive on the retailer, in circumstances where the retailer was not intended under the terms of the directive to bear it. There was therefore a clear failure to transpose the directive correctly. This is not quite the same as the position under English law, where the liability under the Sale of Goods Act has an entirely different character. It is perhaps unfortunate that the court did not make it clear that it was not intending to cast doubt on the rules applicable in England and Wales, and the similar rules which apply in Scotland and Ireland.

As matters stand, the position under English law does not appear to be free from doubt, and there may be future litigation on the point in this country. Undoubtedly the recommended course of action where damage has been done by a defective product is to sue the producer as well as, or even in preference to, the retailer, in case it is argued that the retailer's liability is incompatible with the directive.

Until fairly recently it would appear that the provisions of the Product Liability Directive and of Part I Consumer Protection Act 1987, which transposes it in this country, have not been the subject of case law very frequently. This may begin to change, and undoubtedly it was one of the intentions of the ECJ to give the directive greater prominence in all member states.
40.2 Master Declan O’Byrne v Aventis Pasteur MSD and Aventis Pasteur SA. (Case C-127/04)

A further important case in February 2006 concerned the provisions on limitation under the Product Liability Directive and the question as to when a defective product can be said to have been put into circulation.

The case related to injury caused by a defective vaccine which was manufactured in France by a French company but then purchased in fully finished and packaged form by that company's wholly owned UK subsidiary which marketed and distributed it. The claimant brought proceedings against the subsidiary, as his lawyers thought just before the expiry of the ten-year limitation period which applies from the date when the product is put into circulation. However, the subsidiary argued that the product had been in fact put into circulation in the date when the product was transferred to it by the French manufacturing company, which had been about a month more than ten years before the proceedings were brought.

The ECJ decided that a product is put into circulation when it is taken out of the manufacturing process operated by the producer and enters a marketing process in the form in which it is offered to the public for sale or consumption. However, it is possible that a product is not put into circulation on transfer to a closely related distributor if the distributor carries out an activity which is part of the production process and is not a pure distributor. This is an issue of fact for the national courts, and it is irrelevant whether or not the distributor has separate legal personality, or whether or not title to the product has passed.

A further issue was raised as to whether substitution of the true manufacturer was permitted in these circumstances. The court declined to rule on the matter, holding that it was a matter for the national courts. However, it said that it was only appropriate to substitute a company which fell within the definition of a producer in the directive. This should not be done lightly and on the basis of the objective criteria which Article 11 of the directive provided for the time limits within which the proceedings must be brought.

In the event, when the matter came back before the High Court in October 2006, the court had no difficulty in deciding that in the circumstances of this case it was appropriate to substitute the original manufacturer, which was clearly the producer, as the defendant. Notwithstanding this, claimants lawyers will clearly need to pay attention in future to the issue as to when products can be said to have been put into circulation in these circumstances.

41. REAL ESTATE: SCOTLAND

For REAL ESTATE: ENGLAND, see section 42.

41.1 E-registration: automated registration of title to land ("ARTL")

ARTL is a paper-free system under which applications to register the transfer of the whole of registered land are effected. The key elements of automated registration are:

- the concept of an "electronic transfer" using "digital deeds" held in the ARTL system and prepoppedulated with authentication by solicitors to a transaction rather than paper deeds or documents.

- legislative changes eg in respect of electronic signatures and registration practice.

Excellence through know-how
• cost benefits which should come from the potential for reduction in administration costs and removal of levels of bureaucracy for the Land Register, solicitors, lenders and other government departments.

• the intention is to create a one-stop shop for solicitors who use ARTL so that they do not have to contact HMRC separately with regard to SDLT. SDLT will be collected by the Keeper by direct debit on behalf of HMRC. Solicitors will be able to complete an electronic Land Transaction Return or electronic self-certificate as part of the ARTL process.

The ARTL system is being piloted in early 2007 with a full roll-out across Scotland to all solicitors and lenders in Spring 2007.

Further information is available from http://www.ros.gov.uk/artl/index.html

41.2 Fire safety: the demise of fire certificates

Previous fire safety legislation in Scotland has been replaced by the Fire (Scotland) Act 2005, as amended, and the Fire Safety (Scotland) Regulations 2006.

In general, the legislation seeks to ensure the safety, in the event of fire, of persons (whether they are employees, residents, visitors or others) by setting out the rights and responsibilities of persons in respect of fire safety. Basically anyone who has control to any extent of the premises will have some responsibilities for ensuring that those occupying the premises are safe from harm caused by fire. Fire certificates will no longer be issued.

Duties imposed by the legislation fall into seven general categories:

• carrying out a fire safety risk assessment of the premises;

• identifying the fire safety measures necessary as a result of the fire safety risk assessment outcome;

• implementing these fire safety measures using risk reduction principles;

• putting in place fire safety arrangements for the ongoing control and review of the fire safety measures;

• complying additionally with the specific requirements of the fire safety regulations;

• keeping the fire safety risk assessment and outcome under review; and

• record keeping.

Further information is available from http://www.infoscotland.com/firelaw/template_summarys.jsp?pContentID=23&p_applic=CC&C&p_service=Content.show&

41.3 Purchaser's information packs

Part 3 of the Housing (Scotland) Bill makes provision for purchaser's information packs to be introduced, although the information to be contained in the purchaser's information pack has
still to be specified. Despite the failure of the pilot scheme, the single survey is also to be introduced. The intention is that this survey, commissioned by the seller at the start of the marketing process, will provide in depth, quality information to buyers about the condition and value of the house and reduce the problem of multiple surveys. The insistence on retaining the survey is in stark contrast to the position in England where the requirement to provide home condition reports has been dropped. These provisions are expected to come into force in 2007.

Further information is available from http://www.scotland.gov.uk/Topics/Housing/Housing/16193/BuyingSelling/18223/PIPsection/PIPIntro

41.4 New cases dealt with under the Title Conditions (Scotland) Act 2003

The owners of a house in an estate and a developer who owned a small parcel of unbuilt ground behind the house, applied to the Lands Tribunal for discharge of title conditions to enable the demolition of the house, allowing the ground to be sold to make way for an access road through to a proposed new neighbouring housing development, outline planning permission for the development having already been granted. It was held that it was not reasonable to grant the application for discharge as the objector's house would have been significantly affected by the demolition of its immediate neighbour and the building of a road, which would carry construction traffic turning just outside the house over a period of years, and this gave the objector a strong enough interest, even when account was taken of the original proposal to develop through the gap site, to outweigh the interest in exploiting a windfall value.

*McPherson v Mackie, Lands Tr, J N Wright, QC, K M Barclay, FRICS, 28 February 2006.*

The proprietors of a large double penthouse flat in a development of flats and offices in a converted warehouse applied for variation of a title condition so as to allow subdivision into two smaller penthouses. The other proprietors of flats in the development objected to the application on the basis that the purpose of the condition was to preserve the amenity of the development by preventing the creation of additional flats, no exception thereto had been made for the penthouse and there was no basis for suggesting that it was inapplicable; there was no relevant change; there were potential difficulties in future management which would be exacerbated if one owner could vary the conditions; variation would disturb the *status quo*; and it was notable that more than 60 proprietors were maintaining objections. It was held, granting the application, that on consideration of the statutory and other relevant factors, subdivision of the flat was an entirely reasonable use of it and to allow it, along with the corresponding revision of the common charges, would have no significant impact on the body of proprietors, nor would it open the floodgates or otherwise disturb the integrity of the management system, notwithstanding that there had been no material change of circumstances and the lack of convincing evidence of difficulty in selling.

*Regan v Mullen, Lands Tr, J N Wright, QC, K M Barclay, FRICS, 17 February 2006.*

The joint proprietors of a 1960s low level bungalow sought discharge or variation of title conditions to permit them to demolish the bungalow and erect two two storey detached houses, for which they had planning permission, in its place. The immediate neighbours and benefited proprietors of the title conditions, objected primarily on the basis that they would be affected by a loss of natural light in one room at the side of their house if the proposals proceeded. It was held, granting the application by varying the title conditions to the extent
necessary to permit the proposed development on which the application was based, that the
neighbours were benefited proprietors in relation to an obligation not to build more than one
dwellinghouse, the question of natural light could fall within an aspect of the amenity
protection given by the title condition, but weighing up all the relevant factors including that
the purpose of the condition was not really to protect against overshadowing but did include
some protection of physical amenity; there had been some, but not very much, change in the
neighbourhood; the existence of the condition prevented the carrying out of the development
for which planning permission had been granted; and the height or depth of the nearest house
would have a noticeable impact on the natural light enjoyed by the objector's house although
it remained within the constraints of the actual building restriction, it was reasonable to grant
the application. The benefit derived from the condition was outweighed by the burden on the
applicant.

_Daly v Bryce, Lands Tr, J N Wright, QC, K M Barclay, FRICS, 28 April 2006._

### 41.5 Access rights under the Land Reform (Scotland) Act 2003

In Scotland, the right of access extends to the whole of Scotland with certain exceptions.
There have been several high profile cases of landowners challenging the public right of
access enshrined in this Act. The first one was settled out of court after the landowner came
to an agreement with the local authority and the remaining cases are currently going through
the courts. In all of the cases the landowners have erected fences or locked gates so as to
prevent public access. The defences put forward range from fear of kidnap or burglary to the
need to maintain privacy. Under the Act the right of access does not include "sufficient
adjacent land" around houses which is necessary to ensure a reasonable measure of privacy
and no unreasonable disturbance of enjoyment. What constitutes "sufficient adjacent land" is
also up for debate with landowners claiming that they require as much as 12 or 70 acres or
even 15,000 acres in one case!

The approach adopted in England is completely different, with access being granted only to
designated areas of open country.

Further information is available from [http://www.outdooraccess-scotland.com/](http://www.outdooraccess-scotland.com/)

### 41.6 Break options

In a recent Scottish case, the tenants had an option to break the lease (by notice given to the
landlords at their registered office) which they wished to exercise. In error, the notice was
addressed to the landlords' holding company at an address supplied for that company.
Considerable correspondence and invoices from the landlords' various agents relating to the
lease had borne the name of the holding company, although some had borne the landlords'
name. The notice was received by the common director of the landlords and the holding
company. He was not misled by the error, and chose deliberately not to draw it to the tenants'
attention until after the latest date for service, as the landlords did not wish the break option to
be exercised. It was held that the notice had not been validly served: notices unilaterally
altering the rights of the parties must comply strictly with the terms of the lease.

This case is in stark contract to the English decision in _Mannai Investment Company v Eagle
Star_ where the English courts rescued a faulty notice on the basis that a reasonable landlord
would understand what the tenant was attempting to do. It was held that it would have been
obvious to the landlord that the tenant wished to terminate the lease on the third anniversary
date, but had made an immaterial error in wrongly describing the date as the 12th instead of the 13th.

The Ben Cleuch case is currently under appeal.


### 41.7 Landlord's consent

This case considered whether landlord's consent to a sublease was unreasonably withheld. Rachel was the landlord and Burgerking was the tenant of premises in High Street, Paisley. The lease was due to expire in September 2009. The rent was £112,000 per annum, this figure having been set in 1989. Evidence at the proof, however, suggested that by late 2004 the market rent was in the region of £75,000. The alienation clause in the lease provided that the tenant was not to assign or sub-let except with the prior written consent of the landlord:

"such consent not to be unreasonably withheld or delayed in the case of a substantial and respectable assignee or sub-tenant … who is of sound financial standing and is in the reasonable opinion of the landlord demonstrably capable of performing the tenant's obligations under the lease…every permitted sub-lease shall be in consideration of a full market rent."

Burgerking wanted to dispose of the restaurant as it was losing money and found a proposed sub-tenant, Quids In.

Burgerking sought consent to the sub-lease in favour of Quids In for the remaining term of the lease at the passing rent of £112,000 with Burgerking paying Quids In a reverse premium of £25,000 per quarter. The application was refused, firstly on the basis that the landlord was not convinced that the sub-tenant met the test in the lease and, in particular, it was concerned as to whether it could meet the financial obligations and, secondly, the application was refused because of the reverse premium as the landlord took the view that this meant that a full market rent was not being paid.

Lord Drummond Young found that the first reason for refusing consent which was based on the financial standing of the proposed sub-tenant was not the act of a reasonable landlord. The second ground for refusing consent which related to payment of the reverse premium was however the act of a reasonable landlord. Lord Drummond Young was of the view that the two reasons were independent of each other. In those circumstances, the validity of one reason was sufficient for the landlord's decision to be upheld. He therefore found in favour of the landlord.


### 41.8 Interim possession of disputed property

The landlords wanted to enter the tenant's subjects to carry out significant works to the common parts of a large office building but the tenants had refused access. At first instance, the landlords were granted an interim possession order under section 47(2) of the Court of Session Act 1988 on the basis that they were the sole judge of whether repairs were required.
and, if they judged that they were, they had an absolute right to enter the premises to carry them out. The Inner House overturned that decision and held that an interim order for possession by the landlords to carry out the works would effectively decide the matter, and the status quo was preserved by allowing the tenants peaceable enjoyment of the premises. The question was raised as to whether section 47(2) could apply where the court was not really dealing with 'possession per se.'


41.9 Liability of lenders for their agents

How closely must a lender scrutinize the acts of their agents?

This important case last year suggests quite a lot. The action followed upon the repossession of the pursuer's property by the defenders (a bank). The pursuer claimed that his property had been sold at undervalue as a result of the failings of the defenders' surveyors who were marketing the property. The surveyors advertised the property on the closing date only and did not approach any of their contacts to generate interest. The defenders maintained that the price obtained was the best price in terms of the Conveyancing and Feudal Reform (Scotland) Act 1970. The court found in favour of the pursuer. It stated that the surveyors' had been negligent and the defenders were therefore responsible for their failings in terms of section 25 of the 1970 Act.

Wilson v Dunbar Bank plc

Further information can be found at: http://www.scotcourts.gov.uk/opinions/2006CSOH105.html

41.10 The extent of repairing obligations

The question arose in this 2006 case as to whether repairing obligations in a lease covered items at the end of their economic life. The pursuers (the landlords) sought to recover the cost of repairs relating to the replacement of certain electrical items which had reached the end of their economic life according to guidelines of the Chartered Institute of Building Services Engineers. The defenders (the tenants) argued that the pursuers' basis for replacing the items was not relevant as the obligation on them in the lease was to maintain and renew the subjects to keep them in good and substantial repair and the pursuers did not suggest in their pleadings that any of the items were in fact defective. Lord Reed in the Outer House found in favour of the defenders.

Westbury Estates Ltd v The Royal Bank of Scotland Plc

Further information can be found at: http://www.scotcourts.gov.uk/opinions/2006CSOH177.html
42. REAL ESTATE: ENGLAND

See also PLANNING, section 39. For REAL ESTATE: SCOTLAND, see section 41.

42.1 Land registration reforms affecting squatters and easements

Two planned changes to land registration law, both taking forward the major reforms of 2003, took effect on 13 October 2006.

First, those who had acquired rights acquired by adverse possession under the Limitation Act 1980 (commonly referred to as "squatters rights") in 2003 are now in a weaker position if they do not take steps to regularise their position by applying to become registered proprietors. A key theme of the 2003 reforms was to reduce the effect of adverse possession in relation to registered land, whilst recognising the principle of squatters' rights. As to a challenge to the pre-2003 law relating to adverse possession, see paragraph 42.18.

Secondly, those who enjoy the benefit of an unregistered legal easement are now at a disadvantage unless they take steps to register their rights. Another key theme of the 2003 reforms was to bring about a more comprehensive register.

http://www.landreg.gov.uk/

42.2 Real estate investment trusts arrive in the UK

It will be possible to create UK real estate investment trusts ("REITs") from 1 January 2007 and a number of property businesses (including such well known companies as British Land, Land Securities and Hammerson) have been gearing up to convert to REITs. The tax advantages of such a move are referred to at paragraph 45.9.1, though one key feature of REITs is that they are tax transparent in that tax is not levied on the REIT but on the investors (subject, of course, to any reliefs and exemptions that the investors may enjoy).

Other advantages of REIT status include the provision of tax transparent opportunities for all investors to share in the success of real estate investment. For example, the shopping centre sector has been very buoyant for some time and London office rents have been soaring. However, such opportunities have, so far, been open only to major players in the real estate market able to acquire a whole centre or office block. In addition, REITs may well also feature in the housing market and the UK government hopes that specialised REITs will assist in delivering the changes required under Kate Barker's 2004 report, Delivering Stability: Securing our Future Housing Needs. Further, investors will enjoy liquidity as their holding will comprise shares in listed companies; many investors will feel comfortable that REITs are subject to the stringent UK listing rules.

The changes are certain to alter many parts of the real estate industry. A number of mergers (for example, between Derwent Valley and London Merchant Securities) and acquisitions of property companies have been completed in readiness for acquiring REIT status.

REITs will join the ranks of other indirect investment vehicles but offer a combination of advantages that a wide range of investors will find appealing.

http://www.hm-treasury.gov.uk/
42.3 A relaunch of the Code of Practice for Commercial Leases

The working party behind the 2002 version of the Code of Practice for Commercial Leases, which included representatives of both investors and occupiers and the respective professional bodies for solicitors and chartered surveyors, has reconvened and is about to publish a shorter and more concise version of the Code. One objective of the working party is to make the new version of the Code more user-friendly than its predecessor and so to articulate a demand by tenants for more flexible lease terms. The main objective, though, is to deter the government from regulating the commercial letting market.

Key features of the new version of the Code include: allowing permitted sub-lettings to be tied only to the market rent and not the passing rent; not requiring an authorised guarantee agreement unless the proposed assignee is of a lower financial standing than the assignor; and the provision by landlords of details of all insurance commissions received by them.

Service charges are to be covered in detail by a separate code, as to which see paragraph 42.4.

http://www.commercialleasecodeew.co.uk/

42.4 A relaunch of the Code of Practice on Service Charges

In September the Royal Institution of Chartered Surveyors ("RICS") relaunched its Code of Practice on Service Charges in Commercial Property. Leading representative bodies were involved in the preparation of a draft of the third edition of the Code which is to take effect on 1 April 2007. Like previous editions, the Code cannot override the provisions contained in existing leases. However, landlords and tenants are expected to adopt the Code as a best practice measure both in relation to the management of property held under existing leases and in the negotiation of new or renewal leases.

Key themes of the revised Code include: value for money; the provision of information by means of continuous communication; and transparency. Under the new edition of the Code owners, occupiers and managers will be able to make informed comparisons between buildings, thanks to the widespread use of Jones Lang Lasalle's OSCAR (Office Service Charge Analysis Report, standardised cost codes compatible with the concept of Total Occupancy Costs used by many tenants). Some other key points include: inducements are to be borne by landlords, not tenants; suppliers of services are to enter into service level agreements; service contracts will be awarded as a result of competitive tendering; and management fees will not be linked to the total amount of service costs.

A major feature of the new edition of the Code is the RICS's introduction of alternative dispute resolution. This could be effected by the RICS's own quality-assured Dispute Resolution Service, which offers a range of methods for resolving disputes. Critically, though, the new edition of the Code is to have the status of an RICS guidance note; the RICS is to manage compliance by its own membership with the Code and, if necessary, take disciplinary action against those members found to be in "substantive transgression" of it.

A High Court judge remarked on the need for reform of the law on commercial service charges in a case in which a landlord who delayed in carrying out repairs to the roof of its property was found to be in breach of its covenant to use all reasonable endeavours to procure the repair. The landlord could not rely on a delay in its works schedule so that the time-limited cap on the tenant's service charge liability would expire, even though there was no suggestion that the landlord had deliberately caused the delay. See paragraph 42.15 for a case
which raised questions as to the division between highly-regulated service charges relating to residential property and service charges relating to commercial property.

http://www.rics.org; princes house ltd v distinctive clubs ltd/

42.5 Fire safety reforms: risk assessment replaces fire certificates

An overhaul of fire safety in non-residential buildings took effect on 1 October. The new regime is no longer based around fire certificates but, like general health and safety, a regime of risk assessment. Few practical changes will be required for well-run properties. However, there are obligations for the various parties involved in multi-occupied buildings to consult each other and to co-operate so that their respective fire safety plans are co-ordinated. In addition, the new regime applies to vacant buildings and expressly protects those in the vicinity of (rather than merely in or on) buildings. The Department for Communities and Local Government has issued a good deal of guidance on the new regime aimed both at fire safety specialists and at others.

For further details, see paragraph 23.4. See, also, http://www.communities.gov.uk/

42.6 Town and village greens: the effect of the Commons Act 2006

For developers, the critical parts of the Commons Act 2006, which gained royal assent in July 2006, are those which re-state the tricky rules which govern town and village greens and which are likely to come into force during 2007. Such greens are defined by the Act as land on which "a significant number of the inhabitants of any locality, or of any neighbourhood within a locality, have indulged as of right in lawful sports and pastimes on the land for a period of at least 20 years". Note that building on a town or village green is an offence and that pressure groups provide objectors to development with advice as to how to apply for and obtain registered green status for all sort of land (some of which is not green in nature). The re-stated rules contain some provisions which are not developer-friendly. In particular, they will operate sometimes to stall development for up to five years until the risk of registration passes and measures taken currently by landowners to prevent green status being obtained will not be as effective.

http://www.defra.gov.uk/

42.7 Disability discrimination

The Disability Discrimination Act 2005 came fully into force on 4 December 2006. It complements the 1995 Act and its key feature for owners and managers of commercial premises are:

• to outlaw unjustified discrimination by them against a disabled person who is (or wishes to be) a tenant or licensee;

• to compel them to take reasonable steps to change any practice which makes it impossible or unreasonably difficult for a disabled person to take possession of the premises or to enjoy the premises and all benefits related to that possession;

• to oblige them to take reasonable steps to provide an auxiliary service in order to make it easier for a disabled person to take occupation of the premises or to enjoy the premises or any such benefit; and
• to make them change or waive a term of a lease or licence which prohibits any alterations to the premises, to the extent necessary to allow a tenant or licensee (at his or her own expense and subject to reasonable conditions including conditions as to reinstatement) to make alterations needed by reason of the disabled occupier's disability.

The retailer Debenhams has entered into a formal agreement under the Disability Discrimination Act 1995 with the Disability Rights Commission to improve access in its stores. This step has been taken by the Commission in lieu of enforcement action.

http://www.drc-gb.org/

42.8 Stamp duty land tax: developments

For further details as to stamp duty land tax ("SDLT") see paragraph 45.9.2.

In response to feedback from customers, Revenue & Customs has published new guides aimed at explaining how to file lease transactions online, in particular, multi-property lease transactions where mistakes are commonly made.

Practice has developed in relation to sub-sales. SDLT is levied only once on a chain of sub-sales, however long, if they are completed at the same time. The law differs from the position in relation to stamp duty which prevailed until December 2003 under which there had to be a single conveyance or transfer involving all the parties executing one document. Now there can be multiple transfers, with tax being payable only by the ultimate purchaser (on the consideration paid by it). There is an argument that multiple transfers and sub-transfers of the same property cannot in law be completed all at the same time because there must be a scintilla of time between each element in the chain; however Revenue & Customs does not take this point and have allowed relief. Intermediate purchasers will still need to submit an SDLT return in order to claim relief.

http://www.hmrc.gov.uk/

42.9 Unfair contracts relating to land: developments

The Law Commission has recommended a reform of legislation dealing with unfair contracts (see paragraph 6.21). If implemented, these reforms would extend the present protection of consumers and introduce a new regime to protect small businesses. Note that some contracts relating to land are already affected by the present law: there have been court challenges to residential tenancy agreements and the Office of Fair Trading has found many of the terms surrounding auctions to be opaque and potentially unfair.

It is against this background that the RICS auctions group, which includes DLA Piper, has published guidance for real estate auctioneers on the effects of consumer law on auctioneers' appointments and on auctioneers' rules as to the conduct of auctions. However, another motivation for taking this step has been the emergence of more individuals both bidding at and selling through real estate auctions; note the growth of the buy to let sector and the emergence of individuals investing in commercial property.

42.10 Proprietary estoppel and abortive deals

Sometimes, when things do not work out on a deal, the parties cannot just walk away. As well as the law relating to contractual formalities, the courts can apply equitable principles to deal with unconscionable conduct in negotiations. When the Court of Appeal applied those principles in July, it led to what seemed at first to be a surprising result.

A landowner and a developer reached an oral agreement about the redevelopment of some flats in Knightsbridge. There was quite a lot of renegotiation of that oral agreement and each party gave the other the impression that a formal contract would be concluded in due course, but no formal contract was ever prepared, let alone signed. The developer, with the owner's knowledge and support, put time, skill and money into obtaining planning permission for the redevelopment. With the planning permission in place the owner tried to walk away from the deal and strike a completely different one. The developer successfully showed that the owner's conduct was unconscionable and so the court awarded him one half of the uplift in value of the property in consequence of the grant of planning permission.

*Yeoman's Row Management Limited and another v Cobbe* [2006] EWCA Civ 1139

42.11 Protecting a landlord's right to collect rent arrears

When there is a delay in settling a rent review, landlords now need to protect their right to recover any backdated increase by serving regular notices on previous tenants. The High Court has said that back-dated increases in rent following a delayed rent review become due for payment on each of the relevant rent payment dates during the period of delay, rather than after the new rent is determined.

If the current tenant fails to pay the backdated increase, the landlord may want to claim against a previous tenant who is still liable. The landlord will only succeed in this if notices of the amount claimed have been served on the previous tenant within six months of the due dates for payment. This is the effect of section 17 of the Landlord and Tenant (Covenants) Act 1995. This applies even though on the due dates the landlord may not know the amount of any increase and the current tenant is not obliged to pay that backdated increase until it is finalised.

A final decision in a rent review process can often be delayed for several years after the relevant review date. If notices have not been served on previous tenants within six months after each rent payment date, the previous tenant cannot be made liable for the part of the backdated rent increase attributable to that rent payment date. Landlords should set up a procedure to protect themselves. When a rent review is instigated, all previous tenants who may have a potential liability should be identified. Shortly after the review date and each subsequent rent payment date, a notice should be served on each such previous tenant stating that an increase in rent has become due and that the landlord may seek to claim it if the current tenant defaults. The notice should state the increase at the highest level the landlord claims rather than the amount expected to be achieved. The notice should also state that the eventual liability may exceed the level stated. If this statement is not included, the landlord's claim against the previous tenant will be capped at that level.

*Scottish & Newcastle plc v Raguz* [2006] EWHC 821 (Ch)
42.12  When black means white - and what solicitors should do about it

The courts can correct obvious mistakes in documents. This is quite separate from the power the courts have to order rectification. An example of an obvious mistake corrected by the Court of Appeal was a break clause in a lease which stipulated that the landlord’s right to determine a lease was dependent on the tenant having complied with its own covenants in the lease. As the trial judge said: "A landlord needs a condition of this kind in relation to its right to break in the same way that a fish needs a bicycle". As it turned out, the tenant's solicitor had spotted the landlord's drafting error but decided not to mention the matter with a view to giving his client an advantage. The Court of Appeal also gave guidance on how solicitors should be expected to act when they know an opponent has made an error. A solicitor should, of course, act wholeheartedly in the best interests of his client, but there is a line between that and failing to act appropriately when negotiations between lawyers result in erroneous documents. The case showed that, if that line is crossed, there is a risk that the courts will step in and order the correction of obvious mistakes.

*Littman v Aspen Oil (Broking) Ltd* [2006] EWCA Civ 1579

42.13 Remedies for infringing rights of light

Even in today’s brightly lit times, money is sometimes not sufficient compensation for an infringement of rights of light. A recent case resulted in a developer being ordered by the Court of Appeal to pull down part of its mixed-use development. The unanimous judgment contains a detailed review of existing case law and clarifies the principles on remedies for infringement of rights of light. In particular, it was not up to the claimant to prove that he was entitled to an injunction and the fact that injunction had a serious effect on the defendant was not the sole decisive factor.

*Regan v Paul Properties DPF No 1 Ltd* [2006] EWCA Civ 1319

42.14 Commonholds become bankable

Since commonholds were approved as security by lenders last year nine commonhold developments (one to be implemented in three phases) comprising well over 100 units have been established and over one third of those units have been registered in the names of the respective unit-holders. Moreover, English Partnerships announced that it is to be involved a 2,000-home commonhold scheme in Milton Keynes. Shared ownership leases cannot be used in commonholds. But the government and key players in the housing market have developed a trust-based alternative which will allow affordable housing to be provided in commonhold and also satisfy Sharia requirements.


42.15 Commercial service charges could be affected by legislation aimed at residential tenancies

Commercial landlords should be aware that maintenance charges imposed in long leases of mixed use premises may now fall within the ambit of residential service charge regulation. In a recent case, the level of maintenance charge imposed by a freehold owner of mixed use premises on a management company which held a long lease of the flats at the premises was successfully challenged by a residential sub-tenant.
The Court of Appeal had to consider whether the maintenance charge could be construed as service charge within the meaning of the Landlord and Tenant Act 1985, which regulates service charges in residential tenancies. The court rejected previous authority that an owner of multiple flats, such as a management company, could not enjoy protections which were designed to benefit an individual tenant of a single dwelling and held that the maintenance charge was indeed service charge within the meaning of the 1985 Act. Further, they found that there was nothing in the 1985 Act which precluded a sub-tenant from making a direct claim, even though the maintenance charge was not levied directly upon him.

The extension of such service charge regulation to commercial mixed use premises raises serious potential problems for landlords, for example, the Housing Act 1996 provides restrictions on a landlord's right to forfeit a lease for non-payment of service charge.

*Oakfern Properties Limited v Ruddy [2006] EWCA Civ 1389*

### 42.16 Managing rural areas and open spaces

Many routes of rights of way in rural areas called byways open to all traffic ("BOATs") or roads used as public paths ("RUPPs") are used (or abused) by motor vehicles. Rights of way for motor vehicles are often based on historical use by horse-drawn vehicles; however motor vehicles are noisier, and cause more pollution and damage than carts or carriages and the government has restricted them heavily.

Rights of way are an essential factor in the value of property and therefore many existing rights of way are to continue. If rights of way for vehicles have been registered with local authorities on or before 2 May 2006, or are part of the adopted public highways network they will not be affected by the changes. Rights will also continue where a road has been used mainly by vehicles for the last five years or before 1930 (when restrictions began), or were created for such use.

Some landowners and occupiers rely on existing rights to access their property and so, where there is reasonable need, a private right can be created.

It is now much harder to create vehicular rights of way. It is only possible to create a new right of way for motor vehicles if the document creating the right expressly includes such vehicles. Long usage of a route by vehicles is no longer enough to create a public right of way.

BOATs and RUPPs will be replaced gradually by restricted byways and vehicular use of these routes is a criminal offence. None of the provisions about rights of way apply to central London.

The Countryside Agency and English Nature have merged to form Natural England which will be based in Sheffield. The Forestry Commission is to merge in due course but the Environment Agency will continue to control pollution. Natural England will promote: land management that enhances the natural environment; and access to National Parks and Areas of Outstanding Natural Beauty as well as green spaces in urban areas.
The government has created the Commission for Rural Communities to remove social exclusion and economic problems in rural areas. The Commission will work to provide advice and monitor government policies. It will be based in an area which is thought to need its assistance.

Natural Environment and Rural Communities Act 2006

42.17 New edition of the City of London Law Society's Certificate of Title

Certificates of title are often used in real estate transactions instead of a full investigation of title. The form of certificate issued by the City of London Law Society's Land Law Committee is accepted as the standard by most firms in England and Wales. Many lenders also insist on this form of certificate being used. The City of London Law Society has issued the sixth edition of its certificate which, once approved by the Law Society, will replace the fifth edition (issued in 2003).

The most significant change in the new edition is that the certificate now includes statements describing the provisions of a typical lease and the giver of the certificate will now make qualifications against those statements where the lease in question differs from the typical lease described. Previously, the details of each lease had to be set out separately. The certificate has also been reformatted to make it more user-friendly. Key provisions and statements are now located at the front of the certificate and the specific details of the property are now in one schedule at the back. The sixth edition of the certificate also no longer deals with details of construction documents, insurance, licensing or environmental matters as these issues are usually dealt with separately between the parties.

The sixth edition of the certificate will be available from the City of London Law Society's website once approval has been received from the Law Society (expected Spring 2007).

http://www.citysolicitors.org.uk/

42.18 Government faces massive compensation payment to developer who lost its land to squatter

A property development company looks set to receive millions of pounds in compensation from the UK government, for the loss of prime development land to a squatter, after a ruling in the European Court of Human Rights in Strasbourg. The court held that the human rights of the developers had been breached by the failure of the government to change the law of adverse possession so as to better protect landowners from an occupier's claim of ownership after a period of 12 years occupation. The money will be payable if the UK government fails in a final appeal to the Grand Chamber of the court.

Since the time of the events which give rise to the claim, there has been an amendment in the law to afford better protection to registered owners of land, but the effect of this change is not retrospective.

_Pye v United Kingdom_ (Grand Chamber, application no 44302/02)
42.19 Statutory framework for recovery of commercial rent arrears proposed to abolish ancient remedy of distress

Following consultation on a draft published in July 2006, the government has announced the Tribunals, Courts and Enforcement Bill. The significance of the new bill for those interested in commercial property is in the proposals to abolish the common law remedy of distress (whereby a landlord can seize goods from its leased property and sell them to realise money to cover arrears) and to set in place a statutory regime for commercial rent arrears recovery ("CRAR").

The bill envisages that CRAR will confer a statutory right on a landlord of commercial premises to use the proposed enforcement procedure, although the landlord will have to appoint certified enforcement agents to carry this out on his behalf. This differs from distress for rent which could be carried out by the landlord personally.

CRAR will only apply to leases of commercial premises (no part of which is let or occupied as a dwelling) which are evidenced in writing. Additionally, it may only be used to recover "rent", meaning the sums payable under the lease for possession and use of the premises, plus VAT. It does not extend to recovery of sums in respect of service charge and insurance, even if such amounts are reserved as rent in the lease.

The bill entitles a superior landlord to serve notice on a sub-tenant requiring rent to be paid directly to him, in a procedure which is similar to existing legislation.

Anti-avoidance provisions are also included so that any attempt to confer rights to seize goods in order to recover rent or to modify CRAR will fail.

The bill has already started its passage through Parliament and it is anticipated that much of the detail relating to the enforcement procedure itself will follow in related regulations once it has reached the statute book.

http://www.dca.gov.uk/

43. RESTRUCTURING

43.1 More new legislation

Not content with having carried out a major overhaul of the insolvency legislation in the last three years, the government has continued to bring out new legislation which impacts significantly on the world of restructuring and insolvency.
On 6 April 2006, the new Transfer of Undertakings (Protection of Employment) Regulations (or TUPE as they are more frequently known) were brought into force. One of the aims of the Regulations was to simplify the transfer of a business from an insolvent entity and to make such a transfer more attractive to potential buyers. Previously the law provided that, on such a transfer, all contracts of employment would automatically pass to the purchaser, including all liabilities to the employees in respect of breaches of those contracts - most commonly arrears of wages. The prospect of inheriting such liabilities from an insolvent business and, in some cases, inheriting contracts of employment with terms that ill-matched those of the purchaser's existing employees, would often prompt the purchaser to demand a significant reduction in price or, in several cases, to walk away from the deal altogether. The former would have a detrimental impact on the return to creditors and the latter, in addition, would mean that legislation to protect employees, when applied in the context of an insolvent employer, had precisely the opposite effect to that which was intended.

In an attempt to alleviate these problems, the new regulations allow, in certain insolvency procedures, for a proportion of arrears of wages to be paid by the government (via the Redundancy Payments Office) (regulation 8) and, with appropriate consultation, for a limited number of changes to be made to the contracts of transferring employees (regulation 9). In the remaining insolvency procedures, TUPE will not apply at all: the business will transfer to the purchaser without an accompanying transfer of the employees' contracts of employment. They will lose their jobs but be entitled to claim statutory redundancy pay and prove for any balance due to them in the insolvency of their former employer. In some cases, this would be disastrous for employees (and precisely what the former TUPE Regulations sought to avoid) but in others, particularly where the purchaser needs or desires to re-employ the individuals, it can mean that they effectively enjoy continuity of employment at the same time as a redundancy payment from the government.

Regrettably, the regulations have been drafted in such a way that it is not clear to which of the various insolvency procedures the new regulations 8 and 9 will apply. The government issued three separate, conflicting sets of guidance, which only added to the confusion. Despite this, to date, all insolvency professionals appear to have been interpreting the regulations in a purposive manner. Most transfers of businesses from insolvent companies are effected by companies in administration. It would be possible for the parties to consider that regulation 8 (which provides for continuity of employment) does not apply to transfers within the context of an administration and thus approach the agreement on the basis that the purchaser would acquire the business free of any employee liabilities. However, this does not appear to be happening. Instead, despite the incomprehensible wording of the regulations, insolvency professionals acting as administrators and those advising purchasers of businesses from insolvent companies are approaching deals on the basis that employees of the business should enjoy the rights which they think the government intended to provide, even if that is not what the regulations actually say, namely continuity of employment. The Redundancy Payments Office is currently prepared to make the payments provided by the regulations for such employees and purchasers appear to be prepared to assume responsibility for any balance of arrears or other sums due to them. Consequently, whilst the market awaits definitive judicial guidance on the correct interpretation and application of the regulations, it is continuing to use them, quite effectively, albeit somewhat in the dark.
43.3 Light at the end of the tunnel for liquidators and their costs

In 2004, in Stiching Ofasec v Buchler and Talbot (more commonly known as Re Leyland Daf) [2004] UKHL 9, the House of Lords held that, where a company has granted floating charge security over its assets (usually in the form of a debenture) and subsequently goes into liquidation, the general costs and expenses of the liquidation cannot be deducted from the proceeds of realising the assets covered by the floating charge. By their nature, floating charges tend to cover all of a company’s assets. Consequently, unless the debts due to preferential creditors and the floating charge holder are significantly less than the value of the floating charge assets, in many cases there will be no money to pay for a liquidator to perform the functions which statute requires of him. Although their Lordships did not appear concerned with the consequences which their decision would have (“those who undertake work for insolvent businesses have always done so at risk of not being paid”), the Department for Trade and Industry appreciated that it is not acceptable for a government, which seeks to promote responsible entrepreneurism, not to provide adequate and properly-funded methods of dealing with business failure.

Liquidators now have a light at the end of their costs tunnel in the form of a clause inserted at a late stage of the Companies Act 2006 (see paragraph 7.1) which seeks to provide a framework within which liquidators will be able to be paid for the work they carry out by obtaining permission to take that remuneration. The government is seeking to balance the interests of charge holders, whom the House of Lords has held are entitled to recover the proceeds of floating charge assets without any incursions or deductions for costs, against the need for liquidators to be reasonably remunerated for the work which they have to perform. The exact circumstances in which permission must be sought and from whom are yet to be set out in secondary legislation. However, it is anticipated that liquidators will be entitled, as of right, to reasonable remuneration for the work which statute requires them to undertake but will need to obtain consent for any further, detailed investigatory work and ensuing litigation. The requisite consent will need to be sought from the party whose recoveries will bear the brunt of the costs with certain situations giving rise to a right to apply to court.

43.4 Distress

They have been talking about it for decades, but finally legislation has been drafted to abolish the common law right to distress for arrears of rent.

The changes appear in the Tribunals, Courts and Enforcement Bill, which runs to some 250 pages. As well as dealing with the abolition of distress for rent, it also provides new rules for the enforcement of judgments, including the seizure of goods, charging orders, attachment of earnings orders and a new court-based mechanism to help the court gain access to information about the judgment debtor on behalf of the creditor. The remainder of the Bill includes proposals for a new County Court administration order, new debt-management schemes, debt relief orders and enforcement restriction orders in respect of debtors with low incomes and few assets.

The government proposes to replace the common law right to distress for rent with "CRAR" which stands for Commercial Rent Arrears Recovery. For the right to exercise CRAR, there must be a written lease. CRAR will only be able to be exercised by authorised enforcement agents (unlike distress for rent which could be carried out by the landlord personally). Service charges, even if prescribed by the lease to be payable and recoverable "as if rent", cannot be recovered by CRAR - it can only be used to recover rent, interest and the costs of recovery.
The Bill is in its early stages and still subject to debate.

See, further, paragraph 42.19.

43.5 Security news

There have been two important cases this year affecting security.

In the summer, the Court of Appeal indicated, in Hill v Spread Trustees, Re Norkowski [2006] EWCA 542, that, perhaps contrary to the impression gained by many professionals following the decision in Re MC Bacon [1990] B.C.L.C. 324, where security is granted by way of gift or on terms that provide for the company to receive no consideration, it may be susceptible to challenge as a transaction at an undervalue. Transactions with such an absence of consideration are rare: in most cases where security is granted to an existing creditor, at the very least, consideration is given in the form of an agreement on the part of the charge holder to refrain from taking immediate steps to recover the debt due to it. Such forbearance will usually amount to sufficient consideration. However the case highlights the importance for lenders to ensure that, when taking security or additional security for outstanding indebtedness, some benefit must be seen to flow from the lender to the company to avoid the arrangement being susceptible to challenge as a transaction at an undervalue.

In June 2001, as a result of a Privy Council case (Re Brumark Investments [2001] UKPC 28), the efficacy of commonly-used fixed charges over book debts was called into question. The issue was resolved in English law against charge holders in June 2005 in Re Spectrum Plus [2005] UKHL 41, when the House of Lords held, contrary to lenders’ expectations, that most standard form security documentation merely creates a floating charge and not a fixed charge over book debts. As sums due to preferential creditors must be deducted from floating charge realisations before those realisations can be paid to the charge holder, the case has potentially reduced the sums which the lender may have expected on realisation of assets under its charge.

This year, in the case of Re Beam Tube Products [2006] EWHC 486, the court was called on, for the first time, to apply the House of Lords decision in Re Spectrum Plus and to apply it to an asset other than book debts. The court was asked to look at whether a purported fixed charge on moveable plant and machinery could be classified as fixed. In reality, the company had been free to buy and sell items of plant and machinery as it saw fit, with no recourse to the charge holder. The court held, using the principles of control set out in the Spectrum case, that the charge was not fixed, but floating. The charge holder had not exercised the requisite degree of control. For further information on this case, see paragraph 3.1.

43.6 Coming up

43.6.1 Administration expenses

Last year, administration expenses hit the insolvency world headlines in connection with payments to employees. This year, the topic in the administration expenses spotlight has been the payment of rates: should they be paid as an expense of an administration, or as an unsecured claim? In the case of Re Trident Fashions Limited, the High Court will consider the question, the answer to which will be of interest not only to Insolvency Practitioners, but also to financially distressed retailers and local authorities. The case was heard over three days commencing on 18 December 2006. At the date of publication the judgment was still awaited.
43.6.2 Landlord's rights in company voluntary arrangements

In the company voluntary arrangement ("CVA") of the electrical retail chain, Powerhouse, the landlords' claims in respect of outlets which were being closed under the proposals in the CVA were reduced to £1. The CVA proposals also provided that any claim such a landlord may have against a guarantor of Powerhouse's obligations under the leases was also compromised by the payment of that £1. The landlords in question launched a challenge to the CVA in the courts, but before the case could be heard, the company went into administration. It is understood that the administrators, using the moratorium in favour of the company in administration, have refused permission to the landlords to continue their action against the company. The landlords have applied to court for permission to continue the challenge and the outcome of that application is awaited. If the landlords are successful, the case may be heard in March 2007 and could well prove to be of vital importance in the world of retail lettings.

43.7 Pensions regulator

Last year, the new player at the table was the Pensions Regulator, who was given powers by the Pensions Act 2004 to negotiate deals protecting the interests of the beneficiaries of a final salary pension scheme of a company, where the company proposes a course of action which could affect the company's ability to fund any deficit in the pension scheme. The predictions as to the scale of the Pensions Regulator's involvement in transactions have all come true - he has indeed become a powerful and assertive force to be reckoned with when negotiating changes to corporate structure. The man on the street may be comforted to know that the mechanism put in place to protect his interests appears to be working smoothly so quickly after its introduction.

For further information, see paragraph 38.5.

43.8 Further information

See paragraph 7.5 relating to unlawful dividends.

See paragraph 7.6 relating to unlawful loans.

44. TAX INVESTIGATIONS AND DISPUTES

44.1 Corporation tax decisions

44.1.1 Recovery of tax overpaid by mistake: Deutsche Morgan Grenfell Group Plc v. HMRC [2006] UKHL 49 (2006) 3 WLR 781

See paragraph 45.3.5.

44.1.2 CFC legislation only valid if wholly artificial arrangement: Cadbury Schweppes Overseas Ltd v Commissioners of Inland Revenue (Case C-196/04) 12 September 2006

See paragraph 45.5.4.
44.1.3 Retail bank disclosure notice cases: *Re an Application by Revenue and Customs Commissioners to Serve a section 20 Notice*(*"Re an Application No. 1"*) and *Application by the Commissioners for Her Majesty's Revenue and Customs to Serve a Section 20 Notice on a Financial Institution and Two Named Subsidiaries in Respect of Customers with UK Addresses Holding Non-UK Accounts*(*"Re an Application No. 2"*)

HMRC used its powers under section 20(8A) of the Taxes Management Act 1970 to obtain a Notice for service upon an (anonymised) retail bank seeking disclosure of records relating to a specified class of its credit card customers (*"Re an Application No. 1"*). The Notice required the bank to provide information or documents in its "possession or power" which contain:

"the names and addresses and date of birth of customers (other than quoted companies) having a UK address with a UK credit card, who on the application form (or subsequently) gave details of a non-UK bank account with which it is associated; the sort code and account number of the bank account, and the interest earned per annum; and the transactions on the credit card for six different months."

Alongside the application regarding credit card customers, a similar application was also made and granted in respect of the same institution's general banking customers (*"Re an Application No. 2"*).

The statistics cited by HMRC during the hearings referred to above indicated that HMRC was of the view that approximately 20% of the customers whose details were disclosed in response to the relevant Notice would be investigated by HMRC.

At the *ex parte* hearing in relation to the bank, HMRC outlined the approach that it will take upon receipt of the information/documents from the bank. This was recorded in the reported decision of the Special Commissioner:

"If the notice is granted the inspector informs me that the Revenue will first try to match the information with tax returns electronically. If this shows that foreign interest is declared no further action will be taken and the customer will not even know about the Revenue’s notice; indeed the inspector points out that the information cannot be used for purposes other than those for which the power is conferred, so that if the Revenue were to ascertain information that might be of interest for, say, value added tax (VAT) they cannot share it with their VAT colleagues (although before the merger they could have done under a statutory provision). If foreign income is not declared, the Revenue will first ascertain whether there is a good explanation, for example that no interest is earned on the account, the person with a UK address is not resident, or is non-domiciled and does not remit any interest, or that interest from, say, the Channel Islands has incorrectly been returned as UK source interest. Only if there is no such explanation will the Revenue pursue their investigation of the undeclared interest."

HMRC has also indicated that it may decide that it is appropriate to investigate some individuals using the Civil Investigation of Fraud procedure, and may bring criminal proceedings against others.

In addition, on 20 March 2006, an *ex parte* hearing was held before the Special Commissioner to hear an application for consent to serve a disclosure notice on an
a tax haven company) (SPC00523). The application was granted and the investment bank was required to provide to HMRC, within 90 days of being served with the notice, copies of all compliance and due diligence materials provided by the relevant clients (and all persons authorised to conduct business on the clients’ behalf), including copies of powers of attorney, passports, utility bills, bank guarantees and related correspondence for the nine year period from 6 April 1995 to 5 April 2004.

44.2 VAT decisions

44.2.1 Whether activities amount to VAT fraud: Kittel v Belgium (Case C-439/04), Belgium v Recolta Recycling SPRL (Case C-440/04) 6 July 2006

On 6 July the ECJ handed down a decision about the way in which the conduct of traders involved in VAT fraud, unwittingly or otherwise, would be determined. The court found that traders who had taken every precaution which could reasonably be required of them to ensure that their transactions were not connected with fraud, be it the fraudulent evasion of VAT or other fraud, could rely on the legality of those transactions without the risk of losing their right to deduct the input VAT. However, where the tax authorities found that the right to deduct had been exercised fraudulently, those authorities were permitted to claim repayment of the deducted sum retroactively. It was a matter for the national court to refuse to allow the right to deduct where it was established, on the basis of objective evidence, that that right was being relied on for fraudulent ends.

In the same way, a taxable person who knew, or should have known, that by his purchase, he was taking part in a transaction connected with fraudulent evasion of VAT had, for the purposes of the Sixth Directive, 77/388/EEC to be regarded as a participant in that fraud, irrespective of whether or not he had profited by the resale of the goods. In such a situation the taxable person aided the perpetrators of the fraud and became their accomplice.


44.2.2 Auctioning of licences not "economic activity": T-Mobile Austria GmbH & ors v. Republic of Austria (Case C-284/04), 7 September 2006

An Advocate General’s opinion (which, while not binding on the ECJ, will usually be followed by it), to the effect that the fee from Vodafone, Orange, O2, Hutchinson & T-Mobile, for 3G licences, did not attract VAT. So, those operators were not entitled to the £22.5bn in tax rebates claims. Key aspects of the decision included the findings that:

- the auctioning by a State body of the 3G licences was an "economic activity" under the Sixth VAT Directive; but
- the auctioning governed by public law under a special legal regime was the exercise of a public authority and therefore not a supply attracting VAT.
44.3 Issues for high-net worth individuals

44.3.1 Special Commissioners considered "non-dom" definition: Robert Gaines-Cooper v. HMRC, SPC00568, Decision of the Special Commissioner released 31 October 2006

The Special Commissioners ruled that multi-millionaire Robert Gaines-Cooper, a British-born businessman with links to both the UK and the Seychelles, had not sufficiently severed his connection with the UK in order to be domiciled outside of the UK. The Commissioners called into question Mr Gaines-Cooper's assessment of the days he spent in the UK, which he claimed were based upon HMRC guidelines.

In order to achieve non-residency status, individuals must not spend more than 90 days on average in any one year in the UK. Mr Gaines-Cooper had claimed that he was not liable to pay tax because he spent fewer than 90 days a year on average in the UK during the relevant period. However, the Commissioners determined that all days and nights spent in the UK were relevant to this calculation. It was not permissible, in this case, to ignore the dates of arrival and departure as this created a distorted picture of the time Mr Gaines-Cooper spent in the UK.

This decision may impact high net worth individuals who divide their time between the UK and low tax jurisdictions, and who have assumed that closely following the 90 day rule will be sufficient to establish that they are not resident within the UK. The Commissioners carefully considered all aspects of Mr Gaines-Coopers lifestyle and connections to the UK, and the case turned very much on his continued social, family and business connections to the UK as well as his physical movements around the world.

Please see http://www.financeandtaxtribunals.gov.uk/aspx/view.aspx?id=2797

44.3.2 Richard and Judy are entertaining: Madeley and Finnigan v. The Commissioners of Her Majesty's Revenue and Customs 8 June 2006 (SpC 547) (2006) STC (SCD) 513

Well-known celebrities, Richard and Judy, were successful before the Special Commissioner in their claim to be entitled to a tax deduction for the fees that they had paid to their agent for the last six years, whilst they were employed by Granada Television. The relevant test was whether Richard and Judy were properly described as "theatrical artists". To their financial (and, no doubt, professional) relief the Special Commissioner agreed they were, and were therefore entitled to the relief available to such entertainers.

There are likely to be other battles in this arena. The Special Commissioner indicated that newsreaders would not be able to claim the deductions, and that there was doubt in relation to other presenters:

"I would certainly accept that newsreaders and the weathermen on television are not "theatrical artists". Few will forget Angela Rippon’s “high kick”, and I accept that the weathermen usually perform an amusing Christmas carol shortly before Christmas. I also accept that with the cult of the celebrity, more attention is given to the appearance and personality of newsreaders than in the past, but I still consider that their role is passive. People switch on the “news” to find out what has happened, and the presenter will ideally be pleasant but unobtrusive. I would not
describe newsreaders as performers or entertainers, and certainly not as theatrical artists.

I reach the same conclusion about presenters of current affairs programmes. Some have their unique style and some or most can be very impressive, but they are again neither entertainers nor theatrical artists.”

The Commissioner went on to comment that game and quiz show hosts presented more difficulties in terms of classification. We can look forward to further evaluation of the entertainment factors of various presenters as claims under this legislation continue to require consideration.

http://www.financeandtaxtribunals.gov.uk/judgmentfiles/j2335/spc00547.doc

44.3.3 Sports stars activities within the UK taxed here: Andre Agassi v Robinson (HMRT), 17 May 2006 (2006) 1 WLR 2126

During the relevant tax years Agassi played in UK tennis tournaments including Wimbledon. He owns a company, Agassi Enterprises Inc, whose business includes entering into contracts with manufacturers of sports clothing and equipment, under which Agassi sponsors or advertises the product and receives payment. The company entered into an agreement with Nike and Head Sport to advertise their products and Agassi Enterprises Inc received payment outside the UK for this. Neither Nike nor Head were resident in the UK, nor did either company carry on any trade in the UK. Agassi was neither resident nor domiciled in the UK.

Sections 555 to 558 of the Income Corporation Taxes Act 1988 and the Income Tax (Entertainers and Sportsmen) Regulations 1987 make provision for the taxation of entertainers and sportsmen who are not resident in the UK in respect of their profits and gains arising from commercial activity carried out by them within the UK. The question was whether section 555(2) should be given its literal effect or a limited effect so as to exclude from its scope persons who neither reside nor carry on any trade in the UK.

Agassi was issued with a notice of amendment to his self-assessment tax return proposing the addition of an income tax charge of £27,000, which he appealed. It was held that foreign entertainers and sportsmen who, or whose controlled companies, receive payments in connection with their commercial activities in the UK should be subject to charge to tax. If the opposite approach is taken then tax liability could be avoided by ensuring payments were made by foreign entities with no residence or trading presence in the UK.

http://www.publications.parliament.uk/pa/ld200506/ldjudgmt/jd060517/agasro-1.htm

44.4 Other regulatory issues

44.4.1 HMRC Civil Investigation of Fraud Teams

On 1 July 2006, new Civil Investigation of Fraud teams were created to increase HMRC’s capability in tackling serious tax fraud and to contribute to reducing the tax gap. The new teams are based in Local Compliance, operating out of London, Nottingham, Wolverhampton, Bristol, Stockport, Southampton, Leeds, Belfast,
Cardiff, Glasgow and Edinburgh. There will also be CIF capability in National Compliance, within the Labour Providers Unit in the Special Trade Investigation Unit.

44.4.2 EU Savings Directive

This directive came into force on 1 July 2005 and requires deposit takers in the UK to make returns of all interest payments made to residents of EU countries. Returns under existing legislation are required to be made to HM Revenue & Customs in respect of interest payments made to UK residents. Compliance with these regulations will be audited vigorously by HMRC. In July 2006, the EU Tax Commissioner announced that there would be a review of the operation of the Savings Directive after it became apparent, as a result of low returns from countries such as Switzerland, Jersey and Luxembourg, that loopholes in the legislation are being exploited.

44.4.3 Modernising Powers Deterrents and Safeguards: second phase of consultation: Criminal Investigation Powers consultation document

HMRC issued a consultation document on 30 March 2006 which aimed to ensure that the powers of the newly merged HMRC department are fair and efficient and make it easy for people to meet their tax paying obligations and claim what is entitled to them. The consultation closed on 23 June 2006. On 9 August 2006, as part of this consultation, HMRC issued a technical consultation document seeking views on the modernisation of criminal investigation powers. In particular, the consultation focuses on the application of the relevant provisions in the Police and Criminal Evidence Act across all HMRC’s activities, rather than specific taxes and duties, as is the case at present.

44.4.4 Finance Act 2006: see paragraph 45.1.2 for details.

44.4.5 Corporate residency: Wood v. Holden [2006] STC 443 - see paragraph 45.3.2 for details.

44.4.6 Temporal limitation: see paragraph 45.5.5 for an update on the Meilicke case (ECJ case C-292-04).

45. TAXATION

45.1 Avoidance

45.1.1 Disclosure of tax avoidance arrangement

A new regime for the disclosure of tax avoidance arrangements came into force on 1 August 2006. The scope of the regime is now considerably widened from previously, covering all income tax, capital gains tax and corporation tax planning (as well as SDLT). Disclosure is now required if the arrangement falls within one of seven “hallmarks”. The new regime imposes a 30 day time limit where disclosure is required by users of arrangements designed “in-house”.

It was announced in the Pre-Budget Report on 6 December 2006 that in order to ensure that the disclosure regime functions consistently (the regime requires
"promoters" and developers of "in-house" tax mitigation arrangements to disclose
details of these to HMRC), the Government would consult on a new power to
investigate arrangements where HMRC has reasonable grounds for believing that a
promoter has failed to comply with its disclosure obligations.

The consultation paper and draft clauses giving HMRC new powers were published
on 18 December. In summary, the proposals involve the use of enhanced powers,
including the power to make inquiries of a promoter as to whether a scheme is
notifiable, the power to request further details about a particular scheme, and the
power to apply to the Special Commissioners for an order requiring a scheme to be
notified.

45.1.2 Finance Act 2006

The Finance Act 2006, which received Royal Assent on 19 July 2006, includes the
following anti-avoidance provisions:

Avoidance involving structured finance arrangements: provisions to prevent
avoidance of tax by the factoring of taxable receipts or the creation of tax-deductible
expenses in return for a lump sum that is not taxed as income. The arrangements
cought are those which, in economic substance and for accounting purposes, are
secured loans;

Sale of lessor companies: provisions to change the way in which lessor companies
are taxed when they change ownership to deter tax-driven sales to loss making
groups. Additional anti-avoidance provisions were announced on 22 November 2006
to prevent avoidance of this legislation through particular arrangements.

Corporate capital losses: three "targeted anti-avoidance rules" have been introduced
to prevent arrangements which exploit the capital loss rules. The three types of
arrangement targeted are:

- the artificial creation of corporate capital losses on disposals;
- the buying of capital gains and losses solely to benefit from capital losses in the
  acquired company; and
- the conversion of income streams into capital gains (where the gain can then be
  franked by a loss) and the creation of a capital gain (covered by capital losses)
  "matched" by an income deduction.

45.2 Capital gains

45.2.1 Goodwill in franchise business

In Balloon Promotions Limited and Others v Wilson and Another SpC 524, the
Special Commissioners ruled against HM Revenue & Customs ("HMRC"), holding
that a franchised restaurant business was capable of being sold for a consideration
part of which was allocable to goodwill which was separate from any goodwill
inherent in the property. HMRC subsequently issued Tax Bulletin 83 commenting on
their interpretation of "goodwill" for capital gains purposes.
45.2.2 Payment on termination of a merger agreement

In *British Telecommunications plc v HMRC Commissioners* SpC 535, it was held that, on the facts of the case, a payment on termination of a merger agreement was not a capital sum derived from an asset but was paid in return for BT being released from an obligation (to vote its shares in a particular way) and so did not give rise to a chargeable gain.

45.2.3 Loan notes issued in exchange for shares

In *Snell v Revenue & Customs Commissioners* [2006] EWHC 3350 (Ch) the High Court confirmed the Special Commissioners’ findings that the anti-avoidance test for paper for paper exchanges in section 137(1) of the Taxation of Chargeable Gains Act 1992 involved a two part test, namely whether the transactions were for bona fide commercial reasons and whether they formed part of arrangements of which a main purpose was the avoidance of tax. In this case, it was held that the Commissioners had been right to find that the share for loan note exchange itself was for bona fide commercial reasons and that where this was the case, it was irrelevant to consider why the parties chose to structure the transaction in the way they had. However (again supporting the Commissioners’ findings), in the circumstances of the case (which involved the taxpayer taking loan notes and then becoming non-resident and redeeming the loan notes whilst non-resident), the share for loan note exchange was still part of arrangements of which a main purpose was to avoid a liability (including a deferred liability) to tax.

45.3 Corporation tax

45.3.1 Finance Act 2006

The Finance Act 2006 includes the following changes to corporation tax:

*Extension of group relief to overseas losses*

See paragraph 45.3.6.

*Reform of the taxation of leasing*

The Finance Act 2005 includes the long heralded legislation to implement the new regime applicable to “long funding leases” under which the right to claim capital allowances on most plant and machinery is transferred from the lessor to the lessee.

45.3.2 Corporate residency

The Court of Appeal has dismissed HMRC’s appeal against a decision on the residency of a company incorporated outside the UK. The court drew a distinction between cases where management and control was exercised by a company through its own organs (ie the directors and in general meeting) and cases where those functions were “usurped”. In this case, it was held that the directors had not been bypassed, albeit the decisions they had to make were limited and they had relied on professional advice in deciding what action to take.
The House of Lords subsequently rejected HMRC's application for leave to appeal the Court of Appeal's decision which is therefore final.

*Wood v Holden* [2006] STC 443

**45.3.3 ACT Class 3 Group litigation: UK group income election provisions**

The Court of Appeal rejected the taxpayers' appeal from the High Court for restitution of the ACT which they had paid on dividends to foreign parent companies. The taxpayers claimed that the UK's ACT group income election provisions were in breach of the non-discrimination article in the double tax conventions with Japan and the USA and that the non-discrimination article was given direct effect in the UK. Although agreeing that, on the face of it, the UK's provisions were inconsistent with the non-discrimination article, the Court of Appeal held that that article had not been incorporated into UK law insofar as it related to ACT.

*NEC Semi-Conductors Limited & Others v Revenue and Customs Commissioners* [2006] EWCA Civ 25

**45.3.4 ACT: calculation of compensation payable for UK group income election provisions being in breach of EC law**

The House of Lords has allowed HMRC's appeal to the effect that in assessing compensation due to an EU resident parent of a UK subsidiary which had not been allowed under UK law (at the time) to make a group income election (the UK group income provisions having been found to be in breach of EC law), account should be taken of the tax credits to which the parent was entitled under a double tax treaty ie those credits should reduce the compensation payable.

*Pirelli Cable Holding NV & ORS v IRC* [2006] UKHL 4

**45.3.5 ACT: time limit for claim to restitution**

The House of Lords has held that the taxpayer had been acting under a mistake of law when making payments of advance corporation tax and its claim for restitution was not statute-barred because the mistake had not been discovered until a decision (on the legality under Community law of the UK's ACT provisions) had been given by the ECJ.


*Deutsche Morgan Grenfell Group pc v IR Commissioners* [2006] UKHL 49

To reverse the effect of this decision, the government announced in the Pre-Budget Report on 6 December 2006 that it will legislate so as to ensure that the limitation period for the recovery of direct tax paid by mistake of law is six years from the date of payment. It is stated that this provison will have retrospective effect, but will not affect those who have secured what amounts to a final judgment in their favour prior to 6 December 2006.
45.3.6 Group relief for non-UK subsidiary's losses: Finance Act 2006

Following the decision of the ECJ in Marks & Spencer plc v David Halsey (Case C-446/03), the Finance Act 2006 includes detailed provisions to allow losses of a 75% subsidiary resident (or having a permanent establishment in) another EEA Member to be group relieved against the UK parent's profits. A number of conditions have to be satisfied, including the requirement that the amount of the loss cannot be taken into account in that other EEA Member (or any other territory in which the company is also resident or has a permanent establishment) in calculating future profits, income or gains. Anti-abuse provisions are also included.

HMRC published guidance on the new provisions in April 2006 which is now available in HMRC's Company Tax Manual.

Please see: [http://www hmrc gov uk/manuals/ctmanual/CTM81500.htm](http://www.hmrc.gov.uk/manuals/ctmanual/CTM81500.htm)

In the actual M&S litigation, Mr Justice Park subsequently dismissed M&S' claim for losses suffered by its French subsidiary to be offset and remitted the claims in relation to Belgium and Germany back to the Commissioners for quantification of the allowable losses, holding that the UK's laws are not invalid as such but fall to be applied on case by case basis. Mr Justice Park's decision is now the subject of an appeal.

45.3.7 Associated companies and the de-grouping charge

The Special Commissioners have held that for the "associated companies" exemption from the capital gains de-grouping charge to apply, the companies in question must be associated not only at the time of leaving the group, but also at the time the asset in question was acquired. It seems likely that this decision will be appealed in view of the amount of tax at stake.

*Johnston Publishing Ltd v Revenue and Customs Commissioners* SpC 564

45.4 Double tax treaties

45.4.1 Meaning of "beneficial ownership" in a treaty context

HMRC has produced draft guidance on its interpretation of the term "beneficial ownership" in a treaty context following the Court of Appeal decision in *Indofood International Finance Ltd v JP Morgan Chase Bank NA* [2006] EWCA Civ 158 earlier this year. The Court of Appeal had regard to guidance which had been given by the Indonesian tax authorities who had said that the term "beneficial owner" in tax treaties was confined to "the actual owner of the interest income who truly has the full right to enjoy directly the benefits of that interest income".

The draft guidance states that the difference between the "international fiscal meaning" (ie that the recipient of the income "enjoys the full privilege to directly benefit from the income") and the UK domestic meaning of beneficial ownership is likely to be an issue where the structure and purpose of the arrangements "amounts to an improper use of the relevant DTC, for example "treaty shopping"". One example given is the use of an intermediate lender where the underlying (true) lender is in a jurisdiction with which the UK does not have a double tax treaty or has a less
favourable one than that of the intermediate lender, or an arrangement where the recipient of the income is in such a jurisdiction.

45.4.2 UK-US agreement on loss relief

Both the UK and the US deny relief for losses which have been relieved in another territory ("dual consolidated losses"). Both countries also deny relief which could have been claimed in an overseas territory but was denied in that territory under a dual consolidated loss rule ("mirror rule"). The interaction of the UK and US rules for loss relief means that it is possible that the losses of a UK PE cannot be offset either against the taxable income of a US affiliate under the US Code or against the profits of a UK affiliate under the UK rules for group relief.

The UK and US authorities have therefore agreed that an election can be made for relief to be given under one or other of the relevant relief provisions.

45.5 ECJ direct tax decisions

45.5.1 Test claimants in the ACT Class IV Group Litigation (Case C-374/04)

The ECJ delivered its judgment in this case on 12 December, another case on the now-abolished UK ACT rules. This particular case was concerned with the fact that the UK's rules prevented foreign shareholders from obtaining a tax credit in respect of UK dividends received, whilst such credits were available to UK shareholders.

The ECJ held in this case that the UK's laws were not in breach of Community law because the UK distributing company was subject to UK tax on its profits as were its UK shareholders whereas a non-UK resident company receiving the dividend and its shareholders were not subject to UK tax and their position was not therefore comparable.

45.5.2 Test claimants in the franked investment income ("FII") Group Litigation (Case C-446/04)

The ECJ also delivered its judgment in this case on 12 December. This case concerned the (now repealed) franked investment income rules and the UK's system of taxing foreign dividends but not UK dividends.

In summary, the ECJ held that:

- on the FII rules, these operate in breach of Community law; and

- on the issue of the apparent differential in tax treatment of UK and non-UK sourced dividends, it is not in principle discriminatory for a Member State to have legislation which exempts from corporation tax dividends received by UK companies whilst at the same time taxing dividends received from overseas companies, but with a tax credit for foreign tax suffered on the underlying income in the latter case. However, it must be the case that the rate at which dividends from foreign companies are taxed is no higher than that at which dividends received from resident companies are taxed. Although somewhat confusing, this seems to be being interpreted as meaning that where an equivalent UK subsidiary would have an effective rate of corporation tax of less than 30%
(for example, because of R&D tax credits) as compared to a foreign subsidiary whose dividends paid to its UK parent end up taxed at 30%, then the differential is unlawful. It is for the UK courts to determine in individual cases whether and to what extent UK parent companies can claim repayments on this basis. Considerable uncertainty does however remain as to how the UK's courts will interpret the decision in practice and how they will deal with the detailed individual claims.

For portfolio investments, the position is somewhat clearer. The ECJ held that a regime which (like the UK's) denies any double tax relief for the underlying tax at all in respect of dividends received by UK shareholders which have less than 10% of the voting rights in a company is in breach of Community law. Such shareholders should therefore be able to make appropriate claims.

45.5.3 Test claimants in the Thin Capitalisation Group Litigation (Case C-524/04)

The Advocate-General has given an opinion to the effect that the UK's thin capitalisation rules, which restricted interest deductions on loans from overseas lenders where the interest exceeded what would have been paid on arms length terms, may be discriminatory under Community law but can be justified on anti-abuse grounds subject to certain conditions.

45.5.4 Compatibility of the UK's controlled foreign company laws with EC law

The ECJ has held that Community law does not in principle preclude national tax legislation which taxes the profits of a controlled foreign company where the profits are subject to a lower level of taxation in the country of residence. However, such legislation is only acceptable where it relates to "wholly artificial arrangements aimed solely at escaping national tax normally due and where it does not go beyond what is necessary to achieve that purpose". The Court went on to say that in order to conclude that there is such an arrangement, the degree of physical presence which the CFC has in the other jurisdiction, the genuine nature of the activities carried on by it and the economic value of that activity to the group were relevant considerations.

The case has been remitted back to the Special Commissioners for a determination as to whether the UK's CFC rules can be justified on this ground.


Cadbury-Schweppes plc (Case C-196/04)

It was widely expected that as a result of the decision, some changes would be announced to the UK's CFC rules in the Pre-Budget Report on 6 December 2006. Predictions ranged from amendments to remove EU subsidiaries from the scope of the legislation except in relation to artificial arrangements, to a more radical review of the deduction rules for interest on borrowing with the possibility of restricted deductions for loans to finance overseas subsidiaries.
In the event, the draft legislation works by carving certain profits out of the scope of the CFC rules, but in a way that construes strictly the ECJ decision. The new legislation will operate by:

- creating a new procedure for UK resident companies to apply to reduce the CFC profits and creditable tax apportioned under the CFC rules. Applications can be made by UK companies which have a relevant interest in a CFC which has a business establishment and individuals working for the CFC in at least one "EEA State" (which means an EU Member or another EEA state with which the UK has International Tax Enforcement Arrangements). Applications will be granted if HMRC are satisfied that the part of the CFC's profits covered by the application can reasonably be regarded as representing the "net economic value" that is created by those individuals in the EEA State.

HMRC have also published draft guidance on the new rules, including guidance on the "net economic value" test. HMRC regards "net economic value" as the profits created by the labour of the individuals working for the CFC in the EEA State, as opposed to profits which derive from capital or from inter-group transactions. Specific examples are given of what constitutes "net economic value". For example, call centre profits generated from an overseas jurisdiction would represent "net economic value" generated, as would a reasonable profit made from a CFC undertaking group treasury operations. However, HMRC's position is that little of the income generated from intellectual property in a CFC set up to hold intellectual property would be within this concept, and nor would income from inter-company loans.

The new legislation therefore requires the individuals who are present in the EEA State to themselves be generating the economic value by their own activities. This arguably is a much stricter test than that required by the ECJ decision and may result in yet further litigation;

- amending the "exempt activities" test for CFCs resident an EEA State by restricting that exemption to cases where there are sufficient individuals working for the company in the territory who have the competence and authority to undertake all, or substantially all, of the company's business (ie requiring an "effectively managed and controlled" test to be satisfied); and

- abolishing the public quotation exemption.

These changes have effect in relation to all or any part of an accounting period of a CFC that falls on or after 6 December 2006 (with a just and reasonable apportionment for accounting periods which straddle this date).

45.5.5 Temporal limitation

The *Meilicke case* (ECJ case C-292-04) concerned the old German tax law which provided that German source dividends received by German tax individuals carried a tax credit whereas overseas source dividends did not. In the first Advocate General's opinion in 2005, the view had been taken that these rules were in incompatible with the principle of the free movement of capital, but that the conditions for a temporal
limitation (ie some form of time limit to the benefit of a decision) in this case were met.

The second Advocate General’s opinion in October 2006 held that the effects of the judgment should not be so limited on the grounds that the German government had failed to provide evidence of serious economic consequences if the judgment was not limited in time.

45.5.6 ECJ judgment in Denkavit International BV (Case C-170/05)

This decision was also delivered in December. The ECJ held that the French tax law, which applied a withholding tax to dividends paid to foreign resident parent companies but not to French resident parents, was in breach of Community law and this is the case even where a double tax treaty allows for double tax relief unless the parent company is able to offset the tax charge.

This decision means that exempt funds in the UK, such as pension funds and other investors who have no corporation tax liability (because of reliefs or expenses), should be able to make repayment claims in respect of wrongly withheld tax. Other corporates may also be able to make claims.

45.6 Employee share plans

45.6.1 Accounting treatment of cancelled SAYE options

The Accounting Standards Board has proposed an amendment to FRS 20 (Share-based payment) which would have the effect, where an option is cancelled because an employee withdraws from the option plan (typically under an SAYE plan), of requiring an immediate expense to be recognised equal to the amount that would have been charged over the vesting period ie it is treated in the same way as the failure of any other market-based condition.

45.6.2 The Prospectus Directive: CESR guidance

The Committee of European Securities Regulators published some frequently asked questions and answers on the Prospectus Directive. These include some useful clarifications in relation to the impact of the Directive on employee share plans, including statements to the effect that:

- neither the grant nor exercise of a non-transferable share option will require a prospectus (though certain Members may take a different view depending on the circumstances); and

- an offer of free shares will not require a prospectus.

45.6.3 ABI guidelines

In December 2006, the Association of British Insurers ("ABI") issued revised guidelines on the structure of executive remuneration and share incentive plans.

The new guidelines are essentially a re-statement of the previous guidelines in a clearer and simplified form, designed to be of more assistance to business.
announcing the revised guidelines, Peter Montagnon, the ABI's Director of Investment Affairs said "...we hope they will help Boards understand how shareholders feel remuneration can be more effectively aligned to performance".

In relation to employee share incentives, there are, however, some changes both in terms of content and emphasis. In particular:

- there is a clearer mandate to remuneration committees that they should ensure that remuneration packages confer appropriate levels of remuneration and reflect the contributions of executives. Remuneration committees are urged to guard against "unjustified windfalls and inappropriate gains" and to be "rigorous" in selecting comparator groups for benchmarking purposes. The guidelines stress the necessity of ensuring that relevant targets have actually been met and that remuneration committees should reduce or reclaim payments where it later transpires that performance achievements have been misstated, seeking legal redress in appropriate cases;

- there is a clearer statement than previously that performance conditions should not govern the grant of options;

- the press release issued with the revised guidelines states that one of the "key updates" is the introduction of an invitation to remuneration committees to consider performance periods of longer than three years for share-based plans. In fact, this recommendation was previously in the main text of the guidelines (and remains so) but a clearer statement is given in the summary of the main provisions relating to share-based incentives, where it is stated that share-based incentives should align the interests of executive directors with that of shareholders and "link reward to performance over the longer term......performance conditions...will not be less than, and may exceed, three years";

- changes have been made to the guidelines as they apply on cessation of employment. In particular, the recommendations for retirement (for example, that remuneration committees should have regard to the ability of an individual to contribute to the achievement of performance conditions in determining the size of an award in the first instance and that pro-rating should apply where retirement occurs within three years of the making of an award) have been removed entirely, presumably because these were potentially discriminatory under the new age discrimination laws.

In addition, the revised guidelines state that, on cessation of employment, the originally stipulated performance period should continue to apply (and in this case, options should be exercised within 12 months of the end of the performance period). However, if the remuneration committee is satisfied that it is appropriate, performance can be measured over the period to cessation of employment;

- additional guidance has been included about awards of shares over subsidiary companies. As previously, the guidelines recommend that this should only be considered in exceptional circumstances where it can be justified in terms of
"contribution to overall value creation". The following additional guidance is now given:

- participation in a subsidiary scheme should be limited to full time employees of that subsidiary;
- the accounting treatment should be fully disclosed;
- appropriately challenging performance criteria should apply;
- dilution limits should be explained in the context of the parent company's dilution limits;
- the methodology (and party responsible for) valuing the subsidiary's shares should be disclosed; and
- any entitlement to convert the award into shares in the parent should be disclosed.

45.7 Employment-related matters

45.7.1 Private equity matters

*Ratchets and thinly capitalised equity*

Schedule 22 to the Finance Act 2003 introduced new anti-avoidance provisions applicable to employment-related securities. This includes a "post-acquisition" benefit charge which charges to income tax any benefit received in connected with employment-related securities. HMRC had previously held the view that this charge extends to the benefit received when a management ratchet crystallised, unless the ratchet has been structured strictly in accordance with the Memorandum of Understanding agreed in July 2003 between HMRC and the BVCA. In August 2006, HMRC issued a press release to the effect that following a legal opinion they had received they now accepted that view to be wrong. They also accepted that a "post-acquisition benefit" charge is inappropriate where a company is thinly capitalised and this gives rise to disproportionate reward in the hands of employee shareholders.

*Good leavers*

In the minutes of the Shares Valuation ("SV") Fiscal Forum held on 11 July 2006, in response to a question from one of the accountancy representatives, SV confirmed that where shares are sold by an employee at "fair value" and that value is not discounted to take account of the fact that his holding is a minority, then a tax charge arises on the difference between the value as so discounted and the value received.

45.7.2 Meaning of "options" for employment income purposes

The Finance Act 2006 broadens the definition of "employment-related security" (with effect from 2 December 2004 ie backdated under the special legislation permitting this in the Finance (No 2) Act 2005) to include employee share option arrangements which have as a main purpose the avoidance of tax.
45.7.3 Termination payments: pay in lieu of notice

In *SCA Packaging Limited v Revenue & Customs Commissioners* [2006] SpC 541, the Commissioners had to consider whether certain employment contracts were to have implied terms in them entitling the employer to make a payment in lieu of notice (in which case, the actual payments in lieu which were made would have been taxable). The Commissioners dismissed HMRC's argument that where a payment in lieu is made as a matter of course by an employer over a period of time, it has become an implied term of the contract that the employer has a right to pay in lieu. The Commissioners held that to be contractual, the making of such payments must have become "notorious".

45.7.4 Employer's right of restitution in respect of PAYE and NICs

The High Court held, following the case of *Bernard & Shaw Ltd v Shaw* [1951], that where an employer has paid PAYE and NICs in respect of an employee's earnings, the employer has a common law right of restitution as against the employee.

*McCarthy v McCarthy & Stone* [2006] EWHC 1851 (Ch)

45.7.5 Computers provided for private use

The Finance Act 2006 withdrew the tax exemption which applied to the first £5000 of annual benefit in kind in respect of computers made available by employers for private use by their employees. However, HMRC have confirmed that where a computer is provided for business use and private use is not "significant", then no income tax charge will arise.

45.7.6 National insurance contributions

The National Insurance Contributions Act 2006 received Royal Assent on 30 March 2006. In outline, this:

- prevents NIC agreements and elections under which the employer's liability is passed onto the employee from including NICs arising as a result of the application of retrospective legislation;
- allows regulations to be made for the disclosure of NIC avoidance arrangements;
- allows regulations to be made in respect of NICs which have retrospective effect to 2 December 2004.

The accompanying regulations have not yet been laid.

45.7.7 Managed service companies

In the March 2006 Budget, the government announced that it would consult on action to tackle Managed Service Companies ("MSCs"). MSCs are corporate structures through which workers provide labour services. They are different to "personal service companies" in that, whilst the worker may be a shareholder of the company, he will not be in business on his own account and will not exercise any form of control over the company, which is provided and controlled by a third party.
("scheme provider"). "Composite companies" and "managed personal service companies" are typical forms of MSC.

HMRC's view is that the nature of the underlying contract in which a worker under an MSC is involved is one of employment and it wishes to bring such workers into the employment income (and PAYE and NIC) net. Whilst HMRC is of the view that such arrangements are in any event caught by the intermediaries (or "IR35") legislation, many MSCs do not apply that legislation and enforcing compliance poses particular problems with MSCs, partly because of the growth in number of the arrangements and partly because by the time the tax liability falls due, the MSC may be closed down and have no assets.

As part of the Pre-Budget Report on 6 December 2006, HMRC published draft legislation to require the MSC to operate PAYE and NICs on all workers which provide services through the MSC and there will be provisions which will allow tax which is not paid by a defaulting MSC to be recovered from a third party who has been "involved directly or indirectly in, and who have materially benefited from" the MSC's provision of services. It is envisaged that the list of appropriate third parties will include, amongst others, the MSC scheme provider, any person in accordance with whose direction the directors of the MSC acts, and the associates, connected persons of, and controlling parties in relation, to the MSC or scheme provider.

The intention is that the legislation will be included in the Finance Bill 2007 and will take effect from 6 April 2007.

45.8 Film tax matters

45.8.1 Film tax relief

The Finance Act 2006 includes provisions for the new film tax relief which provides:

- for qualifying films costing up to £20m, an enhanced deduction of 100% and a payable tax credit at a level of 25%; and

- for other qualifying films, an enhanced deduction of 80% and payable tax credit of 20%.

It was originally intended that this new relief would apply to films which commenced principal photography on or after 1 April 2006. However, formal state aid approval for the new relief was not obtained from the EC until November 2006 and this was based on a revised "cultural test". To allow time for the revised provisions to be approved by Parliament, it was therefore announced in November 2006 (and this was confirmed in the Pre-Budget Report on 6 December) that the new relief would be available for films commencing principal photography on or after 1 January 2007. Transitional provisions will apply to films which have commenced principal photography before 1 January 2007 and which are still uncompleted at that date.

For further information on Film Finance, see the separate Film Finance supplement.
45.8.2 Anti-avoidance: restriction of interest relief

The Finance Act 2006 includes provisions to prevent exploitation of the film tax reliefs. The arrangements targeted are those which involve the investor borrowing a sum of money to invest in the film partnership (and claiming interest relief) and at the same time contributing capital to another "investment" partnership which produces little in the way of taxable income or gains but produces a capital return sufficient to repay the initial loan (the overall result being that relief is given for the initial investment but tax on the partnership's income in later years is permanently avoided).

In addition, the Partnerships (Restrictions on Contributions to a Trade) Regulations 2006 (SI 2006 no 1369) supplement provisions introduced in the Finance Act 2005 to restrict the extent to which members of a limited liability partnership and non-active partners can set off their share of a partnership's trading losses (in respect of film-related losses) against their other income or gains.

45.9 Real Estate tax

45.9.1 REITs

The Finance Act 2006 includes the primary legislation necessary to enable companies to set up as, or convert to, REITs with effect from 1 January 2007. Supporting regulations have also been published. Important changes to the proposals as originally published in December 2005 include:

- it is no longer a condition to being a REIT that single shareholdings are maintained below 10%. Instead, if a distribution is made to a body corporate with a shareholding above this level and the REIT has not taken reasonable steps to avoid the distribution being made, then a tax charge is levied on the REIT based on the proportionate holding of that body corporate; and

- the requirement to distribute will only be in respect of 90% (95% previously proposed) of rental profits and the period for distributing is extended.

A number of further changes to the REITs legislation were announced in the Pre-Budget Report on 6 December 2006. The changes proposed fall into the following categories:

- changes to make it easier for a newly-established company to become a REIT:
  
  (i) such a company will no longer need to have its shares listed on a recognised stock exchange at the date it gives notice to join the regime, but will need to affirm that it will meet the condition when it does actually join the regime; and

  (ii) the "balance of business" test is to be relaxed. This test requires 75% of a REIT's total income to accrue from the exempt rental business and 75% of the total value of its assets to be held for the tax exempt rental business. It will be possible for newly established companies to satisfy this test at the end of the first accounting period rather than when first within the regime;
• the definitions of various terms are to be amended to clarify various matters (for example, the definition of "profits" for the interest cover test will make it clear that brought forward losses are excluded; and definitions which have different meaning in different places in the legislation are to be aligned);

• where a REIT demerges into two parts and both parts meet the conditions for a REIT, there will no longer be a deemed termination and re-entry (with the consequent re-entry charge);

• the provisions which apply to joint ventures carried on via a limited company will be extended to those carried on by more complex structures; and

• the exemption from tax on property income for charities will be extended to property income distributions received from a REIT.

45.9.2 SDLT

The Finance Act 2006 includes a number of provisions affecting SDLT, including:

• the withdrawal of SDLT unit trust "seeding" relief;

• removal of the SDLT charge where partners' shares are transferred into a partnership which includes land, provided that the partnership's main activity is the carrying on of a trade or profession other than a property dealing or development trade; and

• the threshold for SDLT for residential property is increased from £120,000 to £125,000 for transactions for which the effective date is on or after 23 March 2006.

Further anti-avoidance measures were announced in the Pre-Budget Report on 6 December 2006 which are aimed at preventing particular types of SDLT planning arrangement which have developed over recent months.

45.10 VAT

45.10.1 Pre-paid phone cards

The Court of Appeal has held that the principles of the avoidance of non-taxation, the avoidance of double taxation and the prevention of the distortion of competition are general principles of the Sixth Directive and entitle HMRC to impose VAT on retailers on the sale of certain pre-paid phone cards designed to exploit the differences between the treatment of vouchers under UK and Irish law.

_Revenue and Customs Commissioners v IDT Card Services Ireland Ltd_ [2006] EWCA Civ 29

45.10.2 Ticket handling charges

The Court of Appeal has confirmed that the fact that part of the service supplied by a ticket handling agency was the transfer of the price of the ticket to the agency's own bank account meant that the transactions involved a change in the legal and financial
consequences of the services provided and that the overall supply was an exempt supply of financial services.

*Bookit Ltd v Commissioners of HMRC [2006] EWCA Civ 550*

Since the decision, HMRC have issued Business Brief 18/2006 setting out their revised policy that where:

- the agent makes a charge to the customer over and above the price of the actual goods or services for a separately identifiable service of handling payment by credit or debit card; and

- that services includes as a component the transmitting of the card information with the necessary security information and codes

then the additional supply is exempt for VAT purposes.

45.10.3 Transactions designed to secure a tax advantage

The ECJ has ruled in three joined cases that:

- transactions entered into solely for the purposes of enabling input tax to be deducted nevertheless qualify as "supplies" in the course of carrying on an economic activity and therefore input tax in respect of those transactions is in principle recoverable; but

- the "abuse of rights" doctrine does apply for VAT purposes: community law precludes the right to recover input tax where the transactions from which the right derives constitute an "abusive practice".

Judgments of the ECJ in the *Halifax plc* (Case C-255/02), *University of Huddersfield Higher Education Corp* (Case C-223/03) and *BUPA Hospitals Ltd and Goldsborough Developments Ltd* (Case C-419/02) cases.

45.10.4 Management of special investment funds

The ECJ has ruled in the *Abbey National case* (Case C-169/04) that the exemption in the Sixth Directive for "management of special investment funds as defined by member states" means only that members may define what a "special investment fund" is and not also what the management activities are. The court went on to state that services performed for the administrative management of the funds, which are specific to and essential for that management are exempt, although services such as depositary and trustee services are not exempt as they are "supervisory" rather than essential to management.

The decision means that outsourced third party fund management services are exempt.

Following the decision, HMRC issued Business Brief 07/06 setting out HMRC’s revised policy in the light of the decision.
45.10.5 Single and multiple supplies

The taxpayer claimed that the zero rating which applies in the UK to the supply of caravans also applies to the contents of a caravan on the basis that, following the Card Protection Plan case, the supply of the caravan and its contents forms a single taxable supply. The Court of Appeal referred the case to the ECJ.

The Advocate-General has given a preliminary ruling to the effect that whilst the rules in the CPP (and other) cases are based on the consideration that splitting transactions too much could endanger the functioning of the VAT system, for zero-rating provisions it is necessary to limit the derogations as far as possible so as not to undermine harmonisation. She therefore held that the supply was not a single supply and that the supply of a caravan's contents does not fall within the zero-rating provisions.

Opinion of the Advocate-General in Talacre Beach Caravan Sales Ltd C&E (Case C-251/05).

45.10.6 Virtual assignments

In Abbey National plc v Revenue & Customs Commissioners [2006] EWCA Civ 886, the Court of Appeal has reversed the decision of the High Court, holding that the effect of the arrangements in this case were contractual only (Abbey had transferred to a third party all the economic burden and benefits of various leases, but without assigning the legal title, and had then also taken a “virtual lease-back” of some of the properties). The arrangements did not (and could not) confer a right of occupation on the third party and there could therefore be no lease-back by the third party. The supplies were therefore taxable supplies of agency and property management services and not exempt supplies of an interest in land.

45.10.7 Effectiveness of three year cap on repayment claims

In the two cases of Michael Fleming (t/a Bodycraft) v Revenue and Customs Commissioners [2006] EWCA Civ 70, and Conde Nast Publications v Revenue & Customs Commissioners [2006] EWCA Civ 976, the Court of Appeal held that Community law required that the three year cap on repayment claims introduced in 1997 should be disapplied in respect of claims for periods before 1997 because it did not contain any transitional provisions.

However, HMRC subsequently issued Business Brief 13/06 in which they stated their view that, in the absence of a transitional period expressly provided for in the legislation, the capping provisions should only be disapplied to the extent necessary to give effect to a taxpayer's Community law rights where, in individual cases, it was made impossible to exercise those rights by the manner in which the cap was introduced. HMRC says that the cap should not be disapplied generally and that if the taxpayer would not have put in a claim even had a transitional period been provided for, then his Community law rights have not been infringed. Accordingly, HMRC has petitioned for leave to appeal the Conde Nast decision to the House of Lords on this point.
45.10.8 Securitisation: assignment of receivables

The High Court has held that assignments of the beneficial ownership of receivables in the context of a securitisation of credit and charge cards were not, in the context, a supply for VAT purposes because the assignments were simply necessary "pre-conditions" to the supply of the securitisation services. This adversely affected the taxpayers partial exemption calculation.

MBNA Europe Bank Ltd v Revenue & Customs Commissioners [2006] EWHC 2326 (Ch)

45.10.9 Reverse charge on certain electronic goods

In an effort to combat carousel fraud, the government applied to the EC for a derogation from the 6th VAT Directive to enable it to apply a reverse charge to certain electronic goods, including mobile phones, computer chips and other handheld devices, the intention being that the reverse charge would apply from 1 December 2006. The derogation was agreed in principle but subsequently certain Member States objected. The matter is now still under discussion between member States.

45.10.10 Re-cast of the Sixth Directive

The recast of the Sixth VAT Directive (Directive 1006/112/EC on the common system of value added tax) was published in December. The directive has been re-cast to make it clearer and to rationalise some of the provisions. The new directive came into force on 1 January 2007.

45.10.11 VAT and eCommerce Directive

See paragraph 32.1.

45.11 Miscellaneous

45.11.1 2006 Review of Links with Large Business

HMRC has published the 2006 Review of Links with Large Business. This contains various important proposals, including:

- the introduction of a system of advance rulings to give UK and international business certainty about the tax consequences of significant investments and corporate reconstructions. The Report states that from Pre-Budget Report 2007, HMRC will provide binding rulings across all relevant taxes to those that provide clear plans for investment, reconstruction and reorganisation including proposed legal structures and financing. HMRC is to consult to clarify the scope of the rulings system on what is considered as significant and the information businesses would be expected to provide;

- the extension of existing clearances so that as normal business practice HMRC will provide businesses with their view of the tax consequences of significant commercial issues whenever there is uncertainty (with 28 days as the norm). This will be implemented by no later than Budget 2008 and will cover both pre-
and post transaction clearances. The Report also states that the scope of the COP10 process will be revised to give clear parameters and operate consistently (HMRC also to consult on this revised process); and

- a comprehensive approach to the settlement of transfer pricing inquiries, to be based on guidance intended to be published before the end of 2007 so that matters will be settled within 18 months as the norm.

45.11.2 Status of extra statutory concessions

In its paper "Delivering a new relationship with business" published on 28 November, HMRC made the following statement in relation to the current status of extra statutory concessions:

"Agents have recently expressed to HMRC their concerns about the implications of a court judgment [the Wilkinson case in which the court stated that HMRC can make concessions where they are in the interests of good management] which ruled on HMRC's scope for putting in place Extra Statutory Concessions. The judgment has called into question the validity of some of these concessions and all will need to be reviewed to ascertain the impact of this ruling, however it is already clear that many concessions will be able to remain in place."

45.11.3 Construction industry scheme

A new Construction Industry Scheme ("CIS") will come into force with effect from 6 April 2007. Whilst the current scheme operates through a system of registration cards, certificates and vouchers, the new CIS will operate through a system of registration and verification. Contractors will be required to submit monthly returns to HMRC containing specified information and this will include a declaration that none of the contracts which the contractor has with sub-contractors is an employment contract.

Payments made under the scheme may be made either gross (where the subcontractor is registered for gross payment) or under deduction of tax (at 20% where the subcontractor is registered for deduction at that rate) or at a rate up to 30% where the subcontractor is not registered at all.

Some new exemptions will apply, including in particular:

- an exemption in relation to payments made by a person where the expenditure in question is on property which that person (or a relevant group company) occupies for the purpose of its business; and

- an exemption for reverse premiums.
45.11.4 Venture capital reliefs

The Finance Act 2006 includes a number of provisions affecting venture capital trusts ("VCTs"), the Enterprise Investment Scheme ("EIS") and Corporate Venturing Scheme ("CVS"). These include:

- the rate at which income tax relief will be available for investors in VCTs will be 30% for shares issued on or after 6 April 2006;
- the minimum holding period for investors in VCTs to qualify for income tax relief will increase from three to five years;
- from 6 April 2007, any cash which a VCT holds will qualify as an "investment";
- for shares issued on or after 6 April 2006, the investment limit for individuals investing in companies under the EIS will double to £400,000 and the "carry back" relief will double to £50,000; and
- however the number of companies which will be able to issue eligible shares for VCT, CVS and EIS purposes will be significantly reduced because in respect of funds raised after 6 April 2006, these reliefs will only be available for investment in companies whose gross assets do not exceed £7m before the investment (the limit is £15m at present) and £8m after the investment (the limit is £16m at present).
## APPENDIX 1

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