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The *Curtin Law and Taxation Review* (*CLTR*) is a scholarly general law journal which also publishes articles that deal with taxation law. It publishes articles and case notes as well as book reviews in both general law areas and in taxation law. The Review's scholarly works are directed to academic staff, legal scholars, practitioners, justice professionals and postgraduate researchers who have to deal with different aspects of the law.

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Articles

THE BENEFIT OF LEGAL TAXONOMY

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Abstract

The Curtin Law and Taxation Review combines general law with the particular specialisation of taxation. At first glance this seems to be a strange contrast: the very general with the very particular. When examined more closely, the fit is perfect. No lawyer can ever be only a specialist. This article defends this idea which goes to the core of how we think about, and analyse law. The idea that the general is necessary to understand the particular is an idea which has become very unfashionable, particularly in Australia. The modern debate is encapsulated around legal taxonomy. And one person more than any other, is responsible for this modern debate. That person is the late Peter Birks, formerly the Regius Professor of Civil Law at the University of Oxford. In considering the importance of a general view of the law to the understanding of particular areas, the purpose of this short article is to examine Birks' use of legal taxonomy and to explain why despite its weaknesses, it illustrates the importance of the fundamental idea about which the Curtin Law and Taxation Review is based.

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I PETER BIRKS

Birks wrote a great deal on the taxonomy of private law.[1] His academic writing on taxonomy divided the academy. It divided judges. It divided courts. He proposed a taxonomy of private law which separated legal events from legal responses. Birks' taxonomy drew from the work of the Roman jurist Gaius whose taxonomy, by the time of Justinian, divided all of Roman private law into contract, quasi-contract ('as though from contract'), delict and quasi-delict ('as though from delict').[2] Birks divided private law claims into events of consent, wrongs, unjust enrichment and other events.[3] He represented his taxonomic scheme diagrammatically as follows. The horizontal axis contains legal categories of events. The vertical axis reflects the different goals of remedies given by a court within each legal category.[4]

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1 See, eg, Peter Birks, 'Equity in the Modern Law: An exercise in taxonomy' (1996) 26(1) *University of Western Australia Law Review* 1; Peter Birks, 'Definition and Division: A Meditation on *Institutes* 3.13' in Peter Birks (ed), *The Classification of Obligations* (Clarendon Press Oxford, 1997) ch 1; Peter Birks, 'Unjust Enrichment and Wrongful Enrichment' (2001) 79 *Tex Law Review* 1769.

2 See discussion in Peter Birks and Grant McLeod (trans), *Justinian's Institutes* (1987) 14.

3 Peter Birks has been compared with Friedrich Karl von Savigny and the modern Pandectist school: See Joshua Getzler, 'Am I my beneficiary's keeper? Fusion and loss-based fiduciary remedies' in Simone Degeling and James Edelman (eds), *Equity in Commercial Law* (Thomson LBC Sydney, 2005) ch 10.

4 Birks labelled these axes 'events' and 'responses': Peter Birks, 'Definition and Division: A Mediation on *Institutes* 3.13' in Peter Birks (ed), *The Classification of Obligations* (Clarendon Press Oxford, 1997) ch 1.

	Consent	Wrongs	Unjust Enrichment	Other
Compensation				
Restitution				
Punishment				
Perfection				
Other responses				

In the short compass of this article, it is not possible to engage with the entirety of the scholarship created by Birks' work on taxonomy. For instance, it generated taxonomies of legal taxonomy;[5] it generated an extraordinary work which aimed to map the entirety of the French and English law of wrongs; [6] and it sparked an enterprise of examination of the nature of difference between the study of law as a social science and the study of natural sciences.[7] Instead, this article sets out several of the major criticisms of Birks' taxonomic enterprise before explaining why the enterprise is nevertheless, valuable. The value of the exercise in taxonomy that Birks so powerfully reinvigorated lies in a fundamental lesson which can be drawn from it.

II CRITICISMS OF BIRKS' TAXONOMY

There are significant weaknesses in Birks' taxonomy. Most of these weaknesses were recognised by Birks. It is sufficient to focus only on three. First, to the eye of a scientific taxonomer Birks' taxonomy

5 Emily Sherwin, 'Legal taxonomy' (2009) 15 *Legal Theory* 25.

6 Eric Descheemaeker, *The Division of Wrongs* (Oxford University Press, 2009).

7 For instance, Geoffrey Samuel, 'Can Gaius really be compared to Darwin' (2000) 49 *International and Comparative Law Quarterly* 297; Geoffrey Samuel, 'English private law: old and new thinking in the taxonomic debate' (2004) 24 *Oxford Journal of Legal Studies* 335; Kelvin Low, 'The use and abuse of taxonomy' (2009) 29 *Legal Studies* 355.

might appear to be a Panglossian ordered and formal law that envisages little discretion for the judge and which constrains legal innovation by reference to abstract, intangible concepts.[8] It was, perhaps, for this reason that in *Bofinger v Kingsway Group Ltd,*[9] a joint judgment of the High Court of Australia said, in relation to the absence of a category for 'equity' that 'the experience of the law does not suggest debilitation by absence of a sufficiently rigid taxonomy in the application of equitable doctrines and remedies'. Another joint judgment of the High Court subsequently described Birks' approach to the law concerning restitution of unjust enrichment as 'a mentality in which considerations of ideal taxonomy prevail over a pragmatic approach to legal development'.[10] As Associate Professor Low has said, the difficulty of a taxonomy of a social science is that there are no observable facts by which a classification can be tested and the classification is not independent of its subject matter.[11] For instance, in the original edition of *Systema Naturae* Linnaeus misclassified a whale as a fish, but this misclassification was corrected based on observable facts, and the reclassification did not physically affect any whales. In contrast, Birks' taxonomy of law was intended to affect its subject matter directly. For instance, as I explain below, the classification as 'wrongs' of actions in equity for actual fraud, and common law actions for deceit directed attention to whether differences in the subject matter of the classification, the actions themselves, should be altered.

A second and related weakness in Birks' taxonomy, which Justice Leeming has described,[12] is the absence of any role for statute despite

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8 See Steven Hedley, 'Rival Taxonomies within the Law of Obligations: Is there a problem?' in Simone Degeling and James Edelman (eds), *Equity in Commercial Law* (Thomson LBC Sydney, 2005) ch 4.

9 (2009) 239 CLR 269, 300–1 [93] (the Court).

10 *Farah Constructions Pty Ltd v Say-Dee Pty Ltd* (2007) 230 CLR 89, 158 [154].

11 Low, above n 7, 359.

12 Mark Leeming, 'Theories and Principles underlying the development of the common law' (2013) 36 *New South Wales Law Journal* 1002, 1028.

its impact and dominance. Legislation need not, and does not always, respect taxonomic boundaries. Legislation and common law are inextricably intertwined. A coherent system of law cannot treat of the two (in Lord Justice Beatson's metaphor) as 'oil and water'.[13] The common law and statute law 'coalesce in one legal system'.[14] As Justice Gageler has observed,[15] 'the meaning of a statutory text is also informed, and reinformed, by the need for the courts to apply the text each time, not in isolation, but as part of the totality of the common law and statute law as it then exists'.

A third weakness in Birks' taxonomy is the absence of a number of internal boundaries which are essential markers in many areas of private law. One boundary is between personal rights and property rights. Birks' taxonomy treated of the two alike. So an obligation to transfer title to, say, a car is an obligation created by consent,[16] but the property right that the purchaser obtains to the car is generated by a different and subsequent event of conveyance. The latter event generating the purchaser's property right needs to be classified separately as either arising by consent (even though the conveyance is something that the vendor is legally obliged to do) or as an 'other event'. Another internal boundary which is concealed by Birks' taxonomy is the distinction between primary and secondary rights.[17] For instance, Birks' taxonomy treats wrongs and unjust enrichment as the same type of event. But the law only recognises a wrong if it has

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13 Jack Beatson, 'Has the Common Law a Future?' (1997) *Cambridge Law Journal* 291, 308.

14 *R v Secretary of State for the Home Department; Ex Parte Pierson* [1998] AC 539, 580 (Lord Steyn); William Gummow, *Change and Continuity* (Oxford University Press, 1998) 1.

15 Simon Gageler, 'Common Law Statutes and Judicial Legislation: Statutory Interpretation as a Common Law Process' (2011) 37(2) *Monash University Law Review* 1, 2.

16 See discussion in Robert Stevens, *Torts and Rights* (Oxford University Press, 2007) 285–6.

17 See, eg, Peter Birks, 'Equity in the Modern Law: An exercise in taxonomy' (1996) 26(1) *University of Western Australia Law Review* 1, 10.

already recognised a pre-existing duty. Furthermore, Birks' taxonomy of private law has no place for a person's duty not to assault another, not to commit trespass, not to defame another, and so on. The only 'event' which gives rise to those rights is a person's birth. Birks was left to say that these fundamental rights are 'superstructural' to his taxonomy. A final internal boundary which is not recognised in Birks' taxonomy is the boundary between different types of right: claim rights, immunities, privileges, and powers. The different nature and character of those 'rights' is essential to understand their interaction as a recent decision of the High Court of Australia has vividly illustrated.[18]

There is sometimes a fourth argument made against Birks' taxonomy. This fourth argument should be rejected. It is the argument that the taxonomy is drawn from the long-distant past of Roman law with no contemporary place in the law. This misunderstands both the contribution and the significance of Roman law to our law today. Not only is Roman law the source of much of our private law but it continues to have direct influence. As Dr Lee has observed,[19] Roman scholarship was relied upon in three of the most important private law decisions given by the House of Lords in the last 15 years: in 2001,[20] 2002[21] and 2007.[22] In the first case, the late, brilliant, Lord Rodger drew from the conflicting views of Ulpian and Julian in relation to the complex question of causation in the law of torts. In the second case,

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18 For an important recent example see *Western Australia v Brown* (2014) 306 ALR 168. There is a basic difference between freedoms from liability which almost never conflict (eg, from liability for trespass to minerals by a mining licence and freedom from trespass to land by native title) and competing claim rights or claim rights and freedoms (eg, to 'exclusive' possession) which almost always do and require one to give way to the other.

19 James Lee, 'Confusio: Reference to Roman Law in the House of Lords and the development of English Private Law' (2009) 5 *Roman Legal Tradition* 24.

20 *Fairchild v Glenhaven Funeral Services* [2002] UKHL 22; [2003] 1 AC 32.

21 *Foskett v McKeown* [2000] UKHL 29; [2001] 1 AC 102.

22 *OBG Ltd v Allan* [2007] UKHL 21; [2008] 1 AC 1.

Lord Hoffmann and Lord Hope of Craighead drew from Roman law the principles concerning *confusio* (and the writings of Iavolenus and Ulpian) to try to resolve the question of tracing of mixed funds. In the third, Baroness Hale referred to the development in Roman law of the *vindicatio* action in her revolutionary dissent concerning whether conversion as a tort extended to intangibles. To put the influence of these Roman scholars in perspective, it would be as if something that one of us had written today on a single point of law, and published extra-judicially, was relied upon as an important authority by a court in the year 3800.

III A Fundamental Lesson from Birks' Taxonomy

Despite its limitations there is a fundamental lesson which can be drawn from Birks' taxonomy. One aspect of the rule of law demands that like cases be treated alike. The lesson from Birks' taxonomy is that we can only have a coherent understanding of what cases are materially alike, and what cases are materially different, through the use of taxonomy and classification.

Despite all its limitations, Birks' taxonomy directs our attention to the need for us to refine the taxonomies within which we operate. It is impossible to argue rationally against *any* form of classification or taxonomy. The human mind operates by classifying and comparing. The need to classify and compare is greater now than it has been at any time in history. Almost a century ago, Benjamin Cardozo said this:

> The fecundity of our case law would make Malthus stand aghast. Adherence to precedent was once a steadying force. The guarantee, as it seemed, of stability and certainty. We would not sacrifice any of the brood, and now the spawning progeny, forgetful of our mercy are rendering those who spared them … An avalanche of decisions by tribunals great and small is producing a situation where citation of precedent is tending to

> count for less and appeal to an informing principle is tending to count for more.[23]

This multiplication of case law has increased at an exponential rate in recent decades as judgments from many courts and tribunals move online and, in turn, the unpublished judgment begins to become a relic. With this growing mass of case law, and its ease of accessibility, there is a great danger of what Birks described as 'stovepipe mentality'. He said that the 'intelligent analysis of the client's problem, the capacity to recognise the cards the client holds, and the presentation of innovative arguments, all these crucially depend upon a sure grasp of the structured overview of the law as a whole.[24]

To have any real understanding of how the law fits together, and to coherently answer legal problems, we therefore need a mental taxonomy of the law. One very important benefit of Birks' taxonomy is that it directs our attention to the fact that all of our current taxonomies of private law are underdeveloped and problematic. Most law schools today divide private law into a taxonomy which includes principal subjects of contract, torts, trusts, and property. Justice Gummow has described the three great sources of obligation in private law as contract, tort and trust.[25] This is a discontinuous and incomplete taxonomy. The taxonomies are not continuous because they include contract alongside trust, but a contract could be the source of a trust. Two persons can contract in terms which create a trust. The taxonomies are also incomplete because there are many obligations which arise other than by contract, tortious act, or creation of a trust. Statute is a prolific example: for instance, the obligation to pay tax. Another example is a unilateral bond or a letter of credit. In

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23 Benjamin Cardozo, 'The Growth of Law: The Need of A Scientific Restatement as an Aid to Certainty', Lecture to Yale Law School (1923) quoted in G C Hall, 'Precedent in Crisis: Official Law Reporting in Ireland' (1996) 27 *Law Librarian* 1946.

24 Peter Birks, 'Introduction' in Peter Birks (ed), *English Private Law* (Oxford University Press, 2000) xxxv.

25 *Roxborough v Rothmans of Pall Mall Australia Ltd* (2001) 208 CLR 516, 540 [64] (Gummow J).

relation to the former, after the decline of covenant this was one of the most common obligations. The obligation was created by deed which commonly recited, in Latin, 'Know all men etc, that I, AB, am firmly bound to CD in £n to be paid at Michaelmas next following'.[26]

It is unsurprising that our modern taxonomies of private law are underdeveloped. The trust arose from the ashes of the executed use in the 16th and 17th centuries,[27] but the modern law of contract did not completely emerge from its foundations of *assumpsit* until the mid-19th century when, following publication of a translation of Pothier's *Traité des obligations*,[28] key English cases in the mid-19th century such as *Hadley v Baxendale* and *Smith v Hughes*[29] developed the will theory of contract. Barely two centuries ago, Pothier lamented in his work upon the law of contract that 'the science of jurisprudence … has been too generally estimated as a mere collection of positive rules … a mere acquaintance with the particular rules and institutes of [a lawyer's] own profession will be a very inadequate foundation for the character of a perfect lawyer'.[30] Although contract emerged from assumpsit by the turn of the 20th century, the law of torts, in the form we understand it today, did not emerge until the mid-20th century after *Donoghue v Stevenson*[31] began the process of generalising a duty of care. Finally, the law of unjust enrichment only clearly and distinctly

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26 John Baker, *An Introduction to English Legal History* (Oxford University Press, 4th ed, 2002) 323.

27 For the evolution of the trust after the *Statute of Uses* (1535) 27 Henry VIII c10 see Baker, above n 26, 248–58, 280–97.

28 W Evans, *A Treatise on the law of Obligations or Contracts by M Pothier* (A Strahan London, 1806).

29 *Hadley v Baxendale* (1854) 9 Ex 241; 156 ER 145; *Smith v Hughes* (1871) LR 6 QB 597. See Alfred William Brian Simpson, 'Innovation in Nineteenth Century Contract Law' in *Legal Theory and Legal History. Essays on the Common Law* (London Hambledon Press, 1987) at 171–202, and David John Ibbetson, *A Historical Introduction to the Law of Obligations* (Oxford University Press, 1999) chs 12 and 13.

30 Robert Pothier, *A Treatise on the Law of Obligations or Contracts* (1806, vol 1: trans W Evans) 35–6.

31 [1932] AC 562.

emerged in judicial decisions in 1987 in Australia[32] and in 1991 in England.[33] In *Equuscorp Pty Ltd v Haxton,*[34] French CJ, Crennan and Kiefel JJ said that unjust enrichment 'has a taxonomical function referring to categories of cases in which the law allows recovery by one person of a benefit retained by another'.

One very significant example can be given of the importance of Birks' taxonomy and the need which it provokes for lawyers to understand the nature and interrelationship of doctrines within the systemic whole of the law. As I explained at the start of this article, the High Court of Australia has suggested that 'the experience of the law does not suggest debilitation by absence of a sufficiently rigid taxonomy in the application of equitable doctrines and remedies'. I do not think that this statement was intended to be understood as suggesting that equitable doctrines and remedies should not be categorised and treated alongside common law categories. That view is very commonly held. Birks' taxonomy directs attention to why it must be rejected.

Many lawyers think of the law of torts and the law of equity as two mutually exclusive categories. 'Tort' is a French word which describes a common law wrong. It is a French delicacy that had crept into our law by the time that Mrs Donoghue decided to sample a snail, with a little ginger, but why should the law of torts be confined to civil wrongs, whose jurisdictional origin is common law rather than equity? Consider, for example, the tort of deceit. It has been recognised for more than a century that the common law tort of deceit is identical to the equitable wrong of deceit. As Lord Chelmsford explained of deceit in equity, '[i]t is precisely analogous to the common law action for deceit. There can be no doubt that Equity exercises a concurrent jurisdiction in cases of this description, and the

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32 *Pavey & Matthews Pty Ltd v Paul* (1987) 162 CLR 221; *David Securities Pty Ltd v Commonwealth Bank of Australia* (1992) 175 CLR 353.

33 *Lipkin Gorman v Karpnale Ltd* [1991] 2 AC 548; [1992] 4 All ER 512; [1991] 3 WLR 10.

34 (2012) 246 CLR 498, 516 [30].

same principles applicable to them must prevail both at Law and in Equity.'[35] Not only is it historical to treat of deceit as a doctrine which is subject to different rules depending upon its jurisdictional origin in Chancery or in the King's courts, but a taxonomy such as that of Birks directs attention to deep underlying questions which anyone defending an independent and separate classification of 'equity' must answer. If all the equitable principles that arose in the Courts of Chancery are somehow based upon a different 'conscience' or a different discretion then why did the Courts of Chancery tussle with the common law for centuries concerning the appropriate test for the wrong of deceit?

IV Conclusion: The History and Future of Taxonomy

The focus of this article has been on the importance of taxonomy. As the criticisms of Birks' taxonomy show, there are serious weaknesses in any attempt to classify or map private law, but there are also significant benefits which can be reaped so long as the limitations of the exercise are not forgotten. The exercise of taxonomy in the future is likely to be primarily undertaken by the academy. In an era where judges are increasingly specialised, increasingly submerged beneath a sea of ever-expanding judicial decisions with arguments that raise finer and finer points of law, the relationship between the judiciary and the academy is more important today than it ever has been in history. It is the academic branch of the profession which, in the future, will have the time, the focus, and hopefully the vision consistently to refine our taxonomy of law.

Birks' taxonomy was born in the academy. It is likely that academic gestation and development of taxonomy will be the way of the future, but it is easy to forget that the professional law schools, and the beginning of a divide between the judiciary and the academy, began barely 150 years ago. The Romans did not recognise a divide between the academic and the practitioner. The jurists were the great scholars. They were the law in action. This divide is very recent in the life of

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35 *Peek v Gurney* (1873) LR 6 HL 377, 393.

our law. Over the last 600 years the greatest developments in the taxonomy of the common law also came from extra-judicial academic writing mostly by judges. Glanvill, who wrote the first great book on English law in the 12th century, was Henry II's Chief Justiciar in the Curia Regis. His foundational book was *Tractatus de legibus et consuetudinibus regni Angliae:* A treatise on the laws and customs of the English Kingdom. Although it is not clear how much of his great work [36] was actually written, or edited, by Bracton, there is a consensus that his contribution came before he had turned 30. Bracton started sitting as a judge at 35. Littleton sat as a judge in common pleas. He was writing only a couple of decades after Gutenberg revolutionised printing and his treatise on *Tenures* became the first printed legal book in English, or rather law-French. It was an indispensable work for more than three centuries. The same pattern has repeated itself again, and again, and again. Sir Edward Coke, who wrote the *Institutes,* was Chief Justice of Common Pleas (and then later the Chief Justice of the King's Bench). Fortescue, from whose great work,[37] we know the maxim that it is better that 20 guilty men go free than one innocent man be condemned, was Chief Justice of King's Bench. So too, Blackstone also sat on the King's Bench.

The beauty of the common law is that it works itself pure. It moves in search of a truth. The shape of the common law is not the product of any single court, nor any single writer. The common law is, as the late Lord Rodger said, like a fine wine: 'trying to rush the process will only spoil the vintage'.[38] That shape is ultimately determined by taxonomy.

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36 *De Legibus et Consuetudinibus Angliae* (On the Laws and Customs of England).

37 *De laudibus legum Angliae* (In Praise of the Laws of England).

38 Lord Rodger, 'An Introduction to *Sempra Metals*' in Simone Degeling and James Edelman (eds), *Unjust Enrichment in Commercial Law* (Thomson Reuters, Sydney, 2008) 317, 331.

WHAT IS TAX AVOIDANCE?

G T PAGONE*

Abstract

For a lawyer, however, it has to be acknowledged at once that there is no such thing as 'tax avoidance'. If a liability to tax has been incurred, then not to discharge that liability is merely to evade payment of tax. If a liability to tax has not been incurred, then it is meaningless to speak of the liability as having been 'avoided'.[1]

Identifying what is meant by tax avoidance with sufficient precision, certainty and predictability, is both difficult and necessary. The difficulty lies in the task of identifying when something, which is legally effective, is found nonetheless to be fiscally ineffective. The necessity lies in the need for tax laws 'to be clear, easily accessible, comprehensible, prospective rather than retrospective, and relatively stable'.[2] Adam Smith taught that 'the tax which each individual is

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1 Allan Myers QC, 'A Minefield of Tax-Avoidance' (Paper presented at Taxation Institute of Australia 38th Victorian State Convention 'At the Cross Roads', Cumberland Lorne Resort Victoria, 9 September 1999).

2 Melissa Casten and Sarah Joseph, *Federal Constitutional Law: A Contemporary View* (Thomson Reuters, 2nd ed, 2006) 5; Joseph Raz, 'The Rule of Law and its Virtue' (1977) 93 *Law Quarterly Review* 195, 198–202; Albert Venn Dicey, *Introduction to the Study of the Law of the Constitution* (McMillan and Co Ltd, first published 1885; 1960 ed); Butterworths, *Halsbury's Laws of Australia*, vol 4 (at 1 July 2008) 80 Civil and Political Rights, 'B Australian use of International Convention on Civil and Political Rights' [80-25].

bound to pay ought to be certain and not arbitrary. The time for payment, the manner of payment, the quantity to be paid ought all to be plain and clear to the contributor and to every other person'.[3] These objectives are not achieved where the fact, and basis, of taxation is not known with precision in advance or if known provisions are not applied consistently in like circumstances.

The concept of 'tax avoidance', however elusive,[4] is to be contrasted with concepts such as 'tax evasion', 'sham', 'tax minimisation' and 'permissible tax planning'. The Privy Council in *Commissioner of Inland Revenue v Challenge Corporation Ltd* considered there to be 'discernible distinctions' between sham, tax evasion, tax mitigation and tax avoidance.[5] A transaction is a sham where the parties have a common intention to create something with the appearance of legal rights and obligations; however, the parties' intention is to not create the legal rights and obligations to which they have given the appearance of creating.[6] A sham transaction is legally ineffective, although not all legally ineffective transactions will be shams, even where some illegality may be involved.[7] A consequence of a transaction being a sham is that it may be disregarded for tax purposes without the need for the application of any anti-avoidance provisions.[8] A sham transaction is, therefore, conceptually different

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3 Adam Smith, *The Wealth of Nations* (first published 1901) Book V, ch II, pt II.

4 *Inland Revenue Commissioner v Willoughby* [1997] 1 WLR 1071, 1079.

5 [1987] 1 AC 155, 167.

6 *Snook v London & West Riding Investments* [1967] 2 QB 786, 802; *Scott v Federal Commissioner of Taxation [No 2]* (1966) 40 ALJR 265, 279; *Equuscorp Pty Ltd v Glengallan Investments Pty Ltd* (2004) 218 CLR 471, 486 [46]; *Raftland Pty Ltd v Federal Commissioner of Taxation* (2008) 238 CLR 516.

7 *Commissioner of Taxation v Lau* (1984) 6 FCR 202, 207, 219.

8 *Jaques v Federal Commissioner of Taxation* (1921) 34 CLR 328, 358; *Richard Walter Pty Ltd v Commissioner of Taxation* (1996) 67 FCR 243.

from a legally effective transaction which is nonetheless fiscally ineffective by reason of tax avoidance.

Tax evasion, as distinct from tax avoidance, involves some element of fault or illegality not present in tax avoidance.[9] Tax evasion involves a failure to discharge an obligation which has arisen while tax avoidance is directed to preventing any legal obligation from arising in the first place. In *Australasian Jam Co Pty Ltd v Federal Commissioner of Taxation*, Fullagar J distinguished 'avoidance' from 'evasion' on the basis that the former did not involve any active or passive fault. [10] In *Denver Chemical Manufacturing Co v Commissioner of Taxation (NSW)*, Dixon J said that it was unwise to define the word 'evasion' but that it meant more than 'avoid' and contemplated 'some blameworthy act or omission'.[11] Avoidance is concerned with lawful conduct while tax evasion is not.

Tax avoidance may also usefully be distinguished from those transactions which fail to achieve their intended taxation consequences because their purpose was to secure only, or to the extent that their purpose was to secure, taxation objectives. In *Fletcher v Commissioner of Taxation*, the High Court said that a deduction would not be allowable under the general deduction provision where the outgoing had been incurred to secure 'very substantial personal income tax advantages' [12] rather than the derivation of assessable income. The case concerned the general provision allowing deductions for losses or outgoings incurred in gaining or producing assessable income or in carrying out a business for the production of such income. In *Fletcher*,[13] deductibility of the outgoing for the taxpayer involved characterising the purpose of the outgoing in question.[14] In that case the taxpayer had entered into a

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9 *R v Meares* (1997) 37 ATR 321, 323; *Australasian Jam Co Pty Ltd v Federal Commissioner of Taxation* (1953) 88 CLR 23, 34.

10 (1953) 88 CLR 23.

11 (1949) 79 CLR 296, 313–14.

12 (1991) 173 CLR 1, 23 ('*Fletcher'*).

13 (1991) 173 CLR 1.

14 Ibid 17.

transaction which gave rise to much greater outgoings than might be received by way of assessable income from the transaction. The terms of the transaction were such that the economic burden of the outgoings may not be felt because of the economic benefits of the tax deductions, and that the potential for assessable income at the end of the period of the transaction might never be enjoyed. The disproportion between the detriment of the outgoing and the possible future benefit of the income gave rise to a need to 'resolve the problem of characterisation of the outgoing'[15] required by the section allowing the deduction 'by a weighing of the various aspects of the whole set of circumstances, including direct and indirect objects and advantages which the taxpayer sought in making the outgoing'.[16] A 'common sense' or 'practical' weighing of all factors relevant to providing the answer would deny the taxpayer any deduction to the extent that the outgoings were explained by 'the very substantial personal income tax advantages which the taxpayers were expected to derive from the early years'[17] of the transaction. The outcome in *Fletcher* did not depend upon a finding of tax avoidance as much as an absence of the necessary character for the outgoing to be effective.[18] The taxpayer's 'tax avoidance purpose' may have been the explanation for the necessary character being absent, but the outcome depended upon the absence of the character to attract the deduction.

The distinction most difficult to make is that between tax avoidance and permissible tax mitigation. The tax consequences of transactions will usually, and permissibly, affect the way taxpayers behave and an awareness of those consequences may have an impact upon the shape that the transaction takes. In *Federal Commissioner of Taxation v Spotless Services Ltd*, it was said in a joint judgment:[19]

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15 Ibid 18.

16 Ibid 18.

17 Ibid 18–19, 23.

18 Ibid.

19 (1996) 186 CLR 404 ('*Spotless*').

> A taxpayer within the meaning of the Act may have a particular objective or requirement which is to be met or pursued by what, in general terms, would be called a transaction. The 'shape' of that transaction need not necessarily take only one form. The adoption of one particular form over another may be influenced by revenue considerations and this, as the Supreme Court of the United States pointed out, is only to be expected. A particular course of action may be, to use the phrase found in the Full Court judgments, both 'tax driven' and bear the character of a rational commercial decision. The presence of the latter characteristic does not determine the answer to the question whether, within the meaning of Part IVA, a person entered into or carried out a 'scheme' for the 'dominant purpose' of enabling the taxpayer to obtain a 'tax benefit'.[20]

That case concerned the specific anti-avoidance provisions found in pt IVA of the *Income Tax Assessment Act 1936* (Cth), but they echo a wider concern to discern how the inevitability of taxpayers moulding their conduct by reference to taxation considerations translates into deciding which moulding is permissible from that which is not.

A constant theme in the jurisprudence concerned with tax avoidance is that tax avoidance is not to be determined by the subjective purpose or motivation of a taxpayer. The United States decision of *Helvering v Gregory* found that a transaction was to be denied its tax effect but it was irrelevant to take into account that the transaction may have been motivated by tax avoidance.[21] The Supreme Court said:

> But the question for determination is whether what was done, apart from the tax motive, was the thing which the statute intended. […] Putting aside, then, the question of motive in respect of taxation altogether, and fixing the character of the proceeding by what actually occurred, what do we find? […] The rule which excludes from consideration the motive of tax avoidance is not pertinent to the situation, because the transaction upon its face lies outside the plain intent of the statute.[22]

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20 Ibid 416.

21 69 F2d 809 (2nd Cir 1934; affd 293 US 465 (1935)).

22 *Gregory v Helvering*, 293 US 465, 469–70 (1935).

Similar statements can be found in other jurisdictions.[23] In *Federal Commissioner of Taxation v Hart*, Gummow and Hayne JJ rejected a consideration of the reason the taxpayers may have entered into the transaction as relevant to a consideration of the dominant purpose saying:[24]

> In these matters, it is, of course, true that the money was borrowed to finance and refinance the two properties. Of course the loan was structured in the way it was in order to achieve the most desirable taxation result. But those are statements about why the respondents acted as they did or about why the lender (or its agent) structured the loan in the way it was. They are not statements which provide an answer to the question posed by s 177D(b). That provision requires the drawing of a conclusion about purpose from the eight identified objective matters; it does not require, or even permit, any enquiry into the subjective motives of the relevant taxpayers or others who entered into or carried out the scheme or any part of it.[25]

The exclusion of the taxpayer's reason in determining the character of a transaction as tax avoidance is instructive and important. It is important because fiscal policy should not depend upon the fiscal awareness of individuals but ought to apply objectively and predictably upon all like situations irrespective of the individual reason a taxpayer (or a taxpayer's agent) may have in entering into a transaction. It would not be desirable for two transactions, identical in all material respects, to produce different outcomes by reference only to the subjective reason the relevant person had for entering into the transaction. It is also instructive because it guides the search for the factors that will determine whether a transaction is to be characterised as an avoidance transaction.

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23 See generally *Canada Trustco Mortgage Co v Canada* [2005] 2 SCR 601; *Copthorne Holdings Ltd v Canada* [2011] 3 SCR 721; *Ben Nevis* (2009) 24 NZTC 23,188; *Federal Commissioner of Taxation v Hart* (2004) 217 CLR 216; *Peabody v Federal Commissioner of Taxation* (1993) 40 FCR 531.

24 (2004) 217 CLR 216.

25 Ibid 243 [65].

Two objective features that figure prominently in tax avoidance law and jurisprudence are those of 'abuse of statute' and 'artificiality of the transaction'. The conclusion in *Gregory v Helvering* that the operation claimed by the taxpayer to be a corporate 'reorganisation' had been, rather, 'a mere device which put on the form of a corporate re-organisation as a disguise for concealing its real character'[26] was not that the parties had intended that the transaction not have legal consequences, but that it lacked the economic or business consequences which the relevant fiscal provision was expected to deal with. The hallmarks of tax avoidance emerging from *Gregory v Helvering*,[27] and other judgments, lie in seeing whether the taxpayer did produce what was to be expected when the relevant statutory provision would ordinarily apply. To say that the transaction was artificial is to say that the transaction did not have the substance that one would expect of transactions of that kind in the context of the provision relied upon. To say that a provision was being abused is to say that it was relied upon in circumstances where there was absent those things which one would ordinarily expect to find when the provision was ordinarily intended to operate.

A similar view was expressed by Lord Nolan in *Inland Revenue Commissioner v Willoughby* when adopting the submissions of counsel, distinguishing tax avoidance from tax minimisation, as a 'generally helpful approach to the elusive concept of "tax avoidance"'.[28] His Lordship said:

> Tax avoidance was to be distinguished from tax mitigation. The hallmark of tax avoidance is that the taxpayer reduces his liability to tax without incurring the economic consequences that Parliament intended to be suffered by any taxpayer qualifying for such reduction in his tax liability. The hallmark of tax mitigation, on the other hand, is that the taxpayer takes advantage of a fiscally attractive option afforded to him by the tax legislation, and genuinely suffers the economic consequences that Parliament intended to be suffered by those taking advantage of the option. Where the taxpayer's chosen course is seen upon

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26 *Gregory v Helvering*, 293 US 465, 470 (1935).

27 Ibid.

28 [1997] 1 WLR 1071.

> examination to involve tax avoidance (as opposed to tax mitigation), it follows that tax avoidance must be at least one of the taxpayer's purposes in adopting that course, whether or not the taxpayer has formed the subjective motive of avoiding tax.[29]

In *Commissioner of Inland Revenue v Challenge Corp Ltd*, the Privy Council said:[30]

> In an arrangement of tax avoidance the financial position of the taxpayer is unaffected (save for the costs of devising and implementing the arrangement) and by the arrangement the taxpayer seeks to obtain a tax advantage without suffering that reduction in income, loss or expenditure which other taxpayers suffer and which Parliament intended to be suffered by any taxpayer qualifying for a reduction in his liability to tax.[31]

The inquiry into the fundamentals of tax avoidance, therefore, is an inquiry into whether what the taxpayer claims is matched by an objective analysis of what has been done. It is not the taxpayer's motive that governs the question of whether a transaction was one of tax avoidance but, rather, whether what has been claimed is what has occurred.

A requirement in most general anti tax avoidance rules ('GAARs') that a liability has been avoided is usually not satisfied just because a tax benefit has been obtained. There must be something about how it has been obtained that can be seen to be an impermissible avoidance. The Australian GAAR, for example, depends upon a conclusion that the dominant purpose of a person entering into or carrying out a scheme was to enable a taxpayer to obtain a tax benefit: *Income Tax Assessment Act 1936* (Cth) s 177D. In that task, attention is focused upon the objective facts and circumstances by which the tax benefit was obtained (the way in which the scheme was entered into or carried out) to determine whether it is to be concluded to have the dominant purpose of avoidance.[32] A requirement in a GAAR that the taxpayer's scheme also abused or misused a fiscal provision requires consideration of the statutory provisions relied upon and a

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29 Ibid 1079.

30 [1987] AC 155.

31 Ibid 169.

32 *Spotless* (1996) 186 CLR 404.

construction of the provision that is contrary to the way in which the taxpayer has relied upon it.[33] There are many provisions explicitly designed to reduce a taxpayer's tax burden, and, to rely upon such provisions will result in reducing a tax burden which would otherwise arise and would not be an abuse or misuse of the provision.

The economic substance doctrine enunciated in *Gregory v Helvering* depended upon the view that to uphold the taxpayer's transaction as effective would have been to sanction an abuse or misuse of the provision which the taxpayer had relied upon.[34] The reasoning in the courts' opinion depended fundamentally upon principles of legislative interpretation. The courts' opinion concluded that what had been done could not be seen to fall within what the section had intended. That conclusion depended upon an objective comparison between what the section intended and what the taxpayer achieved. Learned Hand's conclusion against the taxpayer fastened upon the absence of economic or business reality in what had been claimed by the taxpayer to fall within the statute:

> We agree with the Board and the taxpayer that a transaction, otherwise within an exception of the tax law, does not lose its immunity, because it is actuated by a desire to avoid, or, if one choose, to evade, taxation. Anyone may so arrange his affairs that his taxes shall be as low as possible; he is not bound to choose that pattern which will best pay the Treasury; there is not even a patriotic duty to increase one's taxes. […] Nevertheless, it does not follow that Congress meant to cover such a transaction, not even though the facts answer the dictionary definitions of each term used in the statutory definition … [T]he meaning of a sentence may be more than that of the separate words, as a melody is more than the notes, and no degree of particularity can ever obviate recourse to the setting in which all appear, and which all collectively create.[35]

The opinion of the Supreme Court on appeal placed emphasis upon the absence of business or corporate purpose to a transaction which otherwise appeared to come within the words used by the legislature:

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33 *Gregory v Helvering*, 293 US 465 (1935).

34 Ibid.

35 69 F 2d 809, 810–11 (1934).

> […] fixing the character of the proceeding by what actually occurred, what do we find? Simply an operation having no business or corporate purpose — a mere device which put on the form of a corporate reorganization as a disguise for concealing its real character, and the sole object and accomplishment of which was the consummation of a preconceived plan, not to reorganize a business or any part of a business, but to transfer a parcel of corporate shares to the petitioner […] To hold otherwise would be to exalt artifice above reality and to deprive the statutory provision in question of all serious purpose.[36]

The reason 'the transaction upon its face' was said to fall outside the plain intent of the statute required consideration of 'what actually occurred'.[37] It also required consideration of how the section was otherwise expected to operate. It was in the comparison of the two that the court concluded that what actually occurred did not match the business or corporate outcomes expected in the usual application of the relevant provision. An abuse or misuse of the provisions was seen not in the taxpayer's actual (subjective) intention, or in the taxpayer securing a tax advantage, but in the objective comparison of how the section was used by the taxpayer with how the section could objectively be expected to operate. The objective features expected in the latter were not actually present in the former.

The Canadian legislature adopted a requirement of abuse in its statutory GAAR in addition to a requirement of avoidance. Section 245(4) applies to deny tax benefits to avoidance transactions, as defined by s 245(3), but s 245(4) excludes avoidance transactions from the operation of the GAAR unless they fail the abuse or misuse test.[38] A transaction to be caught by the Canadian GAAR must be both an 'avoidance' transaction and an 'abuse or misuse' of the provision relied upon. Section 245(4) provides:

> Subsection (2) applies to a transaction only if it may reasonably be considered that the transaction

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36 293 US 465, 469–70 (1935).

37 Ibid.

38 *Income Tax Act* RSC 1985, c 1.

(a) would, if this Act were read without reference to this section, result directly or indirectly in a misuse of the provisions of any one or more of
  (i) this Act,
  (ii) the *Income Tax Regulations*,
  (iii) the *Income Tax Application Rules*,
  (iv) a tax treaty, or
  (v) any other enactment that is relevant in computing tax or any other amount payable by or refundable to a person under this Act or in determining any amount that is relevant for the purposes of that computation; or

(b) would result directly or indirectly in an abuse having regard to those provisions, other than this section, read as a whole.[39]

In *Canada Trustco Mortgage Co v Canada*, the Canadian Supreme Court explained that in determining whether the GAAR applies to a transaction there needs to be considered: (a) whether there was a tax benefit arising from the transaction; (b) whether the transaction was an avoidance transaction because it was not arranged primarily for bona fide purposes other than to obtain the tax benefit; and (c) whether the avoidance transaction was abusive.[40]

The requirement that the transaction be abusive depends upon an enquiry into whether the transaction, albeit an avoidance transaction, was also to be regarded as abusive in the sense that the taxpayer was relying upon a specific provision 'in order to achieve an outcome that those provisions seek to prevent'.[41] In that context the focus of enquiry will be the 'contextual and purposive interpretation' of the relevant provision 'and the application of the properly interpreted provisions to the facts of a given case'.[42] In *Canada Trustco*, the court explained that the application of the abuse and misuse text in s 245(4) imposed a two part enquiry:[43]

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39 Ibid.

40 [2005] 2 SCR 601 ('*Canada Trustco*').

41 Ibid [45].

42 Ibid [44].

43 [2005] 2 SCR 601.

> The first step is to determine the object, spirit or purpose of the provisions of the *Income Tax Act* that are relied on for the tax benefit, having regard to the scheme of the Act, the relevant provisions and permissible extrinsic aids. The second step is to examine the factual context of a case in order to determine whether the avoidance transaction defeated or frustrated the object, spirit or purpose of the provisions in issue.[44]

In that case, the court concluded that deductions which had been claimed by the taxpayer from a sale and lease back transaction, albeit an avoidance transaction, was consistent with the object and spirit of the taxing provisions relied upon by the taxpayer notwithstanding that there may not have been real financial risk or economic cost.

In *Copthorne Holdings Ltd v Canada*, the Supreme Court upheld the application of the GAAR to a company amalgamation in which the amalgamated corporation redeemed a large portion of its shares and paid out the aggregate paid up capital attributable to the redeemed shares to its non-resident shareholder who, in turn, treated the payment as a return of capital rather than as taxable income.[45] In that case, the court considered that the transaction was abusive of the provision which the taxpayer relied upon. Critical to that conclusion was the double counting of paid up capital in a transaction which was structured to preserve, 'artificially', the paid up capital. In delivering the judgment for the court, Rothstein J wrote:

> I am of the opinion that the sale by Copthorne I of its VHHC Holdings shares to Big City, which was undertaken to protect $67 401 279 of PUC from cancellation, while not contrary to the text of s 87(3), does frustrate and defeat its purpose. The tax-paid investment here was in total $96 736 845. To allow the aggregation of an additional $67 401 279 to this amount would enable payment, without liability for tax by the shareholders, of amounts well in excess of the investment of tax-paid funds, contrary to the object, spirit and purpose or the underlying rationale of s 87(3). While a series of transactions that results in the 'double counting' of PUC is not in itself evidence of abuse, this outcome may not be foreclosed in some circumstances. I

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44 Ibid [55]; see Brian Arnold, 'Policy Forum: Confusion Worse Confounded — The Supreme Court's GAAR Decision' (2006) 54 *Canadian Tax Journal* 167.

45 [2011] 3 SCR 721.

> agree with the Tax Court's finding that the taxpayer's 'double counting' of PUC was abusive in this case, where the taxpayer structured the transactions so as to 'artificially' preserve the PUC in a way that frustrated the purpose of s 87(3) governing the treatment of PUC upon vertical amalgamation. The sale of VHHC Holdings shares to Big City circumvented the parenthetical words of s 87(3) and in the context of the series of which it was a part, achieved a result the section was intended to prevent and thus defeated its underlying rationale. The transaction was therefore abusive and the assessment based on application of the GAAR was appropriate.[46]

The abuse in that case was revealed in the comparison between the outcome achieved by the taxpayer and what could be expected in the ordinary course of the application of the provisions.

The general anti tax avoidance rule in Australia before 1981 had been in s 260 of the 1936 Act,[47] and depended fundamentally upon finding that a transaction was entered into predominantly for the purpose of tax avoidance. The principle relevant to its application was the predication test enunciated by the Privy Council in *Newton v Federal Commissioner of Taxation.*[48] In that case their Lordships said:

> In order to bring the arrangement within the section you must be able to predicate — by looking at the overt acts by which it was implemented — that it was implemented in that particular way so as to avoid tax. If you cannot so predicate, but have to acknowledge that the transactions are capable of explanation by reference to ordinary business or family dealings, without necessarily being labelled as a means to avoid tax, then the arrangement does not come within the section. Thus, no one, by looking at a transfer of shares *cum* dividend, can predicate that the transfer was made to avoid tax. Nor can anyone, by seeing a private company turned into a non-private company, predicate that it was done to avoid div 7 tax … Nor could anyone, on seeing a declaration of trust made by a father in favour of his wife and daughter, predicate that it was done to avoid tax ….[49]

This test required a consideration of the particular contract, agreement or arrangement which the Commissioner had identified as caught by s

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46 Ibid [127].

47 *Income Tax Assessment Act 1936* (Cth) ('*1936 Act'*).

48 (1958) 98 CLR 1.

49 Ibid 8–9.

260 to determine whether its objectively ascertainable purpose was to avoid taxation.[50] The application of s 260 did not expressly require, nor depended upon, an express consideration into whether the transaction was an abuse or misuse of the statutory provisions relied upon by the taxpayer. There developed however, jurisprudence which excluded from the operation of s 260 those transactions which could be said to have been choices permitted by the legislature. In *W P Keighery Pty Ltd v Federal Commissioner of Taxation*, the High Court held that s 260 did not apply to a corporate taxpayer which had rearranged its affairs to become a public company to avoid undistributed profits tax imposed upon private companies under the then provisions of div 7 of the *1936 Act*.[51] Dixon CJ, Kitto and Taylor JJ said in a joint judgment:

> The very purpose or policy of div 7 is to present the choice to a company between incurring the liability it provides and taking measures to enlarge the number capable of controlling its affairs. To choose the latter course cannot be to defeat, evade or avoid a liability imposed on any person by the Act or to prevent the operation of the Act. For that simple reason the attempt must fail, and the Commissioner cannot rely upon s 260 in order to treat as void any more extensive set of facts, for an attempt to do so could not stop short of including the incorporation of the appellant company itself.[52]

The 'choice principle', like the abuse or misuse doctrine, sought to make the GAAR dependent upon whether the avoidance was affected by something contemplated by the taxing statute.

The restriction of the choice principle was a significant feature in the enactment of pt IVA in 1981 and finds legislative expression in s 177C(2).[53] The operation of pt IVA excludes those tax benefits which are 'attributable' to something 'expressly provided for' in the taxing statute provided however, that the scheme giving rise to the tax benefit had not been for the purpose of creating the conditions necessary for the tax benefits to be obtained. Section 177C(2)

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50 *Bailey v Federal Commissioner of Taxation* (1977) 136 CLR 214.

51 (1957) 100 CLR 66.

52 Ibid 93–4.

53 *Income Tax Assessment Act 1936* (Cth).

expressly provides that something which is obtained by a taxpayer as a tax benefit (and which, therefore, might otherwise be a tax avoidance scheme to which the Act applies) may nonetheless be excluded from the operation of the GAAR. The structure adopted by pt IVA makes the exclusion depend upon a consideration of, first, whether a taxpayer has obtained a tax benefit within the meaning of s 177C(1), second, whether the obtaining of the tax benefit was 'attributable' to a specifically provided statutory allowance, and third, whether the scheme through which the tax benefit was obtained was one for the purpose of creating the conditions necessary for the allowable event to arise.[54] The intent, and effect, of the provisions, however, is to exclude from the operation of the GAAR a scheme which is productive of a tax benefit even if it otherwise would be regarded as an avoidance transaction as long as it was one specifically provided for by the legislature. The inquiry into whether the scheme was entered into or carried out for the dominant purpose of enabling a taxpayer to obtain a tax benefit need not be asked if, whatever the result of the inquiry might have been, the scheme is one which was a choice expressly provided for by s 177C according to its terms.

The general anti avoidance rule in New Zealand is now found in *Income Tax Act 2007* (NZ) and does not expressly include a concept of abuse or misuse such as that found in the Canadian legislation, nor are its terms confined to statutory choices expressly provided for as in the Australian pt IVA, but the NZ Supreme Court has construed the provisions by reference to similar concepts. In *Ben Nevis Forestry Ventures Ltd v Commissioner of Inland Revenue*, the NZ Supreme Court adopted a test for the application of the GAAR which requires consideration of the purpose contemplated by Parliament when enacting the provision which a transaction was said to have avoided.[55] Tipping, McGrath and Gault JJ said in a joint judgment:

> When, as here, a case involves reliance by the taxpayer on specific provisions, the first enquiry concerns the application of

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54 G T Pagone, *Tax Avoidance in Australia* (Federation Press, 2010), 63–8.

55 (2009) 24 NZTC 23,188 ('*Ben Nevis*').

> those provisions. The taxpayer must satisfy the court that the use made of the specific provision is within its intended scope. If that is shown, a further question arises based on the taxpayer's use of the specific provision viewed in the light of the arrangement as a whole. If, when viewed in that light, it is apparent that the taxpayer has used the specific provision, and thereby altered the incidence of income tax, in a way which cannot have been within the contemplation and purpose of Parliament when it enacted the provision, the arrangement will be a tax avoidance arrangement.[56]

The NZ Parliamentary contemplation test calls for an enquiry into whether the specific transaction which was entered into by the taxpayer was the kind of transaction which the Parliament could have been expected to contemplate by the provision relied upon by the taxpayer. The test provides some principles by which to decide which choices adopted by taxpayers (otherwise within the scope of tax avoidance) might nonetheless be permissible within the context of the provision. In *Ben Nevis*, their Honours said:[57]

> The general anti-avoidance provision does not confine the Court as to the matters which may be taken into account when considering whether a tax avoidance arrangement exists. Hence the Commissioner and the courts may address a number of relevant factors, the significance of which will depend on the particular facts. The manner in which the arrangement is carried out will often be an important consideration. So will the role of all relevant parties and any relationship they may have with the taxpayer. The economic and commercial effect of documents and transactions may also be significant. Other features that may be relevant include the duration of the arrangement and the nature and extent of the financial consequences that it will have for the taxpayer. As indicated, it will often be the combination of various elements in the arrangement which is significant. A classic indicator of a use that is outside Parliamentary contemplation is the structuring of an arrangement so that the taxpayer gains the benefit of the specific provision in an artificial or contrived way. It is not within Parliament's purpose for specific provisions to be used in that manner.
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> In considering these matters, the courts are not limited to purely legal consideration. They should also consider the use made of the specific provision in the light of the commercial reality and

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56 Ibid 211–12 [107].

57 (2009) 24 NZTC 23,188.

> the economic effect of that use. The ultimate question is whether the impugned arrangement, viewed in a commercially and economically realistic way, makes use of the specific provision in a manner that is consistent with Parliament's purpose. If that is so, the arrangement will not, by reason of that use, be a tax avoidance arrangement. If the use of the specific provision is beyond Parliamentary contemplation, its use in that way will result in the arrangement being a tax avoidance arrangement.[58]

The Parliamentary contemplation test, like the choice principle and the abuse doctrines, aims to provide a predictable and objective foundation for determining when a taxpayer may rely upon a provision to secure its benefit without falling foul of the GAAR.[59] A conclusion of abuse of the statute may be justified if the facts reveal that what was expected by the legislation is absent from the particular facts of the case.

The approach adopted in the United Kingdom in *W T Ramsay Ltd v Inland Revenue Commissioners* is, like the US economic substance doctrine and the NZ Parliamentary contemplation test, based upon statutory interpretation.[60] In *Ramsay,* Lord Wilberforce said that the principle of construction adopted in that case did not introduce a new principle.[61] The question in *Ramsay* was whether there had been a disposal of an asset giving rise to a loss under a taxing statute. The issue of construction was whether the particular transaction came within the intended terms of the statute where the disposal was effected by a series of steps, each of which the parties necessarily intended to be effective according to their terms, but where their ongoing practical and economic effect had been intentionally negated by other transactions. The House of Lords held in *Ramsay* that the transaction did not come within the intended contemplation of the statute. Implicit in the decision in *Ramsay* was that the section relied

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58 Ibid 212 [108]–[109].

59 See Interpretation Statement IS 13/01, Tax Avoidance and the Interpretation of sections BG1 and GA1 of the *Income Tax Act 2007*, New Zealand Inland Review (13 June 2013).

60 [1982] AC 300 (*'Ramsay'*).

61 Ibid 326.

upon by the taxpayer was not operating in the case in question as it was intended to operate as objectively ascertainable.

The basis of the *Ramsay* principle is statutory interpretation, but its application was concerned with transactions which nullified the consequences of other aspects of the transaction for all purposes other than tax. In other words, with a consideration of whether the transaction did what it purported to do in the context of the provision relied upon. The terms of the principle were recently traced to the acceptance by Lord Wilberforce of the argument which had been put by the Revenue in *Ramsay*. In *Schofield v HM Revenue and Customs*, the Chancellor (with whom Hallett and Patten LJJ agreed) said:[62]

> The argument for the Revenue, as recorded on page 314, was that:
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> > 'Where the taxpayer enters into a preconceived series of interdependent transactions deliberately contrived to be self-cancelling, that is to say, to return him substantially to the position he enjoyed at the outset, and incapable of having any appreciable effect on his financial position, no single transaction in the series can be isolated on its own as a disposal for the purposes of the statute.'
>
> This argument was accepted by Lord Wilberforce, with whom Lords Russell of Killowen, Roskill and Bridge of Harwich agreed, and by Lord Fraser.
>
> On page 323 Lord Wilberforce set out the argument for the taxpayer in opposition to that of the Revenue, namely, the subject was to be taxed by clear words and if a transaction is genuine the courts cannot go behind it and continued:
>
> > 'This is a cardinal principle but it must not be overstated or overextended. While obliging the court to accept documents or transactions, found to be genuine, as such, it does not compel the court to look at a document or a transaction in blinkers, isolated from any context to which it properly belongs. If it can be seen that a document or transaction was intended to have effect as part of a nexus or series of transactions, or as

62 [2012] EWCA Civ 927.

> an ingredient of a wider transaction intended as a whole, there is nothing in the doctrine to prevent it being so regarded: to do so is not to prefer form to substance, or substance to form. It is the task of the court to ascertain the legal nature of any transaction to which it is sought to attach a tax or a tax consequence and if that emerges from a series or combination of transactions, intended to operate as such, it is that series or combination which may be regarded.'

At page 326 Lord Wilberforce added:

> 'I have a full respect for the principles which have been stated but I do not consider that they should exclude the approach for which the Crown contends. That does not introduce a new principle: it would be to apply to new and sophisticated legal devices the undoubted power and duty of the courts to determine their nature in law and to relate them to existing legislation. While the techniques of tax avoidance progress and are technically improved, the courts are not obliged to stand still. Such immobility must result either in loss of tax, to the prejudice of other taxpayers, or to Parliamentary congestion or (most likely) to both. To force the courts to adopt, in relation to closely integrated situations, a step by step, dissecting, approach which the parties themselves may have negated, would be a denial rather than an affirmation of the true judicial process. In each case the facts must be established, and a legal analysis made: legislation cannot be required or even be desirable to enable the courts to arrive at a conclusion which corresponds with the parties' own intentions.'[63]

What emerges from these passages is that transactions need to be analysed to determine whether their effect achieved the non-tax consequences which the taxing provisions contemplated. The statutory interpretation foundation of the principle directs attention to the non tax outcomes for which the taxing provisions were intended, and then requires an analysis of the transactions to determine whether what was achieved by the transaction is anything more than a tax

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63 Ibid [30]–[32].

outcome. The self-cancelling nature of the transaction may be a sufficient reason in one case for concluding that a taxpayer's reliance upon a provision was not as the provision was intended to operate. In every case the question is whether the section was intended to apply as the taxpayer has purported that it does. In each such case the question will require a comparison between the taxpayer's outcomes and those that would be expected by operation of the section.

The United Kingdom has adopted a statutory anti avoidance rule after an independent report headed by Graeme Aaronson QC and the release of a government consultation document published on 12 June 2012.[64] The target of the proposed GAAR is 'artificial and abusive tax-avoidance schemes which, because they are often complex and/or novel, could not have been contemplated directly when formulating the tax legislation'. [65] The provisions authorise the revenue to counteract abusive arrangements on a just and reasonable basis subject to a number of safeguards.[66] The statutory targets (before consideration of any of the safeguards) are arrangements 'which cannot reasonably be regarded as a reasonable course of conduct' judged by reference to the relevant provisions, the substantive results and any other arrangements forming part of the arrangements.[67] The UK model is targeted upon arrangements having consequences that Parliament would not have countenanced had it foreseen the arrangement, and the tax consequence claimed.[68] The UK model is, therefore, directed primarily to abuse and looks to presumed intentions of Parliament rather than to a constructive purpose of the participants by analysing the transaction, although such a distinction is not easy to maintain sharply (as the jurisprudence on the NZ Parliamentary contemplation test shows).[69]

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64 Graham Aaronson QC, *GAAR Study* (London, 11 November 2011); HM Revenue and Customs, 'A General Anti-Abuse Rule: Consultation document' (2012) <http://customs.hmrc.gov.uk>.

65 Ibid 7 [2.2].

66 Ibid 17 cl 4(1); *Finance Act 2013* (UK) c 29, s 209(2).

67 Ibid 14 cl 2(2); *Finance Act 2013* (UK) c 29, s 207(1).

68 Ibid 15 [3.15].

69 *Ben Nevis* (2009) 24 NZTC 23,188.

The primary safeguard proposed in the model is the 'double reasonableness test'. The UK GAAR is to apply only where conduct 'cannot reasonably be regarded as a reasonable course of action'.[70] The double reasonableness test is designed to ensure that the GAAR will be limited to counteract 'only artificial and abusive schemes'.[71] One of the reasonableness requirements in the test looks to the course of action and asks whether it is reasonable. The other looks to the observer and asks whether the otherwise unreasonable course of action would nonetheless be regarded as reasonable.

An essential aspect of the proposed UK GAAR is the existence of a 'tax advantage'. A broad definition was adopted,[72] but implicit in it is that the tax position obtained by a transaction is to be contrasted with something else. In *Inland Revenue Commissioners v Parker*, it was said in respect of a different definition of 'tax advantage':[73]

> The paragraph, as I understand it, presupposes a situation in which an assessment to tax, or increased tax, either is made or may possibly be made, that the taxpayer is in a position to resist the assessment by saying that *the way in which he received what it is sought to tax* prevents him from being taxed on it; and that the Revenue is in a position to reply that if he had received what it is sought to tax *in another way* he would have had to bear tax. In other words, there must be a contrast as regards the 'receipts' between the actual case where these accrue in a non-taxable way with a possible accruer in a taxable way, and unless this contrast exists, the existence of the tax advantage is not established.[74]

The existence of a tax advantage will therefore need to be determined by first identifying something against which to compare what was done. The appropriate comparator was contemplated in the report to derive from the 'arrangements that *would have occurred* absent the

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70 *Finance Act 2013* (UK) c 29, s 207(2).

71 HM Revenue and Customs, 'A General Anti-Abuse Rule: Consultation document' (2012) <http://customs.hmrc.gov.uk>, 15.

72 *Finance Act 2013* (UK) c 29, s 208.

73 [1966] AC 141.

74 Ibid 178–9 (emphasis added).

relevant tax purpose'. [75] In other words, it will require the identification of a hypothetical fact based upon a prediction about what would otherwise have happened.

The concept of abuse, however, is central to the operation of the UK GAAR. 'Abusive' is defined in s 207(2) as follows:

> Tax arrangements are 'abusive' if they are arrangements the entering into or carrying out of which cannot reasonably be regarded as a reasonable course of action in relation to the relevant tax provisions, having regard to all the circumstances including — (a) whether the substantive results of the arrangements are consistent with any principles on which those provisions are based (whether express or implied) and the policy objectives of those provisions, (b) whether the means of achieving those results involves one or more contrived or abnormal steps, and (c) whether the arrangements are intended to exploit any shortcomings in those provisions.[76]

The underlying concept, like that in other GAARs, calls for an inquiry into whether the way a taxpayer seeks to use a provision is the way the provision was intended to be used.

The statutory provisions expressing anti avoidance rules in the many jurisdictions which have them are, of course, complicated, lengthy and often difficult of application. However, despite their complexity and length, their underlying focus is to prevent fiscal advantages which were predictably not intended and predictably capable of denial, consistently with principle and the rule of law. The statutory GAARs are not intended to operate as an unpredictable basis for independent taxation nor as an unguided discretion to tax. Rather, the statutory GAARs are intended to maintain the integrity of the fiscal system by providing a legal foundation where a literal application of the law would permit outcomes that could not have been intended.

A principled basis for GAARs to operate is to focus upon a disciplined comparison of what an impugned transaction or claim

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75 HM Revenue and Customs, 'A General Anti-Abuse Rule: Consultation document' (2012) <http://customs.hmrc.gov.uk>, 16 [3.20].

76 *Finance Act 2013* (UK) c 29.

achieves with what the operation of the fiscal provision relied upon is ordinarily expected to achieve. The reorganisation claimed in *Gregory v Helvering* was held not to be a reorganisation because what was produced is not what would, from a business or commercial point of view, be expected as a reorganisation.[77] The derivation of income from a foreign source in *Spotless* was secured by methods directed to maintaining the fiscal claim without the incidents that would be found in a deposit of funds to obtain foreign source interest.[78]

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77 293 US 465 (1935).

78 (1996) 186 CLR 404.

STATUTORY INTERPRETATION — THE TWO STEP APPROACH

BRUNO ZELLER*

Abstract

This paper argues that courts and tribunals too often overlook the important position conventions and model laws take in the legal landscape. Of importance is the interpretative article that is embedded within the conventions and model laws requiring a rethink of domestic interpretative methodologies. It is not by accident that drafters have included interpretative articles in order to facilitate a harmonised approach in the application of conventions and model laws. This paper argues that a transnational approach in the interpretation of conventions and model law is long overdue. Furthermore this paper also argues that specifically in model laws which are embedded in or form part of domestic laws, a clear understanding of a multi-tiered interpretive framework is essential. As the interpretative articles directly influence the application of evidence it is of real importance that an ethnocentric view is abandoned and a uniform application of conventions and model laws becomes the norm.

Statutory Interpretation — Interpretation of Conventions and Model Laws — International Materials — Transnational Legal Methodology

I INTRODUCTION

Professor Fleischer, in a recent article, noted that 'questions of legal methodology and statutory interpretation were long neglected on either side of the Atlantic'.[1] He further argued that despite national differences, 'in legal reasoning … there are sufficient common national features to begin tracing the contours of a *transnational* legal methodology'.[2] Lord Hoffmann explained the function of statutory interpretation, as 'the general principle of construction is, of course, that legislation is prima facie territorial'.[3] Furthermore, it is a settled practice that the interpretation of statutes has to be in accordance to the intention of the drafters. This is true, however, the stumbling block is not the lack of a theoretical background, or the facts of territoriality, but the ethnocentric views regarding the application of the relevant tools in statutory interpretations.

Courts and tribunals often overlook the fact that conventions and model laws occupy a special place within domestic laws. That is the drafters are not the Australian Parliament and hence it follows that domestic methods are not entirely applicable in the interpretation of conventions and model laws introduced by Parliament into the domestic legal landscape. Parliament is, in essence, the surrogate of the international diplomatic conference and hence Parliament's supremacy is subrogated.[4] To illustrate, and as an example, in relation

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1 Holger Fleischer, 'Comparative Approaches to the Use of Legislative History in Statutory Interpretation' (2012) 60 *American Journal of Comparative Law* 401, 401.

2 Ibid 402.

3 *Lawson v Serco* [2006] 1 All ER 823, [6].

4 Graham Corney, 'Mutant Stare Decisis: The Interpretation of Statutes which Incorporate International Treaties into Australian Law' [1994] 18 *University of Queensland Law Journal* 50, 51.

to substantive law Professor Goode stated: 'The first point to note is that international interest [as defined by the Cape Town Convention] is the creature of the Convention and in principle does not derive from or depend on national law.'[5] The same can be said when the question of applicable statutory interpretation of conventions and model laws has to be resolved.

The issue this paper is addressing is not whether 'common national features' are, or can trace, the contours of transnational legal methodology but rather what are the practical steps in choosing the correct legal framework, when international instruments are the relevant legislation needing interpretation. It is argued that courts and tribunals must 'restock [their] interpretative armoury'[6] to meet the new challenge. Dworkin correctly stated that legislators are not like novelists but are instead authors of a text they did not choose alone.[7] Arguably therefore, as Fleischer[8] puts it, the importance of legislative history cannot be underestimated.

It follows that an understanding and application of the 'correct interpretation method' is important. This has become more important as the increasing amount of drafting, and hence volume, of uniform international laws incorporate interpretive articles into their regime which shifts the 'interpretational tools or methods' into the transnational regime. The term 'statutory interpretation' includes two steps, first the theoretical understanding of the aim of legislative interpretation which, as an example, in Australia finds expression in the debate of the textual vs the contextual approach. However there is also another step required; namely, the ability to distinguish between legislation inspired by either domestic or international drafters. Once that is established the use of the relevant and correct tools is determined. These are either embedded in the relevant legal document

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5 Roy Goode, 'International Interests in Mobile Equipment: A Transnational Juridical Concept' (2003) 15 *Bond Law Review* 9, 12.

6 Corney, above n 4, 51.

7 Richard Ekins, 'The Intention of Parliament' [2010] *Public Law* 709, 712 n 23.

8 Fleisher above n 1.

or prescribed by the legal system in which the interpretation takes place.

This paper will not be debating works by Dworkin, Wittgenstein, Derrida and others. The main focus will be on an examination and debate of how courts and academics have approached the issues of applying the correct tool that is the practical application of the interpretive mechanism within the transnational framework. Remarks by Justice Scalia best describe the two facets of statutory interpretation. When Justice Scalia wrote on his textual approach, Dworkin noted that he 'managed to give two lectures about meaning with no reference to Derrida or Gadamer or even the hermeneutic circle …'.[9] This paper is not concerned with the issues highlighted by Dworkin but with the fact that Justice Scalia in *Chan v Korean Air Lines Ltd*[10] used the wrong interpretative tool to resolve the case[11] as he treated the interpretation of the Warsaw Convention as if it would have been a domestic legislation. In other words the textualism advocated by Justice Scalia can be debated on two levels. First, whether his methodology is correct and, second, whether he is using the correct tool to interpret the governing statute.

It is argued that problems related to lack of understanding of a multi-tiered interpretative framework are the stumbling block of a true understanding of an interpretive methodology. To put the issue into context some observations need to be made first.

It is obvious that any statute cannot be interpreted in a vacuum; it needs a factual basis. Hence interpretation is a multifaceted issue. Questions must be asked such as; how do courts interpret the statements and conduct of the parties? How is the law dealing with

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9 Ibid 403, n 13.

10 490 US 122, 135 (1989).

11 The interpretation of the Warsaw Convention was at issue and Justice Scalia did not follow the mandate of the *Vienna Convention* nor did he take any notice of *Fothergill v Monarch Airlines* [1977] 3 All ER 616. He instead relied on *The Amiable Isabella* 19 US 1 (1821). He simply did not use the relevant tool to interpret the case at hand.

the parties' expectations and how is the applicable interpretative instrument interpreted? If the dispute is purely based on domestic law the answer to these questions would be found in domestic tradition and supported by precedent. However, domestic law is increasingly being enriched by the adoption of conventions and model laws which contain an interpretative article.

The distinctions described above have a bearing on the appropriate interpretive tool which is applicable. It is argued that each step requires a different approach and cannot be automatically duplicated, as each domestic law based on conventions or model laws has the potential to be different. Hence, private international law will also play a role in the outcome of a dispute. Most importantly it will show that 'statutes should be read, not according to what judges believe would make them best, but according to what the legislator who actually adopted them intended'.[12] This is where the problem lies. In any statute that has an international source, the intent of the domestic legislator is not known. Instead intent is derived from the designers of the document that are the participants of the diplomatic conference. It is argued, therefore, that the suggestion of Professor Fleischer to use legislative history is important.[13] The practical effect is that judges need to be aware of the source of the legislation. Once that is established the relevant methodology can be applied.

Dworkin noted that 'a statute owes its existence not only to the decision people made to enact it but also to the decision of other people later not to amend or repeal it'.[14] This observation is correct and it could be argued that a wrong application or non-application of an interpretative article amounts to an amendment of the statute. Arguably the problem is overcome if the interpretative issue is to be separated from the above functions — which are merely mechanical, specifically in cases of international documents.

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12 Ronald Dworkin, *Laws Empire* (Fontana Press, 1986) 314.

13 Fleischer, above n 1.

14 Dworkin, above n 12, 318.

It needs to be noted that ratification of conventions is a voluntary act by a government. Once the decision is made to ratify a convention it cannot be amended and it is difficult to repeal. Hence, the issue is not what Parliament thought but what the international community thought when the convention was designed. This opens a different dimension.

This paper is concerned with whether the correct interpretative tool is used when a court needs to interpret a convention, which does not include an interpretative article. This will be discussed in Part 1. Second in part 2, the discussion centres on conventions which include an interpretative article. It will use the United Nations Convention on Contracts for the International Sale of Goods ('CISG') as an example and flesh out the necessary steps in the interpretative hierarchy — which can be termed the interpretation ladder.

The third part will briefly address some of the theoretical dicta in order to close the loop between theory and practical constraints which occur when domestic courts interpret a domestic law which in essence tracks a convention.

II PART ONE

A *The International Framework*

When examining international conventions it is interesting to note that a fundamental shift took place with the introduction of the Uniform Law for the International Sale of Goods, which was replaced by the CISG in 1984. Previous conventions such as the Warsaw Convention and the Hague Visby Rules did not contain interpretative articles. Hence, the whole convention and in this case the both the Warsaw Convention and the Hague-Visby rules have to be interpreted by the *Vienna Convention on the Law of Treaties*[15] — specifically arts 31 and 32. This of course raises the issue how do domestic courts

[15] *Vienna Convention on the Law of Treaties,* opened for signature 23 May 1969, 1155 UNTS 331 (entered into force 27 January 1980) ('*Vienna Convention*').

apply the *Vienna Convention*? For the purpose of this paper it is sufficient to investigate one domestic system, namely, Australia. This system should give an insight into the ability, or willingness, of the judiciary to apply statutes that do not have a domestically designed source in order to resolve municipal disputes.

1 *The Vienna Convention*

It is of value to make some preliminary comments. Before the introduction of the *Vienna Convention* courts had already recognised that international conventions cannot be usefully interpreted with domestic interpretative methods.[16] In England, *Fothergill v Monarch Airlines* [17] was the culmination of a new approach taking the requirements of the *Vienna Convention* into account and hence changed the interpretation of conventions in the English common law.[18] Arguably this is demonstrated by the fact that Lord Diplock changed his views dramatically in relation to the interpretation of conventions. Two statements that he made in separate cases illustrate this change well. In *Black-Clawson International Ltd v Papierwerke Waldhof-Aschaffenburg AG*,[19] Lord Diplock noted:

> It is for the court and no one else to decide what words in a statute mean. What the committee [writing the *travaux préparatoires*] thought they meant is, in itself irrelevant. Oral evidence by members of that committee as to their opinion of what the section meant would plainly be inadmissible. It does not become admissible by being reduced to writing.[20]

Five years later his view changed and he stated:

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16 See also ch 3 in Bruno Zeller, *Four-Corners — The Methodology for Interpretation and Application of the UN Convention on Contracts for the International Sale of Goods* (May 2003) CISG Database <http://www.cisg.law.pace.edu/cisg/biblio/4corners.html>.

17 [1980] 2 All ER 696 ('*Fothergill*').

18 See *Fothergill* built on the decisions in *James Buchanan & Co Ltd v Babco Forwarding & Shipping (UK) Ltd* [1978] AC 141.

19 [1975] 1 All ER 810.

20 Ibid 835.

> It should be interpreted, as Lord Wilberforce put it in *James Buchanan & Co Ltd v Babco Forwarding & Shipping (UK) Ltd* [1978] AC 141, 152, 'unconstrained by technical rules of English law, or by English legal precedent, but on broad principles of general acceptation' [and] … [t]he language … has not been chosen by an English parliamentary draftsman. It is neither couched in the conventional English legislative idiom nor designed to be construed exclusively by English judges.[21]

Lord Roskill, as part of his judgment, furnished a useful history of the development of the interpretation of international conventions.[22] As the *Vienna Convention* was not yet applicable, this willingness to consider broader principle indicates that the English courts arguably were 'ahead of their time'.

In Australia the above development could not be detected in case law as, in the meantime, the *Vienna Convention* was ratified. The first consideration of arts 31 and 32 in an Australian case can be found in *Commonwealth of Australia v Tasmania*.[23] Can changes in Australian law be discovered in the treatment of the interpretation of treaties? The court generally believed that the *Vienna Convention* codified existing customary law and furnished 'presumptive evidence of emergent rules of general international law'.[24] Brennan J noted that: 'there is no occasion to resort to preparatory work if the text of a Convention is sufficiently clear in itself.'[25] Such a view is far too narrow and it indicates that *Fothergill* did not find a fertile ground in Australia. However, it must be stated that later decisions modified these earlier approaches.

In *Applicant 'A' v Minister of Immigration & Ethnic Affairs*,[26] the court consulted the *Vienna Convention* as well as taking note of *Fothergill*. The conclusion was that the starting point for any interpretation had to be the treaty and 'accordingly, technical

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21 *Fothergill* [1980] 2 All ER 696, 713.

22 Ibid 718, 719.

23 (1983) 158 CLR 1 *('Tasmanian Dam Case')*.

24 Ibid 223.

25 Ibid 224.

26 (1997) 190 CLR 225 ('*Applicant 'A'*).

principles of common law construction are to be disregarded'.[27] McHugh J commented that art 31(1) contained three separate but related principles. First, the principle of good faith which flows directly from the rule *pacta sunt servanda*, second, that the ordinary meaning of the words as expressed in the Convention are authentic and represent the parties' intentions and, third, that the ordinary meaning of the words are not to be determined in a vacuum but rather within the context of the treaty or its object or purpose.[28] McHugh J further determined that the correct approach to art 31 is to be found in the statements by Zekia J in the European Court of Human Rights in *Golder v United Kingdom*:[29] 'Judge Zekia emphasised an ordered yet holistic approach. Primacy is to be given to the written text of the Convention but the context, object and purpose of the treaty must also be considered.'[30]

The approach of all judges in *Applicant 'A'* to art 31(1)[31] can be best summed up by McHugh J who observed:

> The lack of precision in treaties confirms the need to adopt interpretative principles, like those pronounced by Judge Zekia, which are founded on the view that treaties 'cannot be expected to be applied with taut logical precision'. Accordingly, in my opinion, Art 31 of the Vienna Convention requires the courts of this country when faced with a question of treaty interpretations to examine both the 'ordinary meaning' and the 'context … object and purpose' of a treaty.[32]

In *Applicant 'A'* the court recognised the importance of art 31 and supported its finding by taking not only *travaux préparatoires* into consideration but also foreign case law. The *Tasmanian Dam Case*, with the exception of the views expressed by Murphy J, did not recognise the importance of an examination 'both of the ordinary

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27 Ibid 251.

28 Ibid 253.

29 (1975) 1 EHRR 524.

30 *Applicant 'A'* (1997) 190 CLR 225, 254.

31 No submission was advanced in this case that calls for the consideration to be given to art 31(2), (3) or (4) of the *Vienna Convention*.

32 *Applicant 'A'* (1997) 190 CLR 225, 256.

meaning and the context … object and purpose of a treaty'.[33] The prevailing view was that: 'at the end of the day, the interpretation of the text itself must determine the content of the obligation it imposes.'[34] It can be seen that McHugh J, in a sense, broke new ground in statutory interpretation and it reflects the current views. It is of no surprise then that the High Court in *Great China Metal Industries Co Ltd v Malaysian International Shipping Corporation*[35] noted:

> Article 31 provides that a treaty must be interpreted in good faith, in accordance with the ordinary meaning of the terms in their context and in the light of its object and purpose. … Primacy must be given, however to the natural meaning of the words in their context.[36]

It is significant that foreign case law was viewed as being persuasive. It shows that the judiciary was well aware that a domestic approach to the interpretation of international law was not adequate. Australian courts appear to have moved away from municipal techniques and adopted a 'uniform interpretation' method. The natural or normal meaning of the words within the text of the treaty must be elaborated pursuant to art 31. Only when the meaning is ambiguous or obscure can extrinsic sources, such as *travaux préparatoires* and the purpose and history of the treaty itself, be used.

As discussed above the *Vienna Convention,* primarily through arts 31 and 32, assists in the interpretation of treaties. Despite the primacy of the mandate of the *Vienna Convention* to achieve uniformity in interpretation it is not always achieved. *Great China Metal Industries Co*[37] is of interest in this instance. McHugh J, who also ruled in *Applicant 'A'* referred — as previously — to *travaux préparatoires* as an aid to interpretation, as the Hague Rules did not incorporate an interpretative article into its regime. However, not all courts tended to use the same approach and instead they relied on ethnocentric

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33 Ibid.

34 *Tasmanian Dam Case* (1983) 158 CLR 1, 224.

35 (1998) 196 CLR 161 ('*Great China Metal Industries*').

36 Ibid 186.

37 *Great China Metal Industries* (1998) 196 CLR 161, 236.

interpretative methods. The result was that McHugh J was moved to state:

> Uniformity of interpretation has not been the feature of the Hague Rules. In particular, courts in the United States and Canada on one hand and in France, Germany, England and Australia on the other have diverged in their approach.[38]

It can be argued that this shows the importance of not only including interpretative articles into conventions but also the importance of courts and tribunals following the mandate of harmonisation and uniformity in the application of conventions. It is unfortunate, but understandable, that McHugh J further stated:

> If uniformity of interpretation could be achieved by abandoning the approach taken by this court in *Gamlen*, I would be in favour of overruling *Gamlen*. But to overrule that decision would not yield uniformity — the approach of courts in England, Germany and France would remain different.[39]

This highlights the problems when transnational laws are not uniformly interpreted. However the conclusion can be drawn that the principles used in the interpretation of treaties pursuant to the *Vienna Convention* do contribute toward a uniform international jurisprudence. After all the convention is now recognised as being part of customary international law and has even found its way into WTO decisions.

It is notable that the House of Lords in *Fothergill* came to a conclusion which appears to be ahead of its time. The *Vienna Convention*, as far as the interpretational aspect is concerned, did not improve on the general principle introduced by the House of Lords except by adding the concept of good faith.

(a) *Travaux Préparatoires*

Much has been said in international, as well as domestic, jurisprudence on the use of *travaux préparatoires* and other extrinsic

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38 Ibid 187.

39 Ibid 187.

aids to interpretation.[40] *Fothergill* and the *Vienna Convention* specifically permit the use of such aids for interpretation, and many authors encourage their use in the interpretation of the CISG. In common law, *Pepper v Hart*[41] created a landmark decision by allowing reference to parliamentary debates. In Australia, special legislation has been passed which specifically permits reference to Hansard as an aid to interpret legislation.[42] Lord Griffiths argued that the self-imposed judicial rule to ignore legislative history as an aid to interpretation is outdated:[43]

> The courts now adopt a purposive approach which seeks to give effect to the true purpose of legislation and are prepared to look at much extraneous material that bears upon the background against which the legislation was enacted.[44]

Such views are not without their critics. The purposive method of construction of statutes is established in England. It is attributed to a shift to the teleological approach of European Community jurisprudence and the influence of the European Court of Human Rights.[45] However some writers contend that: 'it is a fairy tale to think that the subjective views of members of parliament, sitting in two separate chambers can be determined.'[46] Interestingly, Johan Steyn, who was in favour of the views in *Pepper v Hart,* writes:

> I am now inclined to agree with Lord Renton QC and Lord Hoffmann that the *Pepper v Hart* decision has by the judgment of experience probably been shown to be an undesirable luxury in our legal system. The pragmatic case against the decision in *Pepper v Hart* is strong.[47]

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40 See especially Fleischer, above n 1.

41 [1993] AC 593 (HL).

42 Ibid 602. See also *Acts Interpretation Act 1901* (Cth) s 15AB.

43 Ibid 617.

44 Ibid.

45 Lord Bingham, 'A New Common Law for Europe' in B S Markesinis (ed), *The Clifford Chance Millennium Lectures: the Coming Together of the Common Law and the Civil Law* (Hart Publishing, 2000) 85.

46 Ibid.

47 Ibid 88.

Steyn takes a pessimistic view on the use of extrinsic material. It should be recognised that the material is a collection of views of many different interest groups and therefore must be treated with caution. The fact is that *travaux préparatoires* and parliamentary debates are a valuable historical insight into the political and social interplay of members of the group. Such insights are not undesirable luxuries. Used appropriately these views are desirable as they can be of assistance in the interpretation of a text if all other means are exhausted.

III PART TWO

A *Interpretational Rules within Conventions and Model Laws*

1 *Introduction*

As seen above it is argued that statutory interpretations of conventions are not governed by domestic methods but by the prescribed method contained within the *Vienna Convention*. However, once a convention has an interpretational rule embedded within its framework the rules somewhat change. The convention now is subject to two rules. The interpretational article is subject to the *Vienna Convention* but the remaining parts of the conventions must be interpreted by the rules as expressed within the relevant legislation. Again, no domestic methods are to be applied as the mandate is clear.

Arguably, the modern version of interpretational articles has been specifically introduced by the CISG and has been paradigmatically indicated by art 7.[48] This article is of special importance. It notes:

> (1) In the interpretation of this Convention, regard is to be had to its international character and to the need to promote uniformity in its application and the observance of good faith in international trade.

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48 Fleischer, above n 1, 403.

> (2) Questions concerning matters governed by this Convention which are not expressly settled in it are to be settled in conformity with the general principles on which it is based or, in the absence of such principles, in conformity with the law applicable by virtue of the rules of private international law.

The importance of this article is reflected in the fact that most of the post CISG conventions and soft laws have in essence copied this article. UNIDROIT conventions include the *Cape Town Convention*,[49] which in essence copy art 7 and add two more paragraphs particular to these conventions. The same can be said for the *Geneva Securities Convention*[50] and the *UNIDROIT Convention on International Factoring*.[51]

In sum, art 7 of the CISG has been recognised as the leading exponent in autonomous interpretation on which all subsequent attempts will be modelled. Much has been written on the effects of art 7[52] and it is important to note that this article mandates that, due to its international character, domestic jurisdiction must be in step with international ones as otherwise uniformity cannot be achieved.

It has been shown that the importance of art 7 has reached beyond the CISG. As an example German domestic law states that if art 7 is not taken into consideration it will give rise to an appeal on 'material'

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49 UNIDROIT, *Convention on International interests in Mobile Equipment* (16 November 2001) <http://www.unidroit.org/english/conventions/mobile-equipment/mobile-equipment.pdf>.

50 UNIDROIT, *Convention on Substantive Rules for Intermediated Securities* (9 October 2009) <http://www.unidroit.org/english/conventions/2009intermediatedsecurities/conference/conferencedocuments2009/conf11-2-042-e.pdf>.

51 UNIDROIT, *Convention on International Factoring* (28 May 1988) <http://www.unidroit.org/english/conventions/1988factoring/1988factoring-e.htm>.

52 See generally *Annotated Text of CISG: Article 7* (4 January 2012) CISG Database <http://www.cisg.law.pace.edu/cisg/text/e-text-07.html>.

grounds.[53] Article 550 of the *Zivile Prozess Ordnung* (ZPO) stipulates that a breach of the CISG must be resolved through the application of art 7.[54]

2 *Incorporation of Model Laws*

As far as the incorporation of international model laws into domestic legislations is concerned, generally the same observation as above can be made. However, the issue is whether the model law incorporates an interpretative article, which has been included into the domestic legislation, or not. If there is no interpretive article a case can be made that the legislation should be interpreted relying entirely on domestic rules. This paper will argue against this notion in Part 3 below. This part will examine situations where the interpretative article in the model law has been taken over by the domestic legislator.

To this end it is useful to examine the UNCITRAL Model Law on Cross-Border Insolvencies ('the Model Law') [55] which was incorporated in parts into the Australian domestic *Cross-Border Insolvency Act 2008* (Cth). Importantly the interpretative section, which is in essence a copy of art 7 of the CISG, was also incorporated. However, the court in *Ackers v Saad Investments Company Ltd* [56] clearly demonstrate that there was a lack of understanding around the interpretative mandate.

Rares J noted that 'importantly the Model provides' [57] an interpretative article — namely, art 8. From that point of view it

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53 Wolfgang Witz, Hanns-Christian Salger and Manuel Lorenz, *International Einheitliches Kaufrecht* (Verlag Recht und Wirtschaft, 2000) 80.

54 Ibid.

55 UNCITRAL, *Model Law on Cross-Border Insolvency* (30 May 1997) <http://www.uncitral.org/uncitral/en/uncitral_texts/insolvency/1997Model.html>.

56 (2010) 190 FCR 285.

57 Ibid [7].

should have been obvious that the tool to interpret the statute, which includes the Model Law, is prescribed. However the court noted that the interpretation of conventions should be approached in accordance with the *Vienna Convention* specifically noting that '[it] is an authoritative statement of customary international law for the purposes of construing a convention'.[58] This statement is completely wrong. First of all the Act is not a convention. Just because the Australian Parliament decided not 'to reinvent the wheel' and include suggestions made by UNCITRAL into their domestic law does not elevate a domestic law into the sphere of conventions.

Rares J simply dealt with a domestic law devised by Australian drafts people and did not make the distinction between a model law and a convention. Even if the Model Law would have been a convention the *Vienna Convention* would only have been applicable in relation to an interpretation of art 8. This is so because the interpretative article cannot interpret itself. However, the court did not have any problem with art 8, but rather questioned if extrinsic material can be used to assist in the interpretation of ambiguities.[59]

Article 8 mandates that: 'In the interpretation of this Law, regard is to be had to its international origin and to the need to promote uniformity in its application and the observance of good faith.'[60] This alone should have been obvious that extrinsic material should be used.

In a recent decision Logan J noted:

> even where an international convention or model law is adopted by Parliament in an Australian enactment, that enactment and the adopted convention or model law must be interpreted in accordance with Australian principles of statutory construction. It is via the application of those principles that the end of harmonious interpretation emerges. It is likewise via those principles that it would be permissible to have regard to general principles for the interpretation of such international instruments

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58 Ibid [45].

59 Ibid.

60 *Cross-Border Insolvency Act 2008* (Cth) sch 1, art 8.

> set out in the Vienna Convention on the Law of Treaties 1969 [1974] ATS 2 and, via Art 32 of that convention, to United Nations Commission on International Trade Law (UNICTRAL) preparatory work in respect of the Model Law.[61]

This statement is indicative of the 'false' approach to the interpretation of convention and model laws. Two basic misconceptions are contained in the above statement. First, the *Cross-Border Insolvency Act 2008* (Cth) includes an interpretative article, namely, art 8 of the Model Law, hence as indicated above the *Vienna Convention* is not applicable. The statement that the 'model law must be interpreted in accordance with Australian principles of statutory construction', [62] especially linking the domestic methods to a harmonised approach, is wrong. The statement could arguably be interpreted as suggesting that a second approach is currently in use in Australia, which is to be distinguished from the domestic approach. If this was the case then the statement is indeed correct as a transnational methodology applied in Australia, which is in line with other countries, would indeed contribute to a harmonised approach. However, this approach must be based on art 8 of the statute and comparatively on art 7 of the CISG on which art 8 is derived from.

It is interesting to note that the US courts have developed their appreciation of statutory interpretation further than Australian courts. As an example *In re Loy,*[63] the court noted:

> Of course, while Section 1508 [art 8 of the model law] provides the Court guidance in matters of statutory interpretation only, it does not grant the Court authority to adopt a provision in a foreign statute that is contrary to the text of Chapter 15.

In sum, uniformity in the application [of the Model Law] is to be observed which means that recourse to foreign and domestic judgments is mandatory. In order to follow this mandate, the *Vienna Convention* is not applicable. If the question arises whether extrinsic material can be used, arguably this question needs to be resolved by comparatively addressing other statutes where the same, or similar,

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61 *Tannenbaum v Tannenbaum* (2012) 216 FCR 543, [37].

62 Ibid.

63 *In re Loy*, 432 BR 551 (ED Va, 2010).

interpretative article is included. This is permissible as the mandate of 'international origin' and 'to promote uniformity' can be extended to all texts with the same or similar wordings. However, of equal importance is that, as pointed out by courts, 'the *Guide to Enactment of the UNCITRAL Model Law on Cross-Border Insolvency* is an informed commentary. It draws attention to the preamble to the Model Law.'[64] As such, the use of extrinsic material has been resolved. It must be noted though that the court did follow the mandates and took stock of international developments in the area under dispute.

The Australian cases above are contrasted with a UK case.[65] It needs to be remembered that the Model Law also found expression in domestic UK legislation with the inclusion of the interpretative article. However, unlike in Australia, the United Kingdom is also subject to EU laws. The court was aware of the interpretive mandate and noted:

> The … appeals depend on the proper construction and application of the UNCITRAL Model Law as given the force of law in the United Kingdom by the regulation to which I have referred. … The regulation implementing it requires, by regulation 2(2), that it be interpreted by reference to any documents of the working group of the UN which produced it and the Guide to its enactment ('the UNCITRAL Guide') prepared in response to the request for its preparation made by the UN Commission on International Trade in May 1997.[66]

The court proceeded under the interpretational guidelines not only of the UNCITRAL guide but also took note of a 'clear correlation between the words used and the purpose to which they are applied in both UNCITRAL and EC Regulations'.[67] Furthermore, in line with the interpretative article, recourse to foreign judgment was also made.

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64 *Rubin v Eurofinance SA* [2010] EWCA Civ 895, (30 July 2010) [53].

65 *Stanford International Bank (SIB) by its liquidators and the Director of the Serious Fraud Office v Robert Allan Stanford, James Davis Laura Pendergest-Holt* [2010] EWCA Civ 137.

66 Ibid [4].

67 Ibid [39].

The effect of the interpretational article has been expressed clearly in *Ruben v Eurofinance SA* where Lord Justice Ward noted:

> The striking similarities conceded by the respondents between sections 238 and 239 of the *Insolvency Act 1986* and sections 547 and 548 of the American Code, and thus between these aspects of our law and the equivalent parts of the American law, justify a harmonised interpretation.[68]

The very essence of the effects of embedded interpretational rules within municipal statutes is a harmonised approach and the avoidance of applying an ethnocentric methodology.

However, great care needs to be taken as all countries do not take up model laws and conventions identically. As an example, Canada has not included the interpretational article of the Cross-Border Insolvency Model Law into their domestic law and hence Canadian decisions cannot be relied upon and are of no international value.

3 *Interpretational Rules Governing the Conduct of Parties*

There is a further aspect to be taken into consideration, namely, that some conventions and model laws might include an interpretative article directed at the contractual parties. The best two examples are the CISG art 8 and the UNIDROIT Principles of Contract Law arts 4.1 to 4.8. These articles assist the court in the interpretation of the conduct of, and statements made by, the parties.

It is in this area where divergence of the application of conventions and model laws is most frequent. Considering that the CISG not only incorporates one interpretative article but two, the interrelationship between these two articles must be understood.

The first question is; how do arts 7 and 8 interrelate? As indicated above, art 7 of the CISG is, in cases of uncertainties, interpreted with the aid of the *Vienna Convention*. However, art 8 is only subject to art 7. The debate is whether art 7 therefore also includes the interpretation of the conduct of the parties. There are two main views

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68 *Rubin v Eurofinance SA* [2010] EWCA Civ 895, (30 July 2010) [60].

on this matter. First, that art 7 does not inform on the conduct of the parties[69] and, the second view argues, that at least impliedly the two articles are linked.[70] For the purpose of this paper, this difference of views is not discussed. It is sufficient to point out that in relation to good faith, as expressed in art 7(1), its effects are far reaching. Eorsi noted that the effect of such a rule for interpreting the Convention is that a court or arbitral tribunal might conclude that communications conflicting with the good faith requirement would be ineffective.[71]

The starting point obviously is the fact that the CISG cannot be read like any other statute.[72] This is so as the harmonisation process indicated in art 7, combined with the prescribed method of interpreting the conduct of the parties in art 8, is at odds with many domestic systems specifically in common law countries, namely, the parol evidence rule.

To note again, art 7 demands that the international character of the convention and the need to achieve uniformity is to be observed. Unfortunately, a lack of understanding of this mandate does not promote a harmonised approach, but rather an ethnocentric one. To assist readers in understanding the overarching mandate of art 7, *The Practitioners Guide*[73] to the CISG noted:

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69 See John Felemegas, *The United Nations Convention on Contracts for the International Sale of Goods: Article 7 and Uniform Interpretation* (5 November 2002) CISG Database <http://www.cisg.law.pace.edu/cisg/biblio/felemegas.html>.

70 See Zeller, above n 16.

71 Gyula Eorsi, *Problems of Unifying Law on the Formation of Contracts for the International Sale of Goods*, (9 October 2008) CISG Database <http://www.cisg.law.pace.edu/cisg/text/eorsi7.html>.

72 Chan Leng Sun, *Interpreting an International Sale Contract - Celebrating Success: 25 Years United Nations Convention on Contracts for the International Sale of Goods* (Collation of Papers at UNCITRAL, SIAC Conference, 22–23 September 2005, Singapore) (1 June 2006) CISG Database, [68] <http://www.cisg.law.pace.edu/cisg/ biblio/sun1.html>.

73 Camilla Baasch Andersen, Francesco Mazzotta and Bruno Zeller, *A Practitioner's Guide to the CISG* (Juris Publishing, 2010).

> this book refers to CISG case law and not to CISG precedents. The reason for this is simple: when faced with persuasive case law from another jurisdiction, a judge may choose to be persuaded to follow a certain line of reasoning. If asked to weigh a foreign case on a carefully balanced scale of precedent, however, the same judge may balk at the concept. The practical implications are exactly the same: asking a judge to consider a case which supports your client. But the effect can be radically different, due mainly to the fact that notions of precedent are domestic, rigid and do not accommodate the notion of looking to foreign law.[74]

As far as art 8 is concerned, the CISG directs courts and tribunals to observe and elicit the subjective intent of parties and only if this approach does not yield any results can the objective intent be used. This mandate runs contrary to the parol evidence rule used in common law countries.[75] Furthermore art 8(3), in conjunction with art 9, sets out the parameters or circumstances which can be taken into consideration when determining the intent of the parties. The circumstances in brief include pre contractual, contractual and post contractual conduct. Furthermore, art 9 also includes usage and practices of the parties as being accessible to the judge in determining the intent of parties.

The practical effect of art 8 is that the subjective intent of parties not only ousts the parol evidence rule but it also can have the effect to negate a merger clause. In *TeeVee Toons, Inc, v Gerhard Schubert GmbH*,[76] a very clear merger clause was included in the boilerplate that reads:

> This quotation comprises our entire quotation. On any order placed pursuant hereto, the above provisions entirely supersede any prior correspondence, quotation or agreement. There are no agreements between us in respect of the product quoted herein

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74 Ibid 'Introduction' (xix)–(xx).

75 See generally Bruno Zeller, 'The Parol Evidence rule and the CISG — a Comparative Analysis' (2003) 36 *Comparative and International Law Journal of South Africa* 308.

76 SD NY, 00GV-5189, 23 August 2006. See CISG Database <http://cisgw3.law.pace.edu/cases/060823u1.html> ('*TeeVee*').

> except as set forth in writing and expressly made a part of this quotation.[77]

Certainly under common law such a clause would be valid and would be paramount. The CISG pursuant to art 8 however must first ask the overarching question; did the clause reflect the parties' intentions? The effect is that the question of intent must not only be asked in cases where terms need to be interpreted but also where parties disagree as to which terms of the contract apply, such as merger clauses. *TeeVee* noted that 'only if both Schubert and TVT shared the intent to be bound by the Merger Clause contained in the "Terms and Conditions" is the Merger Clause operative'.[78] In this case the merger clause was found to be inoperative.

The real issue — and perhaps the real problem — is to be found when both arts 7 and 8 are relevant in the interpretation of a statute such as in *Guang Dong Zhi Gao Australia Pty Ltd v Fortuna Network Pty Ltd*,[79] a recent Australian case. The court did recognise that the CISG applies by noting: 'It is to be recalled that the Convention on the International Sale of Goods (CISG) governs the international trade agreement and disputes.'[80]

Furthermore, the court stated that the parol evidence rule is only to be used when the contract is 'wholly in writing, and thus has no scope to operate until it has first been ascertained that the contract is wholly in writing'.[81] The fact is that the parol evidence rule is not applicable at all — even when a contract is wholly in writing as seen above. As the contract was not wholly in writing, the court at least correctly observed that: 'In determining what are the terms of a contract that is partly written and partly oral, surrounding circumstances may be used as an aid to finding what the terms of the contract are.'[82]

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77 Ibid.

78 Ibid.

79 [2009] NSWSC 1170 (4 November 2009).

80 Ibid [8].

81 Ibid [3].

82 Ibid [5].

However the court, instead of applying arts 7 and 8, chose to base its judgment around domestic case law totally ignoring international jurisprudence. It is questionable why the court made reference to the CISG at all and then totally ignored the fact that the solution to the question must be found in articles and general principles contained within the four corners of the CISG and not in domestic jurisprudence.

The lack of understanding of the interpretation and application of the CISG is further illustrated by *Castel Electronics Pty Ltd v Toshiba Singapore Pte Ltd.*[83] This case highlights the problem of courts referring to previous decision without understanding that they are faulty and hence should not be used. At least the court understood to look for CISG precedents, but unfortunately only domestic ones which have been criticised in the past, in the decision-making process.[84]

The court noted that the CISG, namely, art 35, applies to the contract 'to the exclusion of any operation which the *Good Act* might otherwise have'[85] but the claimant 'invoked, further or alternatively, the warranties of fitness for purpose and merchantable quality implied by s 19(a) and (b) of the *Goods Act 1958* (Vic) ('*Goods Act*')'.[86] In essence two problems arise. First, if a statute applies to the exclusion of others then 'the other statute', namely, the *Goods Act*, cannot be invoked. Furthermore, art 7 was also ignored, as the international charter of the convention is not compatible with the application of domestic legislation.

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83 [2010] FCA 1028 (28 September 2010). See Bruno Zeller, *CISG Case Presentation — Castel Electronics Pty Ltd v Toshiba Singapore Pte Ltd — Editorial Remarks* (4 August 2011) CISG Database <http://cisgw3.law.pace.edu/cases/100928a2.html>.

84 See generally editorial remarks on Australian case law. To be found on CISG Database <http://www.cisg.law.pace.edu/cisg/text/casecit.html#australia>.

85 *Castel Electronics Pty Ltd v Toshiba Singapore Pte Ltd* [2010] FCA 1028 (28 September 2010) [122].

86 Ibid [53].

This confusion is exemplified by the court stating:

> Those provisions [art 35] have been treated by Australian courts as imposing, effectively, the same obligations as the implied warranties of merchantable quality and fitness for purpose arising under s 19 of the *Goods Act*; see *Playcorp Pty Ltd v Taiyo Kogyo Ltd* [2003] VSC 108 at [235], *Ginza Pte Ltd v Vista Corp Pty Ltd* [2003] WASC 11 at [189]–[191] and *Summit Chemicals Pty Ltd v Vetrotex Espana SA* [2004] WASCA 109.[87]

The question is not whether the obligations are effectively the same; as simply put the *Goods Act* does not apply. If at least the editorial notes re *Summit Chemicals*[88] would have been consulted, the remarks by Zeller and Spagnolo would have shown that the above statement is patently wrong. Spagnolo specifically notes:

> Certainly, [*Summit Chemicals*] betrays a level of misunderstanding about the operation of the CISG. Buyer's counsel sought to plead, inter alia, both the CISG and *Sale of Goods Act* as alternatives. Clearly, the CISG's application excludes that of the *Sale of Goods Act*, and had the seller's counsel made such an application, the *Sale of Goods Act* claims should have been struck out.[89]

The fact of being unaware of the language and hence application of the CISG is further expressed in *Summit* where the plaintiff stated:

> in addition to reliance upon breach of implied terms of merchantable quality and fitness for purpose resulting from the application of s 14 of the *Sale of Goods Act 1896*, the [Seller] wishes to plead that there similar implied obligations together with a further implied obligation to ensure that the product was packaged in a manner adequate to preserve and protect it, resulting from the operation of the *Sale of Goods (Vienna Convention) Act 1986* and Article 35 of the *United Nations Conventions on Contract for the International Sale of Goods*

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87 Ibid [123].

88 See Bruno Zeller, *CISG Case Presentation — Summit Chemicals v Vetroex Espana — Editorial Remarks* (31 July 2009) CISG Database <http://cisgw3.law.pace.edu/cases/040527a2.html>.

89 Lisa Spagnolo, *CISG Case Presentation — Summit Chemicals v Vetroex Espana — Editorial Remarks* (31 July 2009) CISG Database <http://cisgw3.law.pace.edu/cases/040527a2.html>.

> which are also to be relied upon to support the claims for breach of contract, breach of duty of care and for damages ….[90]

First, contrary to s 14 of the *Goods Act*, art 35 of the CISG does not contain implied terms but express ones. Section 14 simply does not apply. Furthermore, it is strange to note that the CISG is referred to in such a way as to give the impression that there are actually two instruments. Also the CISG does not contain rules as to a breach of a duty of care — which is a matter of tort law.

These cases demonstrate clearly the problem of assuming that internationally devised legislation can be interpreted with the same tools as domestic ones. It is argued that because of the assumption, obvious differences between domestic and international law are overlooked or not appreciated. Specifically, in relation to the interpretation of the CISG, Australia is at odds with most other countries and simply the transnational methodology as advocated by Fleischer and others has not yet resonated in Australia.

The interesting point is that the High Court frequently noted:

> The primary object of statutory construction is to construe the relevant provision so that it is consistent with the language and purpose of all provisions of the statute. The meaning of the provisions must be determined 'by reference to the language of the instrument viewed as a whole'.[91]

This statement — if followed in the above cases — would have indicated that the interpretative articles are pivotal in an understanding of the meaning of the provisions. It would indicate that the purpose of the CISG — as indicted in art 7 — is to be international in character by promoting uniformity in its application. This alone would direct the court away from domestic jurisprudence. Chief Justice Spigelman noted that statutory interpretation requires a

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90 *Summit Chemicals Pty Ltd v Vetrotex Espana* [2004] WASCA 109 [35].

91 *Project Blue Sky Inc v Australian Broadcasting Authority* (1998) 194 CLR 355, 69.

refocusing on the text.[92] However, it is argued that this is not correct. It requires a focusing on the interpretive articles. This approach is contrary to the textual approach. It then becomes obvious that the international interpretation method must be given priority over domestic ones in the application and interpretation of conventions and model laws.

IV PART 3

A *Interpretation of Legislation other than Conventions*

It is obvious that legislation which is exclusively drafted by domestic draftsmen is subject to domestic interpretative methodology and is therefore not of interest within the scope of this paper. On occasions, however, a legal system finds it useful to duplicate in essence an international convention in order to regulate the equivalent problem within the domestic sphere. As an example, the *Warsaw Convention on International Carriage by Air*[93] governs problems emanating from international travel but the same problems are also encountered with domestic air travel. To that end, the Australian Parliament enacted the *Civil Aviation (Carriers Liability) Act 1959* (Cth) ('*Carriers Act*'). The domestic Act basically tracks the Warsaw Convention. It would be arguable that a domestic Act irrespective of its source — and not including an interpretive article — should be interpreted using domestic laws. However, Kirby J, in an insightful judgment, noted:

> As a matter of logic, a decision on each of the points argued in these proceedings applies to a much wider class of air carriage. Accordingly the decision must be reached by this court with close attention to the developments of international law,

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92 J Spigelman, 'The Intolerable Wrestle: Developments in Statutory Interpretation' (2010) 84 *Australian Law Journal* 822.

93 *Convention for the Unification of Certain Rules Relating to International Carriage by Air*, opened for signature 12 October 1929, (1955) 478 UNTS 371 (entered into force 1 August 1963) ('Warsaw Convention').

> including decisions of municipal courts of other states parties to the Warsaw convention.[94]

It can be argued that by merely following the decisions to investigate international jurisprudence the application of domestic interpretational methods is at least minimised. This does not suggest that domestic interpretative methodology, or any methodology for that matter, is abandoned. On the contrary, any statute must be interpreted with a methodology in mind to give meaning to words and complying with the purpose and intent of the drafters. However, if a truly transnational interpretative scheme is to be successful, a new methodological theory would need to be developed in order to harmonise the substantive law applicable within a domestic area where the subject matter is of international significance.

Kirby J noted that when interpreting the *Carrier's Act* the purposive approach must be chosen in line with the drafting history of the Convention.[95] The real significance of this case was the High Court's unequivocal statement that 'no differentiation could be drawn on the basis that it was not obligatory for Australia to apply the language of the Warsaw Convention to domestic carriage'.[96] The court went on to explain that the reason for the decision was that if a country has elected to ratify a Convention, 'it must be assumed that an interpretation consistent with any treaty provision should be adopted, in so far as the treaty language was borrowed'.[97]

Of real interest is that Kirby J draws attention to the fact that in Australia there is an established principle of interpretation, which is designed to give effect to the language of international law.[98] By overruling the lower court, Kirby J stated:

> In effect the error of the Court of Appeal … was the result of failing to give the language of s 34 a purposive construction. Particularly so when its origin, and operation, within the Warsaw

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94 *Air Link Pty Ltd v Paterson* (2005) 223 CLR 301 [40].

95 Ibid [312].

96 Ibid [303].

97 Ibid [304].

98 Ibid [303].

> Convention language is to be considered, in all of its differing applications in different countries by different decision-makers.[99]

It is important to note that despite the fact that it was the Australian Parliament who was the drafter of the statute, the court found it necessary to consult the Warsaw Convention to arrive at a harmonised solution. The court furthermore relied on foreign jurisprudence as well as academic writing. It is clear that Kirby J did not blindly follow domestic interpretive methods but noted the purposive issues connecting the two legal instruments. 'No doubt this conclusion extends beyond this case and lends itself to the interpretation and application of whichever other international Convention [requires interpretation].'[100]

These steps indicate that there is an appreciation within the Australian court system that interpretative methodologies must be adjusted when the ramification of decisions go beyond the borders of Australia.

V Conclusion

This paper has shown that 'the task of statutory interpretation is at once complex, contestable and fascinating'.[101] The approach is to give 'effect to the purpose or policy apparent in the statutory language'[102] specifically when an embedded interpretative article is involved.

This brief comparison between applicable statutory methods giving meaning to the intent of the drafters has shown that in Australia a uniform approach to statutory interpretation has not yet been achieved. The still ongoing debate between textual versus contextual approaches within domestic legislation has not been settled either, which is not conducive to a transnational approach to statutory interpretation. It is obvious that conventions and model laws demand

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99 Ibid [312]–[313].

100 Bruno Zeller, 'Case Notes' (2005) *Uniform Law Review* 908.

101 Michael Kirby, 'Statutory Interpretation: The Meaning of Meaning' (2011) 35 *Melbourne University Law Review* 113, 131.

102 Ibid.

a dual process of statutory interpretation and has caused a mutation in *stare decisis*, which is now heterophyllous.[103] Courts are charged with the proper application of statutes — crucially in this context the interpretative mandate.[104] This mandate is derived from the embedded interpretative articles within conventions and model laws. Simply put:

> International conventions cannot be subject to interpretation. If everyone were to interpret conventions in their own way, there would be no point in having common rules for international sales. The Supreme Court must ensure that judges avoid the temptation to accept small exceptions to an international rule.[105]

It could be argued that courts and tribunals are interpreting all legislation according to the intention of the drafter. However, suggesting that all laws forming part of our domestic system, irrelevant of its source, is drafted by parliament hence needs to be interpreted pursuant to prevailing Australian methodologies. This is not the case as this approach neglects to understand the interpretation of conventions and model laws which already have their own interpretative articles embedded within the statute. Arguably, in many circumstances courts in Australia have adopted the correct methodology, but unfortunately not in all cases. This is specifically evident in the application of the CISG where the necessary mutation in *stare decisis* has not been detected and hence not applied.

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103 Corney above n 4, 52.

104 See Bruno Zeller, 'The Determination of the Contractual Intent of Parties under the CISG and the Common Law — A Comparative Analysis' (2002) 4(4) *European Journal of Law Reform* 629.

105 Olivert Vibert, 'Editorial Remarks — *Société Bati-Seul v Société Ceramiche Marca Corona* Cour de Cassation [Supreme Court] France 8 April 2009' (3/2009) *European Journal of Contract Law* 154. See also CISG Case Notes <http://cisgw3.law.pace.edu/cases/090408f1.html>.

PRINCIPLE OF NON-DISCRIMINATION IN GSP SCHEMES: REVISITING EC-TARIFF PREFERENCES

SHARMIN TANIA*

Abstract

Non-discrimination, a central pillar of the General Agreement on Tariffs and Trade (GATT) and World Trade Organisation (WTO), is on the wane when it comes to the operation of preferential market access. This issue of wide-scale discrimination was brought to the limelight through EC-Tariff Preferences case. The Appellate Body, by interpreting the term 'non-discriminatory' as authorising differential treatment among developing countries, overturned the more logical interpretation of the term by the panel. The panel interpreted 'non-discriminatory' as requiring identical tariff preferences under Generalised Schemes of Preferences (GSP schemes) to all developing countries without differentiation, except for the more favourable treatment for the least developed countries (LDCs). This article argues that the appellate body appeared to have upheld the view held by developed countries that GSP, being merely a 'gift' to developing countries, depends on the preference-giving countries' political will. On the other hand, the panel's interpretation was more in favour of developing countries' interest since it recognised their legal entitlement to equal preferential treatment with other developing countries and acknowledged the special situation of LDCs requiring more favourable treatment.

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Generalised System of Preferences — Most Favoured-Nation Clause — Enabling Clause — Dispute Resolution — Developing Countries — Preferential Market Access

I INTRODUCTION

The Generalised System of Preferences (GSP), standing on the legal basis of the 1979 Enabling Clause,[1] allows preference-giving countries to grant preferential tariff treatment to the products of developing countries. The objective of the Enabling Clause is to encourage the WTO-Members to deviate from the Most Favourable Nation (MFN) treatment of art I of the General Agreement on Tariffs and Trade 1994 (GATT) in pursuit of 'differential and more favourable treatment' for developing countries so that enhanced market access can stimulate their economic development. Paradoxically, this objective is frequently thwarted by the way the preference-granting countries pick and choose from developing countries to bestow GSP benefits upon them. All major GSP schemes incorporate conditionality, which often results in discrimination among the preference-receiving countries. Developed countries use GSP schemes couched with conditionality as a tool for reward or punishment. Through India's challenge of the European Communities' GSP scheme in the *European Communities — Conditions for the Granting of Tariff Preferences to Developing Countries*, known as the *EC-Tariff Preferences case*,[2] the issue of the discriminatory feature of GSP scheme was brought to the forefront. The case has significant implications for all conditional grants of

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1 *Decision on Differential and More Favourable Treatment, Reciprocity and Fuller Participation of Developing Countries*, Decision of 28 November 1979, (L/4903), GATT BISD, 26th Supp, 203–18 (1980) ('the Enabling Clause').

2 *European Communities — Conditions for the Granting of Tariff Preferences to Developing Countries*, WTO Doc WT/DS246/AB/R, AB-2004-1 (2004) (Report of the Appellate Body); *European Communities — Conditions for the Granting of Tariff Preferences to Developing Countries*, WTO Doc WT/DS246/R (2003) (Report of the Panel) ('EC-Tariff Preferences').

trade preferences.[3] It poses a vital question both for the GSP-granting countries and beneficiaries: whether and to what extent discrimination can be made among developing countries through non-trade conditionality in GSP schemes.

Much of the academic study for the case focuses on analysing the Appellate Body's (AB) decision and predicting its implications on conditionality in GSP schemes. This article instead makes a comparative analysis between the Panel Report and AB Report on the issue of 'non-discrimination'. Although the Panel's argument on 'non-discrimination' was slammed for being too radical, the paper finds the Panel's interpretation more persuasive than the AB's interpretation. The AB, in an attempt to strike a political balance in the decision, as this article argues, introduced a new framework for the application of GSP conditionality, which actually made the operation of the system even more confusing. The article argues that the Panel Report was dynamic in unfolding and rectifying one of the vital hitches in GSP system. The article begins with an account of conditionality in GSP schemes drawing from the EU and the US GSP schemes and its relation with the principle of non-discrimination. The third part introduces the dispute along with the political reality behind it. Part four looks into the key legal issues in the dispute regarding non-discrimination. Finally, it evaluates both the Panel and Appellate Body's decision from the perspective of a developing country to establish its argument that the Panel's interpretation of non-discrimination was more in favour of developing countries' interest.

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3 Gregory Shaffer and Yvonne Apea, 'Institutional Choice in the General System of Preferences Case: Who Decides the Conditions for Trade Preferences? The Law and Politics of Rights' (Legal Studies Research Paper Series, Paper No 1008, University of Wisconsin, Law School, 2006), 2.

II CONDITIONALITY IN GSP AND THE PRINCIPLE OF NON-DISCRIMINATION

The issue of conditionality has never been specifically mentioned in the Enabling Clause or in the 1971 Waiver Decision.[4] This is a deviation from the MFN treatment in GATT art I.1, which requires the same treatment to be extended 'immediately and unconditionally' to all other Member countries, once it is accorded to any one of them. Hence the absence of express requirement for non-conditionality in the Enabling Clause has been perceived by preference-granting countries as authorisation to impose conditions in GSP as per their discretion. In the initial stage, these conditions were based on the competitiveness of developing countries' products, which nearly reproduced the 'imperial preference' schemes that predated the GATT.[5] Since then almost all the GSP schemes have been providing for the 'graduation' of competitive product sectors as well as of any beneficiary country that reached a certain development threshold.[6] They even retained an 'escape-clause type' mechanism to protect a domestic industry from GSP imports.[7] Developing countries quite unwillingly accepted this economic conditionality in preferential market access based upon the rule of graduation during the Tokyo Round Negotiations (1973–79).[8]

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4 *Waiver for Generalised System of Preferences*, Decision of 25 June 1971, GATT BISD, 18th Supp, (1972) 24.

5 The colonial preferences programmes that preceded the GSP contained 'competitiveness' limitations that could be modified by the grantor at its discretions: Shaffer and Apea, above n 3, 4.

6 Lorand Bartels, 'The Appellate Body Ruling on EC-Tariff Preferences to Developing Countries and its Implications for Conditionality in GSP Programmes' in Joost Pauwelyn, Thomas Cottier and Elisabeth Bürgi (eds), *Human Rights and International Trade* (Oxford University Press, 2005) 463.

7 Shaffer and Apea, above n 3, 4.

8 Robert E Hudec, *Developing Countries in the GATT Legal System* (Gower Publications, 1st ed, 1987).

However, over the years, developed countries moved forward to link their preferential schemes to a plethora of non-trade conditions to uphold political ideology such as human rights and intellectual property protection to uphold political ideology. These GSP conditions have been identified to be of two broad types: positive and negative conditionality.[9] Positive conditionality functions as an incentive to meet certain standards set by the preference-granting countries for gaining additional preferences and works as a reward for complying with those standards. Negative conditionality, on the other hand, poses a threat of withdrawal of existing preferences in case of failure to comply with certain standards, also set unilaterally by preference-giving countries. It operates as a punishment for the beneficiaries for not complying with certain labour standards or rule of law, to mention a few. Instances of both types of conditionality are worth mentioning.

Negative conditionality can be found in the GSP system of both the United States and European Communities. The US GSP Scheme which came into effect in 1976 through the *Trade Act* of 1974,[10] created mandatory and discretionary criteria for eligibility of GSP status. Both of these criteria are essentially negative since they specify conditions under which a particular developing country cannot be designated as a beneficiary.[11] Under a set of mandatory criteria, countries are deemed ineligible for GSP beneficiaries for any of the following reasons: communism, membership of an international cartel (Organization of the Petroleum Exporting

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9 For an account of both of these types conditionality, see Stephanie Switzer, 'Environmental Protection and the Generalised System of Preferences: A Legal and Appropriate Linkage' (2008) 57(1) *International and Comparative Law Quarterly* 113; Lorand Bartels, 'The WTO Enabling Clause and Positive Conditionality in the European Community's GSP Program' (2003) 6(2) *Journal of International Economic Law* 507.

10 19 US Code ch 12, Trade Act of 1974, subch V — Generalized System of Preferences.

11 Tracy Murray, *Trade Preferences for Developing Countries* (John Wiley & Sons, 1977) 36.

Countries [OPEC]) causing damage to the world economy (based on US opinion), reverse preferences, expropriation, failure to enforce arbitral awards, involvement in terrorism, the violation of worker's rights and child labour.[12] Under the discretionary criteria, the United States Trade Representative (USTR) can take an account of factors, such as the desire to be a beneficiary, the level of economic development, GSP status in other country's GSP scheme, market openness, level of intellectual property protection, trade policy regarding trade in services and investment practices, and implementation of internationally recognised worker's rights.[13] Even the President can withdraw or suspend the GSP status of a country if he determines that due to the changing circumstances the country should be barred from being designated as a GSP beneficiary.[14] The US system permits any interested US private party to petition for a country's removal, total or partial, from a GSP beneficiary.[15] It created a public-private review process.[16] Labour unions and intellectual property trade associations have been the two more active users of this provision.[17] Before finally suspending the GSP status of Bangladesh in June 2013 the US GSP Subcommittee had been considering the withdrawal or suspension of the GSP program in response to the petition filed by the American Federation of Labor and the Congress of Industrial Organizations (AFL-CIO), alleging Bangladesh for her under-performance in providing workers with

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12 19 US Code, Trade Act of 1974, s 2462(b).

13 Ibid s 2462(c).

14 Ibid s 2462(d)(2).

15 Office of the USTR, *US Generalized System of Preferences (GSP) Guidebook*, (Executive Office of the President, Washington, DC, December 2012), 10 ('*US Generalized System of Preferences (GSP) Guidebook'*); Office of the USTR, *Part-2007: Regulation of the USTR Pertaining to Eligibility of Articles and Countries for the Generalised System of Preferences,* 15 CFR § 2007.0(a) and (b), <http://ecfr.gpoaccess.gov/cgi/t/text/textidx?c=ecfr&sid=9c1e2fb5a48d543abd219d1725ab3575&rgn=div5&view=text&node=15:3.2.1.7.7&idno=15#15:3.2.1.7.7.0.36.1>.

16 Gregory Shaffer, *Defending Interests: Public-Private Partnerships in WTO Litigation* (Brookings Institution Press, 2003) 54–5.

17 Shaffer and Apea, above n 3, 5.

internationally recognised worker rights, specifically the right of association and the right to organise and bargain collectively.[18] The behaviour of a developing country is monitored by the United States in deciding periodically whether it should continue to enjoy GSP benefits.[19] United States GSP provisions also show how GSP is used by the United States to elicit reciprocity from developing countries by extracting 'economic or political behaviour on the part of developing countries which is consistent with US international economic and political interest'.[20]

Similarly, the EC GSP scheme, introduced in 1971, also contains the negative conditionality but they do not negatively determine a country's eligibility to become GSP beneficiary, rather they provide for temporary withdrawal of GSP status. Under this scheme, preferential arrangement can be temporarily withdrawn on the following grounds: serious and systematic violations of the principles laid down in certain international conventions concerning core human rights and labour rights or related to the environment or good governance; export of goods made by prison labour; failure in custom controls on illicit drugs; money laundering; serious unfair trade practices; an infringement of the objectives of regional fishery organisations or arrangements of which the European Union is a Member.[21] A developing country may also lose their GSP status concerning all or certain products for fraud, failure to comply with rules of origin or failure to provide administrative cooperation for

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18 Office of the USTR, *Generalised System of Preferences (GSP): Request for Public Comments on the Possible Withdrawal, Suspension, or Limitation of GSP Benefits With Respect to Bangladesh*, Federal Register, Vol 78, No 5, Tuesday, 8 January 2013, Notices, 1300, <http://www.gpo.gov/fdsys/pkg/FR-2013-01-08/pdf/2013-00067.pdf>.

19 Murray, above n 11, 36.

20 Ibid.

21 Regulation (EU) No 978/2012 of the European Parliament and of the Council of 25 October 2012, applying a scheme of generalised tariff preferences and repealing Council Regulation (EC) No 732/2008 of 22 July 2008, ch V: *Temporary Withdrawal and Safeguard Provision*, art 19.

implementation of GSP schemes.[22] In the aftermath of the Savar building collapse tragedy in Bangladesh in April 2013, which killed 1200 ready-made garment workers, the European Union threatened to revoke its GSP facility to Bangladesh.[23] However, unlike the United States, the European Union retracted and continued its GSP to the country.

Positive conditionality is the more prominent feature of the present EU GSP scheme, as commented by Sanchez Arnau that unlike the United States, 'the EU has tried to avoid using GSP-linked sanctions'.[24] The current EU GSP, enforced in January 2014 retains the basic structure of the three-fold arrangements established in 2005: General Arrangement, Special Incentive Arrangement for Sustainable Development and Good Governance (GSP Plus scheme) and Special Arrangement for the Least-developed Countries (Everything But Arms).[25] To benefit from the special incentive arrangement, a country must have ratified and effectively implemented all the 27 conventions related to labour rights, environment and governance principle; must give an undertaking to maintain the ratification and their implementing legislation and measures; and must accept the regular monitoring and review of its implementation.[26] The special incentive arrangement can be temporarily withdrawn if the country's legislation no longer incorporates those convention provisions or if the legislation is not effectively implemented.[27]

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22 Ibid.

23 'EU Threatens to Withdraw GSP', *bdnew24.com* (online), 24 May 2013 <http://bdnews24.com/economy/2013/05/24/eu-threatens-to-withdraw-gsp>.

24 Juan C Sanchez Arnau, *The Generalised System of Preferences and the World Trade Organisation* (Cameron May, 2002) 270.

25 Regulation (EU) No 978/2012 of the European Parliament and of the Council of 25 October 2012 applying a scheme of generalised tariff preferences and repealing Council Regulation (EC) No 732/2008, OJEU, L 303/1, (31 October, 2012).

26 Council Regulation (EC) No 732/2008 of 22 July 2008, art 8.

27 Ibid art 15(2).

However, developing countries have raised concerns about the reward-based system of positive conditionality since the operation of this conditionality discriminates against some developing countries. Positive conditionality apparently treats all developing countries equally since the conditions are the same for all. However, the reality is all developing countries are not similarly capable of complying with these requirements. Although conditionality does not necessarily entail discrimination and these two are conceptually different, there is a close tie between the two. Conditions can act as a camouflage for subtler form of discrimination.[28] Even conditions that are formally applicable to all countries can in fact be de facto discriminatory, if not de jure. The AB's explanation in *US-Shrimp* is pertinent here:

> Discrimination results not only when countries in which the same conditions prevail are differently treated, but also when the application of the measures at issue does not allow for any inquiry into the appropriateness of the regulatory program for the conditions prevailing in those exporting countries.[29]

The EU justified its GSP Plus scheme stating 'no discrimination occurred, no reciprocity was required, but a positive incentive obtained available to all countries under the GSP scheme'. [30] However, this could not prevent developing countries from complaining about the non-trade issues for introducing elements of discrimination and reciprocity into GSP scheme.[31]

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28 James Harrison, 'GSP Conditionality and Non-Discrimination' (2003) 9(6) *International Trade Law and Regulation* 159.

29 *United States — Import Prohibition of Certain Shrimp and Shrimp Products*, WTO Doc WT/DS58/AB/R, AB-1998-4 (1998) (Report of the Appellate Body), para 165.

30 WTO, *Trade policy Review — The European Union — Minutes of the Meeting on 12 and 14 July 2000*, WTO Doc WT/TPR/M/72, para 165.

31 WTO Secretariat, *Implementation of Special and Differential Treatment Provisions in WTO Agreements and Decisions*, WTO Doc WT/COMTD/W/77 (25 October 2000), 21.

III THE *EC-TARIFF PREFERENCES* DISPUTE IN A NUTSHELL

Developing countries have long suffered from the conditionality in GSP preferences imposed for pure non-trade reasons, including political ones. Nevertheless, India's challenge to the ECs' Drug Arrangement was the first in this kind of dispute and still remains the only one which unleashed a core concern of developing countries regarding the operation of GSP system. This dispute centred upon the granting of additional tariff preferences to a 'closed list' of developing countries to assist them in combating drug production and trafficking. This was one of the five tariff preferences schemes available to developing countries under the *EC Council Regulation 2501/2001*:[32]

- The General Arrangements;
- Special Incentive Arrangements for the protection of labour rights;
- Special Incentive Arrangements for the protection of the environment;
- Special Arrangements for the least developed countries;
- Special Arrangements to combat drug production and trafficking ('the Drug Arrangements').

Among these, the General Arrangements are applicable to all developing countries while other countries have several eligibility requirements. The Drug Arrangements applied to a closed list of 12 countries. All beneficiaries, except Pakistan, were Andean and Central American Countries.[33] The drug scheme for these countries itself was not novel as the history can be traced to a Cooperation Agreement signed in 1985 between the European Economic Community and the Members to the General Treaty on Central

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[32] *Council Regulation (EC) No 2501/2001 of 10 December 2001*, applying a scheme of generalised tariff preferences for the period from 1 January 2002 to 31 December 2004, OJEC, L346 (31 December 2001).

[33] Bolivia, Colombia, Costa Rica, Ecuador, El Salvador, Guatemala, Honduras, Nicaragua, Panama, Peru and Venezuela.

American Economic Integration.[34] Pakistan's inclusion within the Drug Arrangements after 11 September 2001 triggered India, who was beneficiary only under the General Arrangements, to challenge the legality of the arrangements. Pakistan was included not because it was severely affected by the drug problem but to secure its acquiescence in the invasion of Afghanistan and for support on the 'war on terror'. The European Union quite openly acknowledged this political aspect of its decision to include Pakistan:

> In recognition of Pakistan's changed position on the Taliban regime and its determination to return to democratic rule in 2002, the Commission has stepped up the EU's assistance to Pakistan … On 16 October, the Commission presented a package of trade measures designed to significantly improve access for Pakistani exports to the EU. It removes all tariffs on clothing and increase quotas for Pakistani textiles and clothing by 15%. In return, Pakistan will improve access to its markets for EU clothing and textile exporters. The package gives Pakistan the best possible access to the EU short of a Free Trade Agreement by making it eligible for the new Special Generalized System of Preferences Scheme for countries combating drugs.[35]

India estimated an annual loss of 250 million through the diversion of its textile trade to Pakistan, the primary competitor of India in the region.[36] India challenged, in 2002, both EU's Drug Arrangements and preference schemes conditioned on labour and environmental grounds. Later in 2003 India dropped her challenges against labour and environmental schemes since she wished to pursue her main claim against the Drug Arrangements and did not want to jeopardise

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34 Cooperation Agreement between the European Economic Community, of one part, and the country parties to the General Treaty on Central American Economic Integration (Costa Rica, El Salvador, Guatemala, Honduras and Nicaragua) and Panama, of the other part — *Declarations by the Community — Exchange of Letters*, OJEC, L172/2 (1986).

35 *EU Response to the 11 September: European Commission Action*, MEMO/02/122, Bruxelles, 3 June 2002 <http://europa.eu/rapid/press ReleasesAction.do?reference=MEMO/02/122&format=HTML&aged=0&language=EN&guiLanguage=en>.

36 'WTO-LD India', *The Press Trust of India*, 28 January 2003 in Shaffer and Apea, above n 3, 8.

this by invoking more politically sensitive trade-labour and trade-environment issues.[37]

India claimed that EC's drug regime was discriminatory and violated the 'non-discriminatory' requirements for GSP program set out in the Enabling Clause. The Panel decided in India's favour and found the EC Drug Scheme discriminatory. The AB also upheld the Panel's decision, but substantially modified the Panel's interpretations of the legal status and effect of the Enabling Clause and differed with the Panel on the rationale behind declaring the drug regime discriminatory. This case aroused severe concern for the third parties, which explains why a good number of them participated in the proceedings before both the Panel and the AB.[38] The next part deals with the core of this paper: how the Panel and the AB have interpreted the non-discrimination principle in GSP.

IV PRINCIPLE OF NON-DISCRIMINATION: INTERPRETATION OF THE PANEL AND THE APPELLATE BODY

The Enabling Clause embodies the principle of non-discrimination as one of its basic features. It applies to GSP schemes in two ways: First, by applying non-discrimination principle in art I.1 to the Enabling Clause and second, by specific mention of the term 'non-discriminatory' in n 3 of para 2(a) of the Enabling Clause. Moreover, GSP has been articulated as 'generalised, non-reciprocal and non-discriminatory system of preferences' in the 1971 Waiver Decision, the Resolution 21 (II),[39] Resolution 96(IV) of 31 May 1976,[40] Doha

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37 EC-Tariff Preferences Panel Report, para 1.15; Shaffer and Apea, above n 3, 8.

38 Paraguay, Brazil, Cuba, Mauritius, Sri Lanka, the United States and the 12 beneficiaries of the Drug Arrangements reserved their right to participate in the Panel proceedings as third parties. Seven of the 12 beneficiary countries (the five Andean Community countries, Costa Rica and panama) as well as Paraguay and the United States participated as third parties before the Appellate Body.

39 UNCTAD, *Resolution 21(II) Preferential or Free Entry of Manufactures and Semi-Manufactures of Developing Countries to the*

Ministerial Decision: Implementation-related Issues and Concerns.[41] Both the Panel and the AB engaged themselves in the legal interpretation of the non-discrimination principle appearing in both ways in the Enabling Clause.

A *Does Non-discrimination Principle of Art I.1 of the GATT Apply to the Enabling Clause?*

Article I.1 of the GATT states:

> Any advantage, favour, privilege or immunity granted by any contracting party to any product originating in or destined for any other country shall be accorded immediately and unconditionally to the like product originating in or destined for the territories of all other contracting parties.

The relevant text of the Enabling Clause provides:

> Notwithstanding the provisions of Article I of the General Agreement, contracting parties may accord differential and more favourable treatment to developing countries, without according such treatment to other contracting parties.

Ascertaining the relationship between art I of the GATT 1994 and para 1 of the Enabling Clause was significant in order to allocate the burden of proof in the dispute. India maintained that the Enabling Clause is an exception to art I.1 and constitutes an affirmative defence.[42] Therefore, India would prove a prima facie case that EC violated art I.1 of the GATT, the EC would come to its defence and bear the burden of proving that its Drug Arrangement was consistent with the Enabling Clause.[43] On the other hand, the EC argued that

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Developed Countries, Proceedings of the United Nations Conference on Trade and Development, 2nd sess, Vol 1, Report and Annexes (United Nations publication, Sales No E.68.II.D14) 38.

40 UNCTAD, *Proceedings of the United Nations Conference on Trade and Development*, 4th sess 10m UN Sales No E76.II.D.10.

41 WTO, *Ministerial Declaration*, WTO Ministerial Conference, 4th sess, Doha, WTO Doc WT/MIN(01)/DEC/1 (20 November 2001) (adopted on 14 November 2001), para 12.2.

42 EC-Tariff Preferences Panel Report, para 7.25.

43 Ibid para 7.25.

'the Enabling Clause was not a waiver but a *sui generis* decision and that it is the main instrument for achieving one of the basic objectives and purposes of the WTO Agreement — special and differential treatment'.[44] Hence, EC's articulation of the Enabling Clause as an 'autonomous right' imposed the burden of proof on India to establish that EC's Drug Arrangements was inconsistent with para 2(a) of the Enabling Clause. This article focuses on how the relationship between art I.1 and the Enabling Clause was determined in the case since this determination was vital to establish whether the non-discrimination principle in art I.1 of the GATT also applies to the Enabling Clause.

To frame it with more clarity, the dispute was whether the Enabling Clause should be characterised as an 'exception' to art I.1 of the GATT or as 'lex specialis' outlining a special regime for preferential treatment of developing countries' products.[45] The Panel first decided that the Enabling Clause is 'in the nature of an exception' to art I.1.[46] In arriving at the conclusion that the Enabling Clause is an exception, the Panel derived from *US — Wool Shirts and Blouses*[47] the following test for identifying an exception: 'it must not be a rule establishing legal obligations in itself; and second, it must have the function of authorising a limited derogation from one or more positive rules laying down obligations'.[48] The Panel found both these characteristics in the Enabling Clause.

The AB upheld the Panel's characterisation, though deviated from the 'positive obligation' test of the Panel. The AB rather applied a different approach for determining an 'exception': whether the text of the provision, which is examined as an exception, indicates that the obligation does not apply in the situations covered by the provision at

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44 Ibid para 7.29.

45 Bartels, above n 6, 463.

46 EC-Tariff Preferences Panel Report, para 7.39.

47 *United States — Measures Affecting Imports of Woven Wool Shirts and Blouses from India*, WTO Doc WT/DS33/R (1997) (Report of the Panel); WTO Doc WT/DS33/AB/R (1997) (Report of the Appellate Body).

48 EC-Tariff Preferences Panel Report, para 7.35.

issue. The AB emphasised the term 'notwithstanding' in para 1 of the Enabling Clause and asserted that this term permits Members to provide 'differential and more favourable treatment' to developing countries 'in spite of' the MFN obligation of art I:1.[49]

The next question was whether art I:1 applies to a measure covered by the Enabling Clause. The Panel first looked into the ordinary meaning of 'notwithstanding' in para 1 of the Enabling Clause as 'in spite of, without regard to or prevention by'. This led the Panel to note that 'the operation of the Enabling Clause is not prevented by Article I:1'.[50] The Panel then found an analogy with the relationship between art XX and arts I, III or XI:1, which has been examined in *US — Gasoline*,[51] *US — Shrimp*,[52] and *EC — Asbestos*;[53] between art XXIV and art XI, examined in *Turkey — Textiles*.[54] The jurisprudence shows how the two types of provisions apply concurrently to a given measure.[55] From this the Panel came to the conclusion that the Enabling Clause does not exclude the applicability of art I.1. Rather, the two provisions apply concurrently, with the Enabling Clause prevailing to the extent of inconsistency between the two provisions.[56]

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49 EC-Tariff Preferences Appellate Body Report, para 90.

50 EC-Tariff Preferences Panel Report, para 7.44.

51 *United States — Standards for Reformulated and Conventional Gasoline*, WTO Doc WT/DS2/R (1996) (Report of the Panel); WTO Doc WT/DS2/AB/R, AB-1996-1 (1996) (Report of the Appellate Body).

52 *United States — Import Prohibition of Certain Shrimp and Shrimp Products*, WTO Doc WT/DS58/AB/R, AB-1998-4 (1998) (Report of the Appellate Body); WTO Doc WT/DS58/R (1998) (Report of the Panel).

53 *European Communities — Measures Affecting the Approval and Marketing of Biotech Products,* WTO Docs WT/DS291/R, WT/DS292/R, WT/DS293/R, (2006) (Report of the Panel); WTO Doc WT/DS135/AB/R (2001) (Report of the Appellate Body).

54 *Turkey — Restrictions on Imports of Textile and Clothing Products*, WTO Doc WT/DS34/R (1999) (Report of the Panel); WTO Doc WT/DS34/AB/R (1999) (Report of the Appellate Body).

55 EC-Tariff Preferences Panel Report, para 7.45.

56 Ibid para 7.53.

The AB upheld Panel's findings, albeit on different grounds. The AB stated that the text of para 1 of the Enabling Clause ensures that, to the extent that there is a conflict between measures under the Enabling Clause and the MFN obligation under art I.1, the Enabling Clause, as the more specific rule, prevails over art I:1.[57] It implies that the non-discrimination principle in art I:1 also applies to the Enabling Clause except when there is a conflict between the two provisions in which case the Enabling Clause prevails. The AB in this determination relied solely on the term 'notwithstanding'. The Panel, instead, focused on the function of the Enabling Clause in the overall balance of rights and obligations making up the WTO legal system and gave more sound interpretation of the relationship.[58]

B *Interpretation of the term 'non-discriminatory' in Footnote 3 to Article 2(a)*

The Panel found that the term 'non-discriminatory' in n 3 to art 2(a) of the Enabling Clause[59] requires that GSP schemes must provide for identical tariff preferences to all developing countries 'without differentiation, except for the implementation of a priori limitations'.[60] To arrive at this conclusion, the Panel first considered the ordinary meaning of the term 'discriminate' by taking into account the neutral meaning, as India proposed, to make a difference as well as the negative meaning, as the EC proposed, to make unjust or prejudicial differences. Thereafter, the Panel found it necessary to consider the term 'non-discriminatory' in its context and in the light of the object and purpose of the GATT in order to determine its appropriate meaning.[61] India argued before the Panel that the context

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57 EC-Tariff Preferences Appellate Body Report, para 101.

58 Bartels, above n 6, 463.

59 Footnote 3 to art 2(a) of the Enabling Clause provides:

> As described in the Decision of the CONTRACTING PARTIES of 25 June 1971, relating to the establishment of 'generalised, non-reciprocal and non-discriminatory preferences beneficial to the developing countries'.

60 EC-Tariff Preferences Panel Report, para 7.161.

61 Ibid para 7.127.

of the term 'non-discriminatory' in n 3 of the Enabling Clause is to be found only in art I.1 of GATT.[62] The EC conversely argued that the appropriate context of the term 'non-discriminatory' in the Enabling Clause is found in paras 1, 2 and 3 of the Enabling Clause, particularly in paras 2(a), 2(d) and 3(c) and in the term 'generalised' in n 3.[63]

In analysing the meaning of para 2(a) of the Enabling Clause, the Panel made an analysis of the Res 21(II), the Agreed Conclusions and the relevant preparatory work leading to the establishment of GSP. This led the Panel to identify the 'unanimous agreement' between developed and developing countries to replace the existing special preferences provided to a limited number of developing countries with a generalised system of preferences provided to all developing countries equally, without the possibility of differentiation in treatment.[64] From its review of the context and preparatory work, the Panel concluded that the requirement of non-discrimination, as a general principle set out in Res 21(II) and later carried over into the 1971 Waiver Decision and then into the Enabling Clause, obliges preference-giving countries to provide GSP benefits to all developing countries without differentiation, except for the implementation of a priori limitations in GSP schemes.[65] Moreover, the Panel interpreted the explicit reference to the special treatment for the LDCs as an intention of the drafters to provide for such treatment only in respect of LDCs. This means that 'formally identical treatment is required to be given to all developing countries under the non-discrimination requirement of footnote 3 …'.[66] Even an examination of para 3(c) of the Enabling Clause provided no ground for the Panel to read 'non-discriminatory' in n 3 in such a way to allow differentiation among developing countries.[67]

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62 Ibid para 7.118.

63 Ibid paras 7.123 and 7.128.

64 Ibid paras 7.134 and 7.144.

65 Ibid para 7.144.

66 Ibid para 7.145.

67 Ibid para 7.148.

The EC challenged the Panel's interpretation of the term 'non-discriminatory' in n 3 as requiring identical tariff preferences under GSP schemes.[68] Rather, the EC maintained that 'non-discrimination' is not synonymous with formally equal treatment.[69] The EC concluded that the term 'non-discriminatory' in n 3 'does not prevent the preference-giving countries from differentiating between developing countries which have different development needs, where tariff differentiation constitutes an adequate response to such differences'.[70]

In interpreting the term 'non-discriminatory' the AB followed a two-step approach. First step was to determine whether the term 'non-discriminatory' creates a legal obligation or constitutes an aspirational language. Since the AB decided in favour of creating legal obligation, it then, in its second step, had to decide whether the term has a neutral meaning or a negative meaning.[71]

1 *First Step: Whether the terms 'generalised, non-reciprocal and non-discriminatory' amount to binding conditions*

The Panel, by examining the contextual instruments of GSP, concluded that the 'generalised, non-reciprocal and non-discriminatory' features of GSP are legal conditions. This view of the Panel was upheld by the AB, which found that these characterisations of GSP impose obligations that must be fulfilled for preferential tariff treatment to be justified under para 2(a). In coming to these findings, the AB referred to the plain text of art 2(a) of the Enabling Clause along with its n 3 as well as the preamble of the 1971 Waiver Decision, which refers to the 'establishment of a mutually acceptable

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68 EC-Tariff Preferences Appellate Body Report, para 127.

69 European Communities' appellant's submission, para 71: ibid para 149.

70 European Communities' appellant's submission, para 188: ibid.

71 If the term has a neutral meaning, then developed countries may not differentiate among developing countries at all, except for the competitiveness criteria as it was decided by the Panel. If it has a negative meaning, then developed countries may differentiate among developing countries on proper basis: Shaffer and Apea, above n 3, 11.

system of generalised, non-reciprocal and non-discriminatory preferences'. Here the AB rejected the arguments of both the EC and US (Third Party) to the effect that these terms do not impose any legal obligation on preference-giving countries, instead they merely refer to the description of GSP in the 1971 Decision.[72] This finding of the AB answers a fundamental question — whether the reference to non-discriminatory tariff preferences in the Enabling Clause is in reference to a legal standard or simply 'an aspirational nature'.[73] The AB clearly upheld the legal force of the 'non-discrimination' principle in the Enabling Clause.

2 *Second Step: Meaning of the term 'non-discriminatory' in the Enabling Clause*

After deciding the legal character of the term 'non-discriminatory' in the Enabling Clause, the AB then proceeded to determine the meaning of the term in the context of the Enabling Clause. Observing India's view of non-discrimination as a distinction per se between beneficiaries and the ECs' view as a distinction on improper bases, the AB found an artificial similarity between the arguments of both parties and held that they both agreed that distinguishing among 'similarly-situated beneficiaries is discriminatory'. It is to be noted that India never conceded to this concept of 'similarly-situated GSP beneficiaries'. This interpretation of non-discrimination as treating similarly situated GSP beneficiaries without any discrimination leaves it up to the discretion of the preference-granting countries to determine which developing countries are similarly-situated and on what basis. Here basically the AB found that the term had a 'negative' connotation.[74]

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72 EC-Tariff Preferences Appellate Body Report, para 146.

73 Robert Howse, 'Back to the Court after Shrimp/Turtle? Almost but Not Quiet Yet? India's Short-lived Challenge to Labour and Environmental Exceptions in the European Union's Generalised System of Preferences' (2003) 18(6) *American Univerisity International Law Review* 1333; Harrison, above n 28, 159.

74 Shaffer and Apea, above n 3, 12.

3 *Interpretation of Paragraph 2(a) of the Enabling Clause*

India argued that the use of the article 'the' before 'developing countries' in n 3 means 'all' developing countries rather than selective ones. In interpreting para 2(a) of the Enabling Clause, the Panel conceded to the Indian argument and considered the intention of the negotiators to provide GSP equally to 'all' developing countries and to eliminate all differentiation in preferential treatment to developing countries, with the exception of the implementation of a priori limitations.[75] This resulted in the conclusion that para 2(a) does not authorise preference-giving countries to differentiate among developing countries.[76] The AB reversed these findings of the Panel by holding that the term 'developing countries' in para 2(a) should not be read to mean 'all' developing countries. Therefore, para 2(a) does not prohibit preference-granting countries from according different tariff preferences to different sub-categories of GSP beneficiaries.[77]

C *The Term 'Generalised' Explained*

The Panel interpreted the term 'generalised' to have two connotations: (i) providing GSP to all developing countries; and (ii) ensuring sufficiently broad coverage of products in GSP.[78] However, on appeal the AB observed that the term 'generalised' requires that GSP schemes of preference-granting countries generally remain applicable.[79] To the AB, this corresponded with the dictionary meaning of the term 'generalised' in the sense that they 'apply more generally; [or] become extended in application'.[80] The AB stated that there could be appropriate reasons to eliminate special preferences.

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75 EC-Tariff Preferences Panel Report, para 7.169.

76 Ibid para 7.170.

77 EC-Tariff Preferences Appellate Body Report, para 175.

78 EC-Tariff Preferences Panel Report, para 7.175.

79 EC-Tariff Preferences Appellate Body Report, para 156.

80 *Shorter Oxford English Dictionary*, 5th ed, W R Trumble and A Stevenson (eds) (Oxford University Press, 2002), Vol 1, 1082: ibid para 155.

However, it does not follow from this, as the AB concludes, that 'non-discrimination' should be interpreted to require that preference-granting countries provide 'identical' tariff preferences under GSP schemes to 'all' developing countries.[81]

D *Interpretation of Paragraph 3(c)*

Paragraph 3(c) of the Enabling Clause provides:

> Any differential and more favourable treatment provided under this clause:
>
> (c) *Shall* in the case of such treatment accorded by developed contracting parties to developing countries be designed and, if necessary, modified, to *respond positively* to the *development, financial and trade needs of developing countries*.[82]

The Panel engaged in an interpretation of para 3(c) since it perceived that in order to give full meaning to para 2(a) and n 3 it was essential to determine whether para 3(c) allows differentiation among developing countries in 'responding positively to the development, financial and trade needs of developing countries'.[83] Neither the Enabling Clause nor its drafting history led the Panel to support the EC's argument that 'paragraph 3(c) permits developed countries to respond to similar development needs of selected developing countries "according to objective criteria"'.[84] The EC argued that preference-giving countries can differentiate among preference-receiving developing countries according to two objective criteria: (i) the difference in treatment must pursue a legitimate aim; and (ii) the difference in treatment must be a reasonable means to achieve that aim.[85] The Panel observed in this context that upholding the ECs' interpretation would have opened the floodgate for setting up of an unlimited number of special preferences favouring different selected developing countries. It would have led to the demise of the whole

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81 Ibid para 156.

82 The Enabling Clause, para 3(c) (emphasis added).

83 EC-Tariff Preferences Panel Report, para 7.65.

84 Ibid para 7.100.

85 Ibid para 7.101.

GSP system and a return to special preferences favouring selected developing countries. The Panel explained the irrationality of selecting an 'objective criteria' according to which preference-giving countries may treat different developing countries differently under GSP schemes:

> There is no reasonable basis to distinguish between different types of development needs, whether they are caused by drug production and trafficking, or by poverty, natural disasters, political turmoil, poor education, the spread of epidemics, the magnitude of the population, or by other problems. There could be no reasonable explanation why certain causes of the problem of development should be addressed through GSP and why other causes of the same development problem should not be so addressed.[86]

However, the Panel did not stop in stating the consequences of differentiating among developing countries according to different objective criteria set up unilaterally by the preference-giving countries. It went further in articulating its view on the appropriate way to respond to the development needs of developing countries: by inclusion of all developing countries in the GSP schemes, inclusion of a breadth of products of export interest to developing countries and provision for sufficient margins of preferences for such products.[87]

However, the Panel considered two limitations that are permitted to impose on this non-discriminatory provision. First is the a priory limitations that may be used to set import ceilings to exclude certain imports originating in individual developing countries where the products concerned reach a certain competitive level in the market of the preference-giving country; and the second case where differentiation is permitted is in favour of special treatment to the least-developed countries (LDCs), pursuant to para 2(d). Paragraph 3(c) permits no other differentiation, according to the Panel, among developing countries.[88]

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86 Ibid para 7.103.

87 Ibid para 7.105.

88 Ibid para 7.171.

The AB observed that the consequences of differentiating among developing countries as the Panel depicted above 'is unwarranted'. The AB believed that the Enabling Clause sets out sufficient conditions on the granting of preferences.[89] It noted that the word 'shall' in para 3(c) suggests an obligation for developed-country Members in providing preferential treatment under a GSP scheme to 'respond positively' to the 'needs of developing countries'. [90] However, the AB disagreed with the Panel's suggestion to take into account the needs of 'each and every' developing country in the absence of any specific reference in the provision to this effect.[91] The AB also observed the need to modify the 'differential and more favourable treatment' accorded by developed to developing countries in order to 'respond positively' to the needs of developing countries.[92] It also resorted to the Preamble of the WTO Agreement, which recognises the:

> needs for positive efforts designed to ensure that developing countries, and especially the least developed among them, secure a share in the growth in international trade commensurate with the needs of their economic development.

The AB interpreted the word 'commensurate' to leave open the possibility that developing countries may have different needs according to their levels of development and particular circumstances.[93]

Drawing on from these findings on para 3(c), the AB concluded:

> In sum, we read paragraph 3(c) as authorising preference-granting countries to 'respond positively' to 'needs' that are not necessarily common or shared by all developing countries. Responding to the 'needs of developing countries' may thus entail treating different developing country beneficiaries differently.[94]

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89 EC-Tariff Preferences Appellate Body Report, para 156.

90 Ibid para 158.

91 Ibid para 159.

92 Ibid para 160.

93 Ibid para 161.

94 Ibid para 162.

After allowing preference-giving countries to differentiate among developing countries, the AB carried on to frame out how this differentiation can be made. It observed that para '3(c) does not authorise any kind of response to any claimed need of developing countries'.[95] It imposed two conditions on needs. First, it must be a development, financial or trade need. Second, the response provided to the needs of developing countries must be 'positive'.

The AB considered these development, financial and trade needs to be subject to change. Hence, instead of an enumeration of such needs it introduced an objective standard to assess the legitimacy of such a development, financial or trade needs when any claim of inconsistency with para 3(c) is made.[96] Previously, the AB seemed to be holding a neutral view on the issue. Thereafter, it turned the balance towards developed countries when it illustrated that the objective standard could be a '[b]road-based recognition of a particular need, set out in the *WTO Agreement* or in multilateral instruments adopted by international organisations'.[97] The implication of setting this objective standard is to give legal coverage to almost all types of needs that the preference-granting countries may determine for the beneficiaries — from intellectual property rights to labour standards to environmental protection to terrorism. Hence the AB, by not explaining in detail what type of objective criteria would render preferences discriminatory,[98] simply kept the status quo of GSP scheme, though formulated in the fashion of disciplining the regime only in letters.

As to the 'positive response' requirement, the AB observed that 'the response of a preference-granting country must be taken with a view to *improving* the development, financial or trade situation of a

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95 Ibid para 163.

96 Ibid.

97 Ibid.

98 Amy M Mason, 'The Degeneralization of the Generalized System of Preferences (GSP): Questioning the Legitimacy of the US GSP' (2004) 54 *Duke Law Journal* 513, 535.

beneficiary country, based on the particular need at issue'.[99] The AB also suggested that 'a sufficient nexus should exist between the preferential treatment provided under the respective measure' and 'the likelihood of alleviating the relevant "development, financial [or] trade need"'.[100] The test to be applied is whether the GSP measure is capable of responding to the designated need in an objective sense.[101]

The AB summed up its view:

> By requiring developed countries to 'respond positively' to the 'needs of developing countries', which are varied and not homogenous, paragraph 3(c) indicates that a GSP scheme may be 'non-discriminatory' even if 'identical' tariff treatment is not accorded to 'all' GSP beneficiaries. Moreover, paragraph 3(c) suggests that tariff preferences under GSP schemes may be 'non-discriminatory' when the relevant tariff preferences are addressed to a particular 'development, financial [or] trade need' and are made available to all beneficiaries that share that need.[102]

The AB did not put emphasis on the language of para 3(a). It simply observed that any positive response of a preference-granting country to the varying needs of developing countries must not impose unjustifiable burdens on other Members.[103] However, it did not elaborate on the remedy of any developing country which is unjustifiably burdened by being excluded from a GSP scheme if it also considers itself to be similarly-situated with the beneficiaries.

Thus, the AB after a lengthy process of examination of the text and context of n 3 to para 2(a) of the Enabling Clause, and the object and purpose of the WTO Agreement and the Enabling Clause, concluded that the term 'non-discriminatory' in n 3 does not prohibit developed country members from granting different tariffs to products originating in different GSP beneficiaries. Then it proceeded to lay out the discipline in a more legalistic language, imposing some empty obligations on preference-granting countries. The first is to meet the

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99 EC-Tariff Preferences Appellate Body Report, para 164.

100 Ibid.

101 Switzer, above n 9.

102 EC-Tariff Preferences Appellate Body Report, para 165.

103 Ibid para 167.

remaining conditions in the Enabling Clause and the second is to ensure that identical treatment is available to all similarly-situated GSP beneficiaries, that is, to all GSP beneficiaries who have the 'development, financial and trade needs' to which the treatment in question is intended to respond.[104]

After analysing the Enabling Clause and the term 'non-discriminatory', the Panel found that the EC's Drug Arrangement did not provide identical tariff preferences to all developing countries and that the differentiation is neither for the special treatment to LDCs, nor in the context of the implementation of a priori measures. Such differentiation was, therefore, inconsistent with GATT art I.1, para 2(a) of the Enabling Clause, particularly the term 'non-discriminatory' in n 3 since as per the Panel's interpretation these provisions require identical tariff preferences to be provided to all developing countries. Also, the Drug Arrangement could not be justified by para 3(a) and 3(c) of the Enabling Clause, which require that preferences be designed to 'facilitate and promote the trade of developing countries' and 'respond positively to the development, financial and trade needs of developing countries'.[105]

The AB also found the EC's Drug Arrangements inconsistent with the Enabling Clause, but not because this scheme created discrimination among developing countries, rather due to its lack of transparency, failure to establish any 'clear prerequisites' or 'objective criteria', which would allow other developing countries similarly affected by the drug problem to be included as beneficiaries.[106] Moreover, the AB expressed its concern that the EC regulation failed to provide any indication as to how the EC would assess whether the Drug Arrangements constituted an 'adequate and proportionate response' to the needs of developing countries having the drug problem.[107] The

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104 Ibid para 173.

105 EC-Tariff Preferences Panel Report, para 7.177.

106 EC-Tariff Preferences Appellate Body Report, para 183.

107 Ibid para 184.

whole issue was left up to the discretion of the EC authorities without specifying any criteria, which posed a risk of using such schemes for political reasons as indeed happened in the case of Pakistan. The question still remains whether the new discipline the AB proposed is enough to thwart such political and unscrupulous use of GSP.

V Evaluation of the Panel and the Appellate Body Report

This part will critically analyse some problematic features of AB's interpretation and shows how the Panel's interpretation is more in favour of the developing country's interest and the AB's interpretation favours developed countries.

A *Who are Similarly-Situated Countries?*

The AB required identical treatment only among the 'similarly situated' developing countries, without providing for any criteria to determine these 'similarly situated' countries. To illustrate this point, there is a specific denominator of the UN to determine the least developed countries, which are an identifiable group. On the other hand, the concept of 'similarly situated' countries are not static, it depends upon the 'need', unilaterally determined by the preference-giving countries to provide GSP. In fact, the chosen need may result in better tariff preferences to some countries than others. For instance, if a GSP scheme is devised for countries which implement intellectual property (IP) law, discrimination occurs against other more vulnerable countries who do not afford the cost of implementation of IP law but who has more acute and valid needs of food, water and medicine. Hence, the AB's legal device may become a faulty tool to select the countries that are similarly situated.

B *Who Needs and Who is Determining?*

The AB's interpretation of 'non-discrimination' and 'development, financial and trade needs' left the preference-giving countries with unfettered discretion to select the 'needs' by giving them a sky-wide option. The AB, with its emphasis on responding to the objectively determined development needs, makes differentiation in GSP scheme consistent with the Enabling Clause.[108]

This phenomenon undermines the sovereignty of developing countries since it seriously downplays the ability of developing countries to determine their own needs. Countries that are in a position to offer preferential market access can also dictate the terms of trade. On the other hand, developing countries must do what the preference giving countries demand to retain those benefits.[109] How effective will the objective standard really be in separating legitimate from illegitimate developing country needs? Unsurprisingly, the AB's interpretation maintains the present situation where Pakistan's troubles with drug production and trafficking was given the status of more legitimate 'development need' than another developing country's problem with poor education or health epidemics.[110] This reminds the Panel's observation on selecting some needs while disregarding the more significant ones.[111] Gregory Shaffer and Yvonne Apea posed the question of how the intellectual property protection conditions contained in the US GSP scheme could be designed to 'respond positively to the development, financial, and trade needs of developing countries'.[112] Likewise, Stephanie Switzer doubted the rationale for selecting the 27 human rights, labour rights, environmental and sustainable development conventions by the EC for its 'special incentive arrangement for sustainable development and

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108 Mason, above n 98, 546.

109 Hans Mahncke, 'Sovereignty and Developing Countries: Current Status and Future Prospects at the WTO' (2013) 22(2) *Leiden Journal of International Law* 395, 405–6.

110 Bartels, above n 6, 463.

111 EC-Tariff Preferences Panel Report, para 7.103.

112 Shaffer and Apea, above n 3, 26.

good governance'.[113] Is preferential treatment or withdrawal of such treatment an appropriate response to the problem of child labour or labour safety? How effective is the action of the United States in withdrawing GSP benefits from Bangladesh to address safety in the workplace and improvement of labour rights while the country in the aftermath of the April 2013 industrial disaster needed more assistance from the preference-granting Members?

C *'All' Developing Countries in Paragraph 2(a)*

The Panel's interpretation of 'developing countries' in para 2(a) to refer to all developing countries was a significant step in arriving at the conclusion that same treatment has to be provided to all developing countries. As mentioned above, the AB reversed the above findings of the Panel due to the absence of the term 'all' in the text. However, the Panel's interpretation did not come out of the blue. The Panel found support from the text of the General Principle 8,[114] which is the instrument of the First Conference of the UNCTAD held in 1964. It says:

> Developed countries should grant concessions to *all* developing countries and extend to developing countries all concessions they grant to one another … New preferential concessions, both tariff and non-tariff should be made to developing countries *as a whole* … Special preferences at present enjoyed by certain developing countries in certain developed countries should be regarded as transitional and subject to progressive reduction.[115]

Also in the Agreed Conclusions:[116]

> The Special Committee notes that, consistent with Conference Resolution 21(II), there is agreement with the objective that in

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113 Switzer, above n 9, 113.

114 General Principle 8 of Recommendation A.I.1 in *Final Act of the United Nations Conference on Trade and Development* (Geneva: UNCTAD, Doc E/CONF.46/141, 1964), Vol 1, 20.

115 Ibid 20 (emphasis added).

116 UNCTAD, *Appendix: Agreed Conclusions on the Special Committee on Preferences*, *Generalized System of Preferences*, Decision 75 (S-IV), 10 ILM 1083, at 1084 (21 June 1971).

> principle all developing countries should participate as beneficiaries from the outset …[117]

Thus, GSP scheme intended to gradually include all developing countries, which was ignored by the AB.

The AB decision generated dejection, cynicism and political criticism from leading developing countries such as Brazil and India.[118] Brazil joined India in its criticism of the AB ruling, stating 'what the Appellate Body did, in a nutshell, might be construed, if taken without qualifications, as legitimising the GSP as a tool of foreign policy of developed countries'.[119] Both of them maintained that the AB had more implicitly authorised the United States and European Commission to use trade as a political grip to forge ahead their strategic and policy priorities.[120] The complex decision of the AB provided ample scope for further litigation to challenge the EC and the US GSP schemes. However, the way the AB handled the dispute between India and European Commission could discourage developing countries to take the same course of action in the future.

VI Conclusion

The AB's interpretation overturned the pro-development interpretation of the Panel. The Panel while acknowledging that the Enabling Clause does not create any legal obligation on developed countries to grant preferences, at the same time recognised developing countries' right not to be discriminated against by GSP schemes, once the preference-granting countries voluntarily decide to provide preferences. Reversely, the AB, by requiring identical treatment only among 'similarly situated' countries according to the needs that the preference-giving countries will determine, subjected

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117 Ibid.

118 Shaffer and Apea, above n 3, 31.

119 Daniel Pruzin, 'India Slams WTO Appellate Body Ruling on EU GSP Benefits; US Welcomes Reversal' (2004) 21(18) *International Trade Reporter (BNA)* 739, 740.

120 Shaffer and Apea, above n 3, 32.

developing countries to the discretion of developed countries. Virtually, it kept the status quo of GSP system except with an addition of some procedural requirements to make the system more transparent in appearance. This article argues that the AB interpretation of non-discrimination favours the interest of preference-giving countries allowing them to use it as an instrument to correct all human rights violations, or to uphold democracy or other standards. The AB decision re-confirmed the legal status of GSP as an entitlement of developed countries to exert their control and political power over developing countries rather than a means for developing countries to achieve development.

THE AUSTRALIAN CONSUMER LAW AFTER THE FIRST THREE YEARS — IS IT A SUCCESS?

DES TAYLOR AND NOELEEN MCNAMARA*

Abstract

The Australian Consumer Law (ACL), which is located in sch 2 of the Competition and Consumer Act 2010 (Cth) (CCA), came into force on 1 January 2011. A main reason for the ACL was to create a single Australia-wide regime, which would replace the myriad of consumer protection provisions contained in the Trade Practices Act 1974 (Cth) (TPA) and the various State and Territory legislation the majority of which being the State Fair Trading Acts. The hope was that this new single Australia-wide regime approach to consumer protection would bring with it greater legal certainty than previously, especially for businesses operating in more than one of the Australian jurisdictions (a common feature in today's business world). However, a consolidation of the existing law was not the only goal; several other significant changes were also implemented, one of which was an increase in the enforcement powers of the Australian Competition and Consumer Commission (ACCC). Now that it has been in force for three years, it is timely to assess whether or not the ACL has been a success. This is an area of the law that is particularly important since various provisions of the ACL apply not just to consumer law matters.

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I BACKGROUND TO THE AUSTRALIAN CONSUMER LAW

Much of the content of the *Australian Consumer Law* (*ACL*) is not totally new. The *Trade Practices Act 1974* (Cth) which was enacted in 1974 had provisions relating to consumer protection (as well as such other matters as anti-competitive agreements and price fixing). However, because of limitations in the Commonwealth's constitutional reach, the *TPA*'s consumer protection provisions only applied to corporations and non-corporations caught by *TPA* s 6.

As a consequence, the States and Territories enacted complementary *Fair Trading Acts* (*FTA*s) which, together with other legislation such as the States' *Sale of Goods Acts*, applied some, but not all, of the *TPA*'s consumer protection provisions to non-corporations coming within the jurisdiction of the States and Territories. The State and Territory *FTA* legislation was neither uniform nor identical with the *TPA* provisions and this caused many difficulties especially for businesses operating in more than one State or Territory.

In July 2009, the Council of Australian Governments (COAG) agreed on a comprehensive Australia-wide new approach to consumer protection in the form of the *ACL*[1] and this was subsequently implemented by changes to the *TPA* and the State and Territory *FTA* legislation. In essence, what occurred was that, in addition to the granting of increased powers to the ACCC and the inclusion in the *TPA* of various new provisions such as those relating to unfair contract terms and consumer guarantees, many of the sections of the *TPA* relating to consumers and consumer-related matters were drawn across into a new sch 2 which has the title 'The Australian Consumer Law'. At the same time, the *TPA* was renamed the *Competition and Consumer Act 2010* (Cth) (*CCA*), with pt XI providing that the *ACL*

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[1] This followed the Productivity Commission's 2008 Report entitled *'Review of Australia's Consumer Policy Framework '* (Report No 45, Canberra, 2008) which came to the conclusion that Australia's consumer policy framework was overly complex and needed an overhaul.

applies as a law of the Commonwealth to the conduct of corporations (other than conduct in relation to financial services).[2] Amendments by the States and Territories to their *Fair Trading Acts* made the provisions of the *ACL* applicable to non-corporations.

II THE CONCEPT OF 'SUCCESS' AND ITS EVALUATION

The aim of this article is to evaluate the success or otherwise of the *ACL* now that it has been in force for three years. Any attempt to evaluate the success of a national legislative scheme such as the *ACL* is difficult from the start because of the complexity of the legislation. This endeavour is also made even more difficult by the fact that the concept of 'success' itself is not straightforward: there can be differing views as to what 'success' means and entails. Thus, what is meant by the concept of 'success' for present purposes needs to be stated at the outset, along with what process is going to be employed to evaluate that notion.

The Macquarie Dictionary defines 'success' as 'a thing or a person that is successful' and 'successful' as 'achieving or having achieved success'.[3] As this is rather circuitous, it is necessary to look elsewhere for some basis that can be used for determining the success or otherwise of the *ACL*. The authors are of the view that the most appropriate basis to use is the Explanatory Memorandum accompanying the *ACL* Bill when it was introduced into the Federal Parliament. The Australian Government's ComLaw site, in its 'An A-Z of Key Jargon', gives the following succinct and straightforward explanation of Explanatory Memorandums (EMs):

> Trying to work out what a Bill does and why it was introduced? An explanatory memorandum or EM is a document that sets out

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2 *Australian Securities and Investment Act 2001* (Cth); *Corporations Act 2001* (Cth) are the main legislative provisions governing financial services.

3 See *Macquarie Dictionary* (online), definitions of 'success' and 'successful' <http://www.macquariedictionary.com.au/features/word/search/?word=success&search_word_type=Dictionary>.

> how a Bill is expected to operate, and often goes into the detail of individual provisions.[4]

This explanation gives us the key; how was the *ACL* expected to operate when the legislation was introduced into Federal Parliament and has it in fact operated in that way during the first three years of its existence.

The most important core aspects of the *ACL* are arguably those relating to:

(a) the purported implementation 'a single national consumer law for Australia';
(b) the prohibition of specific types of conduct and marketing practices, especially misleading or deceptive conduct, false or misleading representations about goods or services and unconscionable conduct;
(c) the prohibition of unfair terms in standard form consumer contracts;
(d) the implementation of non-excludable consumer guarantees;
(e) the regulation of product safety and such matters as unsolicited consumer agreements (eg, door-to-door selling);
(f) the providing of more effective powers to the Australian Competition and Consumer Commission to enforce the provisions of the *ACL*.

Therefore what was stated in the Explanatory Memorandum[5] as regards these various aspects will be identified and thereafter there will be analysis as to whether or not in fact such aims have been achieved. This should enable a determination to be made as to whether or not the *ACL* after the first three years can be considered to be a success.

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4 See Australian Government ComLaw, <http://www.comlaw.gov.au/Content/WhatIs It#E> (emphasis added).

5 Herein, unless indicated otherwise, when there is a reference to 'Explanatory Memorandum', it is a reference to the Explanatory Memorandum to the Trade Practices Amendment (Australian Consumer Law) Bill (No 2) 2010 (Cth).

III SINGLE, NATIONAL CONSUMER LAW?

In the early part of the Explanatory Memorandum to the Trade Practices Amendment (Australian Consumer Law) Bill (No 2) 2010 (Cth), under the heading 'General outline and financial impact', it is stated:

> The *ACL* … will deliver the agreements of the Council of Australian Government (COAG) made on July 2008 and October 2008, to create *a single national consumer law for Australia* ….[6]

Therefore the first task is to determine whether or not the *ACL* has in fact now provided Australia with 'a single, national consumer law'. A main reason for this aim of establishing a single national consumer law was (as mentioned earlier) that, up to that point of time, there were the *TPA* and numerous State and Territory consumer laws and it was felt that this created inconsistency and legal uncertainty. Using what is mentioned in the Explanatory Memorandum ('a single national consumer law') as the criteria, the following two aspects will now be considered: (a) is the *ACL* indeed a 'single, national (ie, Australia-wide) law' and (b) is it in fact a 'consumer law' (as the title proclaims).

A *Single, National Law*

As regards the first question (as to whether there is now a single, national law), the answer is, arguably, no. Instead of just one *ACL*, what we have applying now are nine non-identical versions of the *ACL* — and this means there are inconsistencies. One of these inconsistencies is as regards the defence of contributory fault in a misleading conduct claim.[7] Some of the other factors also working against there being a single, national law are:

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6 Ibid (emphasis added).

7 For further information on this aspect, see, eg, Nick Seddon and Saul Fridman, 'Misleading conduct and contributory fault: Inconsistency under the uniform Australian Consumer Law' (2012) *Australian Journal of Competition and Consumer Law* 87.

(1) Not all of the consumer provisions of the *TPA* were moved over to the *ACL*, some remained in what is now the *CCA*; and the States and Territories have made their *FTA*s align with the *ACL* (ie, just sch 2 of the *CCA*, not the entire *CCA*).
(2) Because of s 19(1) of the *Fair Trading Act* 2010 (WA), only the text of the *ACL* in force as at 1 January 2011 applies as a law of Western Australia and consequently any further amendment to the text of the *ACL* does not automatically apply in Western Australia.
(3) The *ACL* does not cover all aspects coming within the ambit of 'Australian consumer law' and other legislation must be consulted if there is a problem in certain areas. This is particularly so because of *ACL* s 65 which states that the *ACL*'s consumer guarantee provisions do not apply to the supply of gas, electricity and telecommunications services.

As can be seen from the final joint communiqué issued by the Federal, States and Territories Ministers for Consumer Affairs following their meeting in Brisbane on 7 November 2013, even they acknowledge that there is, as regards the *ACL*, a problem of inconsistent legislation.[8] So it is arguable that the first goal of having 'a single, national law' has not been achieved, despite what many people might think.

B *Consumer Law*

We now move on to the second question in our quest to determine if the *ACL* has given Australia a single, national consumer law, namely, is the *ACL* in fact a 'consumer law' (as the title proclaims). The title of sch 2, 'The Australian Consumer Law', is a misnomer. This is because the *ACL* does not apply only when there are 'consumers'; the

[8] Joint Communiqué of the Meeting of Ministers for Consumer Affairs, Thursday 7 November 2013, <http://www.consumerlaw.gov.au/content/Content.aspx?doc=caf/meetings/005.htm>.

ACL has a much wider ambit. The authors do not criticise this; they are just making the observation that the *ACL* is not exclusively a 'consumer law'. For example, *ACL* s 18 (relating to misleading or deceptive conduct), *ACL* s 29 (relating to false or misleading representations in relation to goods and services) and *ACL* ss 20–22 (relating to unconscionable conduct) do not require that there be a 'consumer' in order for them to apply. This can be seen in, for example, the wording of *ACL* s 18(1) which states:

> A *person* must not, in trade or commerce, engage in conduct that is misleading or deceptive or is likely to mislead or deceive.[9]

And in the wording of *ACL* s 20(1) which states:

> A *person* must not, in trade or commerce, engage in conduct that is unconscionable, within the meaning of the unwritten law from time to time.[10]

Likewise, *ACL* s 29(1) has the introductory words:

> A *person* must not, in trade or commerce, in connection with the supply or possible supply of goods or services or in connection with the promotion by any means of the supply or use of goods or services …[11]

All refer to a 'person'; there is no requirement that the person must also be a 'consumer'. Further, even where the *ACL* does have what are clearly 'consumer provisions' (such as the Consumer Guarantees regime),[12] these provisions overlap and impact on non-consumer areas of the law. For example, all contracts for the supply of goods to end users and all contracts for the supply of services, not exceeding $40 000, are subject to the *ACL*'s Consumer Guarantees regime which means that even business-to-business contracts, not exceeding $40 000 are included. As John Carter has stated:

> The decision to enact a separate 'Australian Consumer Law' would, of course, be easier to understand if the provisions of the Australian Consumer Law were limited to consumer protection. However, that is manifestly not the position. A great deal of the

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9 Emphasis added.

10 Emphasis added.

11 Emphasis added.

12 *ACL* ss 51–68.

> Australian Consumer Law applies in favour of — and therefore provides 'consumer protection' to — corporations, partnerships and sole traders acting in the course of their respective businesses.[13]

To confound matters even more, the *ACL* has not just one but at least three different categories of 'consumer', ie, there is no one universal definition of consumer. There is one type of 'consumer' for the purposes of the Consumer Guarantees provisions,[14] another for the Unfair Contract Terms provisions,[15] and a third when it comes to consumer goods and the *ACL*'s provisions regarding product recall, safety standards, safety bans and safety warning notices.[16] This makes it difficult and complex when one is endeavouring to determine just who is a consumer for the purposes of the *ACL*. It can even mean that, at times, a contract with a consumer is not a consumer contract for the purposes of the *ACL*. Further, because it is not restricted exclusively just to consumer transactions, the *ACL*, due to its provisions concerning such matters as misleading or deceptive conduct, false or misleading representations about goods or services and unconscionable conduct, has a wider impact than just true consumer law matters. In other words, the *ACL* often substantially impacts on other areas of the law.

Thus, arguably, the *ACL* is not 'a single, national law' and it is not a law dealing exclusively with 'consumer' matters; therefore, putting these two together, it is not a 'single, national consumer law'. As mentioned earlier, the authors are not criticising this fact. They are merely pointing out that the aim expressed in the Explanatory Memorandum of having 'a single, national consumer law' is not what has resulted.

We will now delve further in our endeavours to ascertain whether or not the *ACL* is, to date, a success. This brings us to the next important

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13 John Carter, *Contract and the Australian Consumer Law — A Guide* (LexisNexis Butterworths, 2011) 4.

14 *ACL* s 3(1).

15 *ACL* s 23(3).

16 *ACL* s 2.

aspect of the *ACL*, namely, the prohibitions against specific types of conduct and marketing practices.

V Specific Types of Conduct and Marketing Practices

The *ACL* provisions relating to specific types of conduct and marketing practices that will now be examined are those prohibiting:

(a) misleading or deceptive conduct;
(b) the making of false or misleading representations about goods or services; and
(c) unconscionable conduct.

The law here is not new; there were similar provisions in the *TPA*. The *ACL* was created by moving various parts of the *TPA* into a new sch 2 (with the title 'The Australian Consumer Law') prior to the renaming of the *TPA* as the *CCA*. The 'core' of the *TPA* provisions carried over to sch 2 were arguably, *TPA* s 52 (which related to misleading or deceptive conduct), s 53 (which related to false or misleading representations about goods or services) and ss 51AA, 51AB, 51AC (which related to unconscionability). Their approximate counter-parts in the *ACL* are ss 18, 29 and 20 to 22.

A *Misleading or Deceptive Conduct*

ACL s 18(1) states:

> A person must not, in trade or commerce, engage in conduct that is misleading or deceptive or is likely to mislead or deceive.

The earlier *TPA* s 52 stated:

> A corporation shall not, in trade or commerce, engage in conduct that is misleading or deceptive or is likely to mislead or deceive.

As regards *ACL* s 18(1), paras 3.2 to 3.5 inclusive of ch 3 of the Explanatory Memorandum state:

> 3.2 The ACL includes a provision to replace the prohibition on misleading or deceptive conduct currently set out in section 52 of the TP Act, *without substantive change* ...

> 3.3 The only change made in including the prohibition in the ACL is to apply the prohibition to *'a person'* rather than *'a corporation'*. This *reflects the broader application of the ACL.*
>
> 3.4 The jurisprudence associated with the understanding and interpretation of section 52 of the TP Act … is still relevant.
>
> 3.5 Subsection 18(1) … is a general prohibition, which creates a norm of business conduct in the market.[17]

The first point to note is (as stated in para 3.2 of the Explanatory Memorandum) that there is no substantive difference between *TPA* s 52 and *ACL* s 18. The second point to note is (as stated in para 3.3 of the Explanatory Memorandum) that the change in wording from 'corporation' to 'person' has just been made to reflect the broader application of the *ACL*. The change of wording from 'shall' to 'must' does not appear to have attracted any judicial comments and, in any event, it is in line with the current approach to legal drafting which takes the view that the use of 'shall' is dangerous and a word which should be avoided, with 'must' being the much better word to use. As mentioned in para 3.4 of the Explanatory Memorandum, the vast body of case law built up in relation to *TPA* s 52 remains applicable to *ACL* s 18. Therefore, because there has not been any great change, the question that needs to be answered as regards this aspect is: during the three years of its existence has the *ACL* maintained, improved or diminished the law concerning misleading or deceptive conduct?

There is nothing in the *ACL* which restricts the application of the former *TPA* s 52 and subsequent significant cases like those in 2013 — *Google Inc v ACCC*[18] and *ACCC v TPG Internet Pty Ltd*[19] — have continued to flesh out the law in this area. Even at the time of writing (2014) it can be easily seen that the ACCC is continuing to be very proactive in taking action where it considers there has been misleading or deceptive conduct, some recent examples being:

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17 Emphasis added.

18 *Google Inc v ACCC* (2013) 249 CLR 435. The High Court held that Google had not engaged in misleading or deceptive conduct in publishing 'sponsored links' in response to web page searches.

19 *ACCC v TPG Internet* (2013) 304 ALR 186.

(a) its institution of proceedings in the Federal Court against Jetstar Airways and Virgin Australia Airlines, alleging that each airline had engaged in misleading or deceptive conduct and made false or misleading representations in relation to particular airfares;[20]
(b) its obtaining of a court enforceable undertaking from Barossa Farm Produce Pty Ltd for false or misleading representations and misleading or deceptive conduct in connection with its product labelling, social media and cooking classes;[21]
(c) its putting the Australian fitness industry on notice that using the phrase 'No Contracts' in advertising, when consumers are still required to sign membership contracts with conditions for termination and payment of the membership, is conduct that the ACCC considers to be misleading.[22]

Therefore, as regards the prohibition of misleading or deceptive conduct, it is arguable that the *ACL* has been successful not only in maintaining the existing extensively developed law, but also in allowing it to continue to develop and be even more effective as a result of further significant court judgments and action on the part of the ACCC.

B *False or Misleading Representations About Goods or Services*

ACL s 29 prohibits a person from making certain types of false or misleading representations about goods or services. It corresponds, to

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20 ACCC Media Release, 19 June 2014 <http://www.accc.gov.au/media-release/accc-takes-action-against-jetstar-and-virgin-for-drip-pricing-practices>.

21 ACCC Media Release, 16 June 2014 <http://www.accc.gov.au/media-release/saskia-beers-barossa-farm-produce-gives-undertaking-to-accc-for-misrepresenting-black-pig-products>.

22 ACCC Media Release, 3 July 2014 <http://www.accc.gov.au/media-release/accc-warns-gyms-about-no-contracts-membership-advertising>.

a substantial degree, with the earlier *TPA* s 53, but there have been changes. In relation to *ACL* s 29, para 6.66 of ch 6 of the Explanatory Memorandum states:

> This provision substantially reflects the section 53 of the TP Act, with the following changes:
>
> - it has been redrafted for ease of use and accessibility;
> - all the prescribed types of representations listed in section 29 are prohibited from being either false *or* misleading;
> - it includes a specific prohibition on false or misleading representations concerning testimonials (or representations that purport to be testimonials);
> - it includes an evidentiary burden on a respondent to adduce evidence in court that representations concerning testimonials are not false or misleading, as the case may be;
> - it includes a reference to consumer guarantees (as set out in Part 3-2, Division 1) in the prohibition of false or misleading representations concerning the existence, exclusion or effect of any condition, warranty, guarantee, right or remedy; and
> - it includes a new prohibition of a false or misleading representation as to a requirement to pay for a contractual right that is wholly or partly equivalent to any condition, warranty, guarantee, right or remedy (including a guarantee under Part 3 2, Division 1) or that a person has under a law of the Commonwealth, a State or a Territory.

The first significant change is that mentioned in the second bullet point. A problem with the earlier *TPA* s 53 was that not all the specific representations were prohibited on the basis that they were false *or* misleading. For example, *TPA* s 53(ea) prohibited false or misleading representations concerning the availability of spare parts but *TPA* s 53(b) only prohibited false, but not misleading, representations that the goods were new. There was no valid reason for this and the anomaly has been corrected in *ACL* s 29.

Other important changes with the coming into effect of *ACL* s 29, are the addition of:

(a) *ACL* s 29(1)(e) and *ACL* s 29(1)(f) which provide specific prohibitions of false or misleading representations concerning testimonials and representations that purport to be testimonials;
(b) *ACL* s 29(1)(n) which is aimed at curtailing the practice of companies endeavouring to induce persons to pay for already existing contractual rights especially those conferred by the *ACL*'s Consumer Guarantees regime.

Here, as with *ACL* s 18, the ACCC is very proactive. This can be seen from, for example, the ACCC's taking action in relation to false or misleading credence claims and testimonials against:

(a) Coles Supermarkets Pty Ltd for alleged false, misleading and deceptive conduct in the supply of bread that was partially baked and frozen off site, transported to Coles stores, 'finished' in-store and then promoted as 'Baked Today, Sold Today' and/or 'Freshly Baked In-Store' at Coles stores with in-house bakeries;[23]
(b) Luv-a-Duck Pty Ltd for alleged false, misleading and deceptive conduct in relation to the promotion and supply of its duck meat products by using statements such as 'grown and grain fed in the spacious Victorian Wimmera Wheatlands' and 'range reared and grain fed' when the duck meat products were in fact processed from ducks that did not have substantial access to the outdoors or access to spacious outdoor conditions.[24]

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23 ACCC, 'ACCC institutes proceedings against Coles for alleged false, misleading and deceptive bakery claims' (Media Release, 12 June 2013) <http://www.accc.gov.au/media-release/accc-institutes-proceedings-against-coles-for-alleged-false-misleading-and-deceptive>; Michael Bradley and Hannah Marshall, 'Misleading advertising update: hot cross regulator sues Coles for half-baked claims' (2013) 29(1) *Competition and Consumer Law News* 13.

24 ACCC, 'Court orders Luv-a-Duck to pay $360 000 for misleading claims' (Media Release, 1 November 2013) <http://www.accc.gov.au/media-release/court -orders-luv-a-duck-to-pay-360000-for-misleading-claims>.

(c) P & N Pty Ltd and P & N NSW Pty Ltd (trading as Euro Solar) and Worldwide Energy and Manufacturing Pty Ltd (formerly trading as Australian Solar Panel) for various online testimonials which (the ACCC alleged) were not made by genuine customers. This particular action resulted in the Federal Court ordering the companies to pay combined penalties of $125 000 for publishing fake testimonials and making false or misleading representations. This was the ACCC's first litigated outcome in relation to the *ACL*'s specific prohibition of fake testimonials.[25]

As with *ACL* s 18, it is again arguable that the *ACL* in this area (the prohibition of various types of false or misleading representations about goods or services) is successful. There were no deletions from *TPA* s 53 when it was transformed into *ACL* s 29 and in fact the addition of *ACL* ss 29(1)(e), 29(1)(f) and 29(1)(n) has plugged loopholes in the previous law. All the previous case law relating to *TPA* s 53 remains relevant and applicable to *ACL* s 29 and the law is continuing to develop as a result of further court judgments. The success of the *ACL* is also being assisted by the ACCC's being very proactive in taking action for any infringements of the provisions of *ACL* s 29.

C *Unconscionable Conduct*

The ACCC's provisions in relation to unconscionable conduct are contained in *ACL* ss 20–22.

Because the original *ACL* unconscionable conduct provisions have been changed as from February 2012, it is necessary to examine what was stated in both the Explanatory Memorandum to the Trade Practices Amendment (Australian Consumer Law) Bill (No 2) 2010 (Cth) and the Explanatory Memorandum to the Competition and

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[25] See Felicity Lee, 'False or misleading credence claims: what's the harm?' (2013) 29(4) *Competition and Consumer Law News* 42.

Consumer Legislation Amendment Bill 2011 (Cth). The original Explanatory Memorandum states in ch 4:

> 4.1 The Australian Consumer Law (ACL) includes provisions prohibiting persons from engaging in unconscionable conduct towards consumers or businesses.

As well as:

> 4.17 The inclusion of a prohibition on unconscionable conduct within the ACL ensures that consumers and businesses are able to access a range of remedies under the ACL, and that regulatory agencies are able to access penalties under the ACL, in addition to any remedies courts may provide under the common law or the principles of equity.

The Explanatory Memorandum to the Competition and Consumer Legislation Amendment Bill 2011 (Cth) states, in ch 2, in relation to the changes to the unconscionable conduct provisions:

> 2.8 The Bill amends the unconscionable conduct provisions of the ACL and the ASIC Act to include a list of interpretative principles and to unify the consumer and business-related provisions prohibiting unconscionable conduct.
>
> 2.9 The inclusion of a statement of interpretative principles in the unconscionable conduct provisions of the ACL and the ASIC Act will assist the courts in applying the prohibition of statutory unconscionable conduct, as well as improve stakeholder understanding of the meaning and scope of the provisions.
>
> 2.10 The Bill also unifies what were sections 51AB and 51AC of the CC Act … Sections 51AB and 51AC of the CC Act were drafted in almost identical terms … and the meaning of unconscionable conduct under each provision was intended to be the same. The unification will avoid the risk that courts might have accorded different meanings to the two sets of provisions.

In a nutshell, the aim has been to provide, in the *ACL*, unconscionable conduct provisions whereby:

(a) *ACL* s 20 prohibits unconscionable conduct within the unwritten law;
(b) *ACL* s 21 creates a single statutory prohibition against unconscionable conduct in connection with goods or services;

(c) *ACL* s 22 provides a list of indicia to which the court may have regard in evaluating whether conduct may be unconscionable.

Under the previous *TPA* provisions relating to unconscionable conduct, it was difficult to determine whether or not a person had acted unconscionably as there was no definition of unconscionability in the *TPA* and, arguably, this remains the situation as there is no definition in the *ACL* of unconscionable conduct. However, helpful assistance is now available in the significant judgments handed down in 2013 in the cases of *ACCC v Lux Distributors Pty Ltd*[26] and *Kakavas v Crown Melbourne Ltd*.[27]

VI UNFAIR TERMS REGIME

One of the new features that came with the implementation of the *ACL* is the Unfair Contract Terms (UCT) regime. It is located in pt 2-3 of the *ACL* (ss 23–28). It makes any term in a consumer contract void if the term is unfair and the contract is a standard form contract. The Explanatory Memorandum states in ch 5:

> 5.7 *The unfair contract terms provisions apply to consumer contracts only*. A consumer contract is defined in the ACL as a contract for a supply of goods or services or a sale or grant of an interest in land to an individual whose acquisition of the goods, services or interest is wholly or predominantly for personal, domestic or household use or consumption.
>
> 5.8 A term in a consumer contract is void if:
>
> - the term is unfair; and
> - the contract is in a standard form contract.[28]

The first part of para 5.7 of the Explanatory Memorandum highlights a major shortcoming with the *ACL*'s Unfair Contract Terms regime, namely, that, even though small businesses can face many of the same issues as individual consumers when negotiating contracts, at the present time the *ACL*'s Unfair Contract Terms regime does not

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26 *ACCC v Lux Distributors* [2013] FCAFC 90.

27 *Kakavas v Crown Melbourne* (2013) 250 CLR 392.

28 Emphasis added.

also extend to them. However, in May 2014, the Commonwealth Treasury published a public consultation paper seeking views regarding a number of proposals designed to protect small businesses from unfair contract terms in standard form contracts.[29] The Consultation Paper suggests various possible models that could be adopted for protecting small businesses from unfair contract terms, with its preferred model being the extension of the *ACL*'s existing Unfair Contract Terms provisions to small businesses.

It has also been suggested that another shortcoming with the *ACL*'s Unfair Contract Terms regime arises because of perceived problems in the United Kingdom where there were suggestions, in a 2009 House of Lords European Union Committee Report, that the EU Consumer Rights Directive (which is somewhat similar to the *ACL*'s Unfair Contract Terms regime) was at risk of being circumvented through charades and artificial negotiations.[30] However, it is contended that this is not a problem since, if such things as charades and artificial negotiations are utilised in an attempt to get around the Unfair Contract Terms regime of the *ACL*, they can be countered by appropriate action on the part of the ACCC and the courts. As Nahan and Webb have commented (in relation to the EU Consumer Rights Directive), 'the eminently sensible approach of the English Court of Appeal in *St Albans City and District Council v International Computers* offers an effective response'.[31]

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29 Consumer Affairs Australia and New Zealand (CAANZ), *Extending Unfair Contract Term Protections to Small Businesses*, Consultation Paper (May 2014).

30 House of Lords' European Union Committee, *EU Consumer Rights Directive: getting it right — Chapter 8: Unfair Contract Terms*, <http://www.publications.parliament.uk/pa/ld200809/ldselect/ldeucom/126/12611.html>.

31 Nyuk Yin Nahan and Eileen Webb, 'Unfair Contract Terms in Consumer Contracts' in Justin Malbon and Luke Nottage (eds), *Consumer Law & Policy in Australia & New Zealand* (Federation Press, 2013) 129, 150; *St Albans City and District Council v International Computers* [1996] 4 All ER 481.

The elimination of unfair contract terms was one of the ACCC's priorities for 2013[32] and in that year it was successful in its first prosecution, this being against ByteCard[33] which consented to a declaration by the court that some terms and conditions in its contracts had been unfair. There are also other prosecutions in train. At the end of 2013, the litigation against Advanced Medical Institute Pty Ltd for using unfair contract terms was still continuing[34] and proceedings had been commenced against Titan Marketing Pty Ltd arising out of its door-to-door sales of first aid kits and water filters to vulnerable and disadvantaged consumers.[35] In these proceedings, there are various allegations, one of which is that Titan had entered into contracts with consumers which contained unfair contract terms.

The *ACL* takes a very good and practical approach to the problem of unfair contract terms. The legislation gives guidance by containing a list of examples of terms that 'may' be (not automatically 'are') unfair and the fact that the court can declare others to be unfair gives the legislation flexibility. An unfair term does not make the whole contract void. What happens is that, if the court declares a term to be unfair, it is excised from the contract which continues to bind the parties if the contract can operate without the unfair term. The only real shortcoming is the aforementioned non-applicability, at the present time, of the *ACL*'s Unfair Contract Terms provisions to small businesses but there are moves to correct this anomaly.

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32 ACCC Chairman Rod Sims' address to CEDA on 20 February 2013 reported in CCH's Consumer & Contract Law Tracker, Issue 2, February 2013 ('ACCC reveals new enforcement priorities, 21 February 2013').

33 *ACCC v ByteCard Pty Ltd*, Federal Court Proceedings VID301/2013, consent judgment 24 July 2013. See also ACCC, 'Court declares consumer contract terms unfair' (Media Release, 30 July 2013) <http://www.accc.gov.au/media-release/court-declares-consumer-contract-terms-unfair>.

34 ACCC Annual Report 2012–13, <http://www.accc.gov.au/system/files/ACCC%20Annual%20Report%202012-13.pdf>.

35 Ibid.

VII Consumer Guarantees Regime

Another new feature that came with the implementation of the *ACL* is the Consumer Guarantees regime. It is arguably the most important reform achieved by the *ACL*. The ACCC's provisions relating to consumer guarantees are contained in *ACL* ch 3, pt 3-2, div 1 (ss 51–68). Paragraphs 7.9 to 7.14 of ch 7 of the Explanatory Memorandum give a summary of the new law and therein it is stated that the consumer guarantees legislation will provide consumers with a *statutory basis* for seeking remedies where, for example:

- goods are not of acceptable quality;
- goods are not fit for a purpose that the consumer made known to the supplier or manufacturer;
- goods are not fit for a purpose that the supplier told the consumer that they will meet;
- goods do not match their description;
- services are not rendered with due care and skill;
- services, and any product resulting from the services, are not fit for a purpose that the consumer made known to the supplier.

Arguably, the most important of the *ACL*'s consumer guarantee provisions are those in *ACL* s 54 (guarantee as to acceptable quality) and *ACL* s 55 (guarantee as to fitness for any disclosed purpose). The predecessors of these two provisions were *TPA* ss 71(1) and 71(2) which related to merchantable quality and fitness for purpose. Small businesses are treated as consumers for these provisions and consequently (unlike the position with the Unfair Contract Terms regime) they have available to them the protection of the *ACL*'s consumer guarantee provisions. Under the *TPA*, the implied terms such as merchantable quality and fitness for purpose were only that; implied conditions of the contract, which still left problems with enforceability. Now under the *ACL* they are specific guarantees[36] which is a definite improvement. However, while it might seem the

[36] As mentioned earlier, the Consumer Guarantees regime links in with the *ACL*'s extended warranties provisions.

ACL's Consumer Guarantees regime is very good and the implementation of a more effective regime than was the case with the implied terms under the *TPA*, there can still be difficulties. For example, the law in this area is extremely complex. Also it seems that at times, consumers can be entitled to remedies even when the quality discrepancies are only minor.

Nevertheless, despite these shortcomings, the ACCC is being very proactive in enforcing the provisions. In 2013 (following its earlier approach focused on educating businesses), the ACCC began taking enforcement proceedings and, on 5 July 2013, the ACCC was successful in obtaining an order from the Federal Court that Hewlett-Packard Australia pay a $3 million civil pecuniary penalty for making false or misleading claims to consumers in relation to warranty and guarantee rights.[37] In subsequent proceedings, the ACCC obtained Federal Court orders that five Harvey Norman franchisees pay a total of $148 000 in civil pecuniary penalties for making false or misleading representations to customers regarding consumer guarantee rights.[38]

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37 ACCC, 'HP to pay $3 million for misleading consumers and retailers' (Media Release, 5 July 2013) <http://www.accc.gov.au/media-release/hp-to-pay-3-million-for-misleading-consumers-and-retailers>. The court also made other orders including declarations, injunctions, consumer redress orders, public disclosure orders, corrective advertising orders, orders to implement a compliance program and an order that there be a contribution towards the ACCC's costs of $200 000.

38 ACCC, 'Harvey Norman franchisees pay for misleading consumers' (Media Release, 9 December 2013) <http://www.accc.gov.au/media-release/harvey-norman-franchisees-pay-for-misleading-consumers>; ACCC, 'Harvey Norman franchisee pays for misleading consumers' (Media Release, 13 December 2013) <http://www.accc.gov.au/media-release/harvey-norman-franchisee-pays-for-misleading-consumers>.

VIII OTHER *ACL* PROVISIONS

The *ACL* also has provisions concerning proof of transaction and itemised bill requirements, unsolicited supplies, lay-by agreements, pyramid selling, harassment and coercion. Many of these, although not in the previous *TPA*, had counterparts in the State and Territory legislation and thus the *ACL* is an improvement on the *TPA* as regards these aspects. The *ACL* continues the *TPA* prohibitions regarding such matters as bait advertising, accepting payment when there is no intention to supply the goods or services and offering prizes with the intention of not providing them; and it has provisions governing door-to-door selling, telephone sales and other forms of direct selling which do not take place in a retail context. In addition, the *ACL* makes it an offence for a supermarket to charge more at the checkout than the lowest price advertised for a product on its shelves. All this shows there has been a genuine attempt to give the *ACL* an extensive and effective coverage. It is not possible to examine all these aspects, so some observations will be made just in relation to two aspects, namely, the *ACL* provisions relating to (a) safety of consumer goods and product related services and (b) unsolicited consumer agreements.

A *Safety of Consumer Goods and Product Related Services*

The *ACL* provisions relating to safety of consumer goods and product related services are contained in ch 3, pts 3-3 to 3-5. As regards these provisions, paras 10.10 to 10.13 of ch 10 of the Explanatory Memorandum state:

> 10.10 The ACL makes administrative powers available to the responsible Commonwealth and State and Territory Ministers, where appropriate, to remove consumer goods or product related services from the market. These administrative powers may only be exercised where a Minister believes that the goods or services in question pose a risk of injury to any person, either through their normal use or a reasonably foreseeable misuse.
>
> 10.11 These administrative powers include the power to:
>
> - make standards for particular consumer goods or product related services;

- ban the supply of particular consumer goods or product related services;
- require a supplier to recall particular consumer goods; and
- issue warning notices to the public about consumer goods or product related services;

10.12 The ACL provides for civil and criminal remedies and penalties for persons who supply consumer goods or product related services in contravention of requirements imposed by the exercise of an administrative power. The ACL also provides for additional procedural requirements (such as suppliers notifying persons outside of Australia or recalls), which must be complied with.

10.13 The ACL further requires suppliers to report to the ACCC or appropriate regulator where the supplier:

- is undertaking a voluntary recall; or
- becomes aware that consumer goods or product related services that they supply have been associated with a death, serious injury or serious illness.

The Federal Government is now the sole entity responsible for establishing safety standards and permanent safety bans (which apply on a national basis). This and the aforementioned in the Explanatory Memorandum have streamlined the previous cumbersome and often ineffective rules governing product liability. However, improving the governing legislative regime does not automatically mean that the *ACL* in this regard is a complete success. There are still shortfalls; in particular, the legislation is complex and the liability provisions concerning manufacturers are often unclear.

B *Unsolicited Consumer Agreements*

The *ACL* provisions relating to unsolicited consumer agreements are contained in ch 3, pt 3-2, div 2. Paragraph 8.6 of ch 8 of the Explanatory Memorandum states:

> Chapter 3, Part 3–2, Division 2 of the ACL will regulate the making of unsolicited offers to supply goods and services to a

consumer and the agreements arising from such offers. The ACL unsolicited selling provisions consist of four types.

- In respect of face to face marketing approaches, express supplier obligations about the way in which consumers are approached and about the making of agreements, including:
  - permitted hours of visiting consumers;
  - the duty to clearly advise the consumer at the outset of an approach of their purpose and to display or produce identification containing certain prescribed information; and
  - the duty to leave a consumer's premises on request.
- In respect of face to face and telephone marketing approaches, express supplier disclosure obligations about the making of agreements, including:
  - the duty to inform the consumer prior to making the agreement of their rights to terminate the agreement; and
  - formal requirements for valid agreements arising from suppliers approaching consumers by telephone or otherwise. A valid agreement must include, for instance, the terms of the agreement, a termination notice (containing prescribed information), supplier information; will need to comply with clarity requirements; and will need to be given to the consumer.
- In respect of face to face and telephone sales, express consumer rights and obligations, including:
  - a 10 day termination right, exercisable by providing the supplier with a termination notice (containing prescribed information) via a wide range of delivery methods;
  - provisions specifying that the consumer can also terminate an agreement after the termination period in various circumstances related to breaches by the supplier of certain supplier obligations specified in the regime;
  - provisions specifying the effect of termination under the termination right and after the termination period; and

  - provisions specifying the entitlement of a consumer to goods and services on termination.
- In respect of face to face and telephone sales, express supplier obligations about post contractual behaviour, including:
  - prohibitions during the termination period against a supplier supplying goods or services, or accepting trade in goods; and requiring or accepting payment for goods or services to be supplied;
  - a requirement that a supplier immediately repay money received under the agreement if the agreement is terminated;
  - prohibitions against a supplier taking action against a consumer under a terminated agreement, including for the purpose of recovering amounts allegedly payable; and
  - prohibitions against a supplier from seeking to avoid provisions concerning a termination right or operation of the regime.

The *ACL*'s provisions concerning unsolicited consumer agreements (such as those arising out of door-to-door sales) are an area where the ACCC has been particularly successful (after some initial difficulties). In March 2012, the ACCC commenced proceedings in the Federal Court against Neighbourhood Energy Pty Ltd, a Victoria-based energy retailer, and its former marketing company, Australian Green Credits Pty Ltd, in relation to their door-to-door selling practices. This was the first case brought under the unsolicited consumer agreement provisions of the *ACL* and the outcome was the Federal Court ordering Neighbourhood Energy and Australian Green Credits to pay penalties totalling $1 million.[39]

In March 2012, the ACCC commenced proceedings against AGL Sales Pty Ltd and AGL South Australia Pty Ltd, and marketing company CPM Australia Pty Ltd, alleging that these companies had

[39] ACCC, '$1 million in penalties for door-to-door sales' (Media Release, 28 September 2012) <http://www.accc.gov.au/media-release/1-million-in-penalties-for-door-to-door-sales>.

engaged in misleading and deceptive conduct and that AGL Sales and CPM Australia had made a range of false representations to consumers in the course of door-to-door selling. The outcome of those proceedings was that the Federal Court ordered AGL Sales Pty Ltd and AGL South Australia Pty Ltd to pay a total of $1.55 million for illegal door-to-door selling practices. CPM Australia Pty Ltd was ordered to pay $200 000 for its role in the conduct.

Action has also been successfully taken against door-to-door sellers in relation to alleged unconscionable conduct as evidenced by the ACCC's eventual successful outcome in *Lux*.[40] All this activity on the part of the ACCC would appear to have contributed to the announcement in June 2013 by Australia's three largest energy retailers, Energy Australia, AGL and Origin; that they had decided to cease door-to-door marketing.

IX ACCC'S POWERS

In addition to the powers it already had under the *TPA* (the 'existing powers'), the ACCC has, as a consequence of the *CCA* and *ACL*, been given 'new powers' which enable it now also to:

(a) issue infringement notices;
(b) conduct random audits and search and seize;
(c) obtain from the courts the imposition of civil pecuniary penalties for unconscionable conduct and more of the unfair practices;
(d) issue substantiation notices;
(e) issue public warning notices;
(f) obtain orders to redress loss or damage suffered by non-party consumers;
(g) obtain disqualification orders.

As regards the ACCC's powers, the Explanatory Memorandum in chs 14 and 15 states:

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40 CAANZ, above n 30.

> 14.7 The ACL provides regulators with uniform and comprehensive powers to enforce the provisions of the Act. By providing a uniform set of enforcement tools, the ACL ensures that regulators can take a multi layered approach to enforcement by tailoring regulatory responses to the severity of breaches of the law. It also ensures that suppliers face the same incentives to comply with the law irrespective of where they reside.

It also states:

> 15.5 The penalty and remedy provisions in the ACL will provide regulators with various court based options for pursuing breaches of the law. The range of remedies from injunctions, through to remedial orders and penalties provides a variety of options to allow proportionate enforcement of the ACL.

The ACCC having these new powers, in addition to its existing powers, is something that arguably, should contribute to the success of the *ACL*; enhanced powers should mean there is an even greater likelihood of the *ACL* being successfully enforced. It is conceded, at the outset, that endeavouring to evaluate the success or otherwise of the *ACL* by reference to the effectiveness of its enforcement by the ACCC has its shortcomings because of the fact that the ACCC is tasked with enforcing the *ACL* and has regulatory discretion and sets his own enforcement agenda.[41] A particular area of the *ACL* may seem benign when in fact there are problems but, for that year, it is not a priority for the ACCC. Likewise, if the ACCC is very proactive and successful in a particular area, that does not automatically indicate the enforcement of the *ACL* by the ACCC is a complete success; it could be that this area has the particular attention of the general public and the ACCC is responding accordingly or it could even be that the ACCC feels it can be successful in taking action in relation to matters in that area and hence show its prowess. Nevertheless, what can be seen from an analysis of the ACCC's enforcement of the *ACL* during the last three years cannot be disregarded out of hand. It definitely does assist in our quest to determine whether or not the *ACL* is success, even if, for the reasons mentioned, it alone cannot be treated automatically as a definitive indication of success or failure.

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41 Each year the ACCC announces what its priorities will be for that year.

A *Infringement Notices*

The ACCC's power to issue infringement notices is contained in *CCA* ss 134–134G.[42] The granting of this power to the ACCC is controversial since it raises a constitutional issue as to whether or not the granting of such a power represents 'an unconstitutional vesting of Commonwealth judicial power on an administrative body'.[43] However, while views have been expressed that there is possibly a constitutional difficulty,[44] the fact is that in 2011, the Federal Court in its judgment in *ACCC v Le Sands Restaurant and Le Sands Café Pty Ltd*[45] upheld the power of the ACCC to issue infringement notices.

It is clear the ACCC has been making extensive use of its infringement notices power and has been quite successful in obtaining payments thereunder. During 2012–13, the ACCC obtained payment for 27 infringement notices across 10 matters with penalties of over $300 000. Details of some of these are as follows:

(g) Super-A-Mart Pty Ltd paid two infringement notices totalling $13 200 for misleading representations regarding the application of consumer guarantee provisions on floor stock furniture offered for sale;
(h) MOI International Pty Ltd paid two infringement notices totalling $20 400 for misleading claims on the label of its olive oil products;
(i) Coles Supermarkets Australia Pty Ltd paid six infringement notices totalling $61 200 for alleged misleading representations about the country of origin of fresh produce made in five of its stores.[46]

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42 ASIC has been given a similar power.

43 Margaret Hyland, 'Infringement Notices under the *Corporations Act 2001* (Cth): Has the Commonwealth Parliament Gone too Far' (2008) 10 *The University of Notre Dame Australia Law Review* 115, 117.

44 Ibid.

45 *ACCC v Le Sands Restaurant and Le Sands Café* [2011] FCA 105.

46 See ACCC Annual Report 2012–13, especially app 9.

This proactive approach has continued in 2014 with the ACCC announcing, for example:

(a) Cardcall Pty Ltd had paid penalties totalling $20 400 following the issue of two infringement notices by the ACCC in relation to advertisements for Cardcall's prepaid phonecard services;[47]
(b) Basfoods (Aust) Pty Ltd had paid penalties totalling $30 600 following the issue of three infringement notices by the ACCC in relation to Basfoods' 'Victoria Honey';[48]
(c) New Aim Pty Ltd and Le Tian had paid infringement notices of $10 200 and $2040 and provided court enforceable undertakings to the ACCC after admitting that they had supplied household cots which did not comply with the mandatory safety standard.[49]

Additionally, to enhance its powers even further, the ACCC has been arguing for the power also to issue infringement notices for breaches of the Franchising Code.

B *Random Audit Power*

The ACCC's Random Audit power is contained in *CCA* s 51ADD. As Alex Bruce has commented, 'One of the limitations on the ACCC's powers to enforce the then *TPA* Pt IVB involved its lack of ability to

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47 ACCC, 'Cardcall pays infringement notices for alleged misleading phonecard advertising' (Media Release, 29 April 2014) <http://www.accc.gov.au/media-release/cardcall-pays-infringement-notices-for-alleged-misleading-phonecard-advertising>.

48 ACCC, 'ACCC acts on "Victoria Honey" misrepresentations' (Media Release, 23 June 2014) <http://www.accc.gov.au/media-release/accc-acts-on-victoria-honey-misrepresentations>.

49 ACCC, 'ACCC takes action against online suppliers of unsafe household cots' (Media Release, 6 August 2014) <http://www.accc.gov.au/media-release/accc-takes-action-against-online-suppliers-of-unsafe-household-cots>.

"audit' corporations" compliance with relevant industry codes'.[50] This shortcoming has now been overcome. *CCA* s 51ADD gives the ACCC the power to conduct random audits so that it can establish whether or not franchisors are complying with their Franchising Code of Conduct.

The ACCC has been proactive in using its random audit power. During the 2012–13 period it issued 31 notices (pursuant to *CCA* s 51ADD) requiring traders in the franchising and horticulture sectors to give information or produce documents and it took four cases to court and finalised a further two cases with over $500 000 in penalties awarded.[51] In continuing its proactive stance, the ACCC announced, on 20 October 2013, that it would undertake an audit of franchisors to check whether they are complying with the mandatory Franchising Code of Conduct, with particular attention being given to franchisors in the takeaway food and health and fitness industries.[52]

C *Civil Pecuniary Penalties*

The civil pecuniary penalties power is contained in *ACL* s 224 and, as can be seen from the previous comments as well as the ACCC Annual Report 2012–13 and the Media Releases available on the ACCC's website, the ACCC has been active in using this new remedy.[53] Important decisions concerning, inter alia, civil pecuniary penalties in 2012 were *Singtel Optus Pty Ltd v ACCC*,[54] *Global One Mobile*

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50 Alex Bruce, *Consumer Protection Law in Australia* (LexisNexis Butterworths, 2nd ed, 2014) 345.

51 See ACCC Annual Report 2012–13.

52 See ACCC, 'ACCC to audit franchisors in take-away food and fitness industries' (Media Release, 21 October 2013) <http://www.accc.gov.au/media-release/accc-to-audit-franchisors-in-take-away-food-and-fitness-industries>.

53 See also Peter Doherty, 'Pecuniary Penalties For Consumer Law Breaches — The Current State of Play And Pay' (2013) 21 *Australian Journal of Competition and Consumer Law* 42.

54 *Singtel Optus v ACCC* (2012) 287 ALR 249.

Entertainment Pty Ltd v ACCC,[55] and *TPG Internet Pty Ltd v ACCC*.[56] The following are some other examples of the ACCC's obtaining the imposition of pecuniary penalties (many more instances can be seen on the ACCC's website):

(a) In September 2012, the Federal Court ordered Rosemary Bruhn to pay a civil pecuniary penalty of $50 000 for conduct involving the substitution of cage eggs for free range eggs.
(b) In July 2013, The Federal Court ordered former Tasmanian Europcar franchisee, BAJV Pty Ltd (BAJV), to pay a $200 000 civil pecuniary penalty for deliberately overcharging customers for hire vehicle repair costs and failing to refund overcharged customers.

Civil pecuniary penalties give the *ACL* teeth and, as can be seen from all the instances where the civil pecuniary penalties have been imposed, there is no hesitation by the ACCC to seek, and the Federal court to grant, such remedy.

D *Substantiation Notices*

In 2012–13, at least 18 Substantiation Notices were issued by the ACCC requiring the addressees to give information and/or produce documents to substantiate claims or representations. The labelling of olive oil received particular attention.

E *Public Warning Notices*

Although there were no public warning notices issued in 2012–13 and the latest earlier one was in relation to Safety Compliance Pty Ltd on 7 November 2011, the fact that the ACCC does have the power to issue same is an important and useful tool available to the ACCC in its efforts to enforce compliance with the *ACL*.

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55 *Global One Mobile Entertainment v ACCC* [2012] FCAFC 134.
56 *TPG Internet v ACCC* (2012) 210 FCR 277.

F *Disqualification Orders*

In 2013, the Federal Court ordered Tuan Nguyen and Thuan Nguyen to each pay a $50 000 penalty after they admitted to being knowingly concerned in breaches of the *ACL*. The Federal Court also accepted undertakings from them that they would not manage or be a director of a corporation for five years. The prosecution arose out of sales tactics engaged in by the Nguyen brothers during the conduct of their ink cartridge business (Artorios). As Melissa Monks has pointed out, this case appears to be the first time undertakings akin to management disqualifications have been agreed to by the ACCC.[57] On 7 February 2013, the ACCC also obtained a disqualification order against Leslie Forsyth Stott whereby he was disqualified from managing a company for five years. The ACCC Annual Report 2012–13 lists quite a number of continuing proceedings (as at the end of 2012–13) for disqualification orders.[58]

G *Other Orders*

While the court was able to issue 'other orders' under the *TPA* and can still do so under the *ACL*, the position regarding 'other orders' under the *ACL* is more complex than previously because there are now three sections that need to be taken into account (*ACL* ss 237, 242 and 243) whereas, under the *TPA*, there was just the one section (*TPA* s 87).

Overall, the ACCC now has arguably extensive and adequate powers and, as can be seen from its website, media releases and the court proceedings; it is being very proactive in enforcing the *ACL*. As well as the ACCC, the State and Territory agencies are generally (there seem to be some exceptions as pointed out in the Consumer Action

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57 Melissa Monks, 'Brothers blotted out' *Lexology* (30 December 2013) <http://www.lexology.com/library/detail.aspx?g=a4c11013-a08d-4830-a6fc-47f30bca 51f4>.

58 ACCC Annual Report 2012–13, 342.

Law Centre's March 2013 Report)[59] active in enforcing the *ACL*. This can also be seen from the examples mentioned in the CAANZ Implementation Report III.[60] There is, however, one particularly significant development in relation to the ACCC's powers and this is as a result of *ASIC v Ingleby*.[61] Even though the appellant in *Ingleby* was not the ACCC, ASIC is the parallel organisation of the ACCC and developments such as this have an effect on both entities. For some time, the ACCC and the ASIC, in many instances, negotiate and agree upon a penalty with the entity that has infringed the provisions of the legislation and the court normally then just accepts and endorses that agreement as to penalty. However, this did not occur in *Ingleby* and that case shows that courts, at least the Victorian Supreme Court of Appeal, still want to exercise their discretion as to the penalty to be imposed and will no longer just 'rubber stamp' any agreement between the ACCC (or ASIC) and the entity being prosecuted.

X OVERALL ASSESSMENT OF THE *ACL* (TO DATE)

A *ACCC'S View*

The ACCC's view is obviously that the *ACL* is a success and this is due to, not only the provisions of the *ACL*, but also the ACCC's very proactive twin approach of education and enforcement. Since becoming chairman of the ACCC, Rod Sims has adopted the procedure of each year setting out the ACCC's priorities for that year and subsequently reporting on whether or not it has achieved those priorities. So the prime source for obtaining the ACCC's view as to

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59 Consumer Action Law Centre, 'Regulator Watch — The Enforcement Performance of Australian Consumer Protection Regulators' (March 2013), <http://consumeraction.org.au/wp-content/uploads/2013/04/CALC-Regulator-Report-FINAL-eVersion.pdf>.

60 Consumer Affairs Australia and New Zealand, 'Implementation of the Australian Consumer Law, Report on progress III (2012–13)' (November 2013) 18 <http://www.consumerlaw.gov.au/content/Content.aspx?doc=the_acl/Progress_ReportIII/progress_III.html>.

61 *ASIC v Ingleby* (2013) 275 FLR 171.

its performance is its Annual Reports, eg, the ACCC's Annual Report for 2012–13.[62] According to the ACCC's Annual Report for 2012–13, as well as launching a new website with information for businesses and consumers and undertaking various consumer rights information campaigns, its significant achievements during the 2012–13 period included the following:

(a) it issued 27 infringement notices across 10 *ACL* matters securing penalties of over $300 000;
(b) it took compliance and enforcement action in the door-to-door energy sector, resulting in significant penalties ($2.75 million) and substantial improvements in behaviour in the sector;
(c) it took court action in 11 separate matters for allegedly misrepresenting consumer guarantees and warranty and refund rights;
(d) it secured the imposition of a $1 million penalty on Cotton On Kids Pty Ltd in connection with the supply of unsafe children's nightdresses and pyjamas and it removed more than two million hazardous products from the market through 450 product safety recalls;
(e) it commenced proceedings in relation to false online testimonials and also misleading or deceptive credence claims and this resulted in court awarded penalties and payments made pursuant to infringement notices of over $700 000.[63]

These are just some of the very positive claims the ACCC has, justifiably, been able to make. In addition, it must also be acknowledged that from the prosecutions launched against such entities as Visa, Apple, Hewlett Packard, Harvey Norman and Flight Centre, it is clear there is a trend on the part of the ACCC to pursue more significant cases against larger businesses (both international

62 ACCC Annual Report 2012–13.

63 See in particular ACCC Annual Report 2012–13, especially pt 3, Goal 2 (Protect the interests and safety of consumers and support fair trading in markets), 60-110.

and local) than was generally the case previously.[64] However, in our quest to determine whether or not the *ACL* has to date been a success, we must also look at what others have stated.

B *Other Views*

Overall, the *ACL* does have its good features and improvements on the *TPA* but, at the same time, it is in many respects complex legislation and there are shortcomings, some of which have already been mentioned. The success of the *ACL* is, at least to a degree, tied in with the performance of the ACCC in enforcing its provisions. From the court proceedings and infringement notices and other action on the part of the ACCC, it has already been shown how proactive the ACCC is being in enforcing the *ACL* but any other comments about the ACCC's performance and future also need to be taken into account. In its issue of 18 October 2013, *The Australian Financial Review* published an article by John Roskam of the Institute of Public Affairs entitled 'It's high time to abolish the ACCC'.[65] However, his argument has been forcefully refuted by Russell Miller in his reply entitled 'ACCC criticism neither fair nor helpful' in the same newspaper on 28 October 2013.[66] The performance of the ACCC has also been considered in detail by Frank Zumbo in his article 'Proposals for an ACCC makeover'.[67] His conclusion therein is not

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64 See the ACCC Media Releases for 2012 and 2013 <http://www.accc.gov.au/media/media-releases>; Michael Terceiro, 'Overview of the activities of the ACCC, lessons learnt and predictions for the near future' (Paper delivered at the Tonkin's 3rd Annual Competition and Consumer Law Conference, 6–7 March 2013) <http://www.lawchat.com.au/wp-content/uploads/2013/03/Overview-of-the-activities-of-the-ACCC-lessons-learnt-and-predictions-for-the-near-future..pdf>.

65 John Roskam, 'It's high time to abolish the ACCC', *The Australian Financial Review* (Sydney), 18 October 2013, 38.

66 Russell Miller, 'ACCC criticism neither fair nor helpful', *The Australian Financial Review* (Sydney), 28 October 2013, 3.

67 Frank Zumbo, 'Proposals for an ACCC makeover' (2013) 21 *Australian Journal of Competition and Consumer Law* 109.

that the ACCC should be abolished but rather, consideration should be given to breaking it up into three stand-alone bodies.

Another issue related to the ACCC is its funding. Michael Terceiro has commented upon this aspect in the following terms:

> The ACCC's financial position has deteriorated significantly over the past three years, due primarily to the current Chairman's ambitious enforcement program. Rod Sims is clearly focused on pursuing larger, more complex and ultimately more important enforcement cases that his predecessor. [W]ith this strategy comes obvious risks — namely, that the ACCC will start losing a greater number of cases than it has in the past …. However, the ACCC must not be dissuaded from pursuing important enforcement cases due to the fear of losing and having to pay significant legal costs.[68]

This brings us to the point where we must now give our conclusion; is or is not the *ACL* a success after its first three years?

XI Conclusion

The task has been to ascertain whether or not, after three years, the *ACL* is a 'success', using primarily the aims expressed in the Explanatory Memorandum when the *ACL* legislation was introduced into the Federal Parliament. The aim of such legislation, as explained in the Explanatory Memorandum, was to implement a law which would as its core features:

(a) give Australia a 'single national consumer law';
(b) prohibit specific types of conduct and marketing practices, especially misleading or deceptive conduct, false or misleading representations about goods or services and unconscionable conduct;
(c) prohibit unfair terms in standard form consumer contracts;
(d) provide non-excludable consumer guarantees;

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68 Michael Terceiro, 'Running on Empty: Why is the ACCC running out of money?', 4 December 2013 in his Competition and Consumer Protection Law blog <http://competitionandconsumerprotectionlaw.blogspot.com.au/>.

(e) regulate such matters as unsolicited consumer agreements (eg, door-to-door selling) and product safety;
(f) provide the ACCC with effective powers to enforce the *ACL*'s provisions.

As can be seen from the preceding analysis, it cannot be said unequivocally that the *ACL* has achieved all its goals. For a start, as has been shown, the *ACL* is not a 'single, national (ie, Australia-wide) consumer law'. In fact, it has even been suggested that to make the *ACL* more effective, all the definitions of 'consumer' in the *ACL* should be deleted so that the *ACL* has a general application.[69] Nevertheless, the *ACL* is an impressive achievement and it might be contended that the *ACL* is a success because, despite any shortcomings like this, it is better than the *TPA* since it has provisions for consumer guarantees (instead of the implied terms in the *TPA*) and unfair contract terms (which were lacking in the *TPA*) and also the remedies available under the *ACL* have been significantly enhanced, particularly by the power of the ACCC to issue infringement notices. However, it needs to be remembered that perhaps all this could, in any event, have been achieved just by amending the *TPA*. This would have avoided the problem we now have that not the entire 'consumer' provisions of the *TPA* have been drawn across into sch 2 of the *CCA* (and the States and Territories have made their *FTA*s akin only to sch 2 of the *CCA*). The States and Territories could still have brought their *FTA*s into line by adopting, instead of *CCA* sch 2, the *TPA* with the exception of certain specified aspects that are just within the Commonwealth government's domain (such as anti-competitive agreements and price fixing).

Irrespective of any of the *ACL*'s shortcomings in strictly achieving completely the aims of the legislation set out in the Explanatory Memorandum, at the end of the day the determinant is really this: does or does not the *ACL* in its present form provide adequate and

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69 Aviva Freilich and Lynden Griggs, 'Just Who is the Consumer? Policy Rationales and a Proposal for Change' in Justin Malbon and Luke Nottage (eds), *Consumer Law & Policy in Australia & New Zealand* (Federation Press, 2013) 39, 51.

sufficient protection for Australian consumers and others who can reasonably expect to be protected.[70] Apart from the need for tinkering here and there, it does seem arguable that the *ACL* does provide a substantial degree of adequate and sufficient protection for Australian consumers and various others. So what is our final conclusion? It is that, all in all for the reasons that have been mentioned, the *ACL* is a reasonable success but there are shortcomings and it cannot be said to be perfect. Actually, it is arguable that the success or otherwise of the *ACL* cannot really be determined by looking at the *ACL* holistically. Rather it seems the success or otherwise of the *ACL* varies considerably from provision to provision and depends very much on the circumstances surrounding the particular scenario.

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[70] Here the writers are taking account of such 'others' as those who are protected by, eg, *ACL* ss 18(1), 20(1) and 29(1).

THE INHERENT FAILURE OF CURRENT OCCUPATIONAL HEALTH AND SAFETY LEGISLATION IN PROSTITUTION

ANUSHKA VAN DER VEEN AND NICK GOIRAN*

Abstract

This article discusses the efficacy of current occupational health and safety ('OHS') frameworks in the context of prostitution. Both the legalisation and decriminalisation of prostitution require OHS principles and workers' compensation schemes to be applied to the recognised prostitution 'industry'. A new and dominant discourse has emerged in prostitution research which states that sex work is not unlike any other occupation and that labour normalisation and the introduction of OHS principles have notably improved the health and safety of sex workers. Examination of the available literature on OHS in prostitution however, evidences that, in those jurisdictions where OHS guidelines are in place, implementation and enforcement has proved to be poor. Additionally, any claim to improvements in health and safety, can only be made in the legal and regulated indoor brothels, while the majority of sex workers continue to operate outside this sector.

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I Introduction

An examination of the 'occupational hazard' of violence in sex work reveals that even within so-called 'safer' indoor brothel work, workers are exposed to significant levels of violence that are unique to the sex industry when compared with other occupations. The practices of prostitution, even in legal and regulated brothels, place workers in situations of danger to their health and safety that would be inconceivable in any other employment context. Within industry-specific OHS literature itself, violence is identified as an inevitable part of sex work, undermining the core principle of OHS, that is, that all workers, no matter what industry they work in, have the right not to suffer harm through carrying out the normal requirements of their work. In contrast to the argument that it is the legal setting which determines the health and safety of sex workers, this paper argues that prostitution is inherently harmful and involves significant levels of risk to mental and physical health for workers that has not been authentically addressed by current OHS principles, even where the industry has been legalised or decriminalised. Indeed this paper argues that a new model of legislation is needed in order to combat the inherent risks of the sex industry.

II The New Trend in Occupational Health and Safety Discourse

'Occupational health and safety' is a broad term used to refer to any issue, task or condition in a workplace that may impact on the health and wellbeing of the people who are working there. The core principle of OHS is that all workers, no matter what industry they work in, have the right not to suffer harm through carrying out the normal requirements of their work.[1] Article 23(1) of the Universal Declaration of Human Rights states that '[e]veryone has the right … to

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1 Occupational Safety and Health Service, Department of Labour New Zealand, *A Guide to Occupational Health and Safety in the New Zealand Sex Industry* (June 2004) WorkSafe New Zealand, 17 <http://www.osh.dol.govt.nz/order/catalogue/pdf/sexindustry.pdf>.

just and favourable conditions of work'. In accepting prostitution as a legal and legitimate form of employment, and in response to the high risk nature of sex work, governments and sex industry lobby groups have had to adopt harm minimisation approaches towards OHS in the sex industry.

Central to the discourse of OHS in prostitution is the argument that it is the context in which sex workers operate that is the most influential factor affecting health and safety, rather than the risk and harm inherent in prostitution itself. The sex industry is identified as the only industry in which laws can have the effect of minimising occupational health and safety risks.[2] Criminalisation of prostitution is said to set sex workers apart from the formal economy, leaving potential for workers in the sex industry to be exploited due to the uncertain legality of the industry's operations,[3] as well as minimising the degree of choice available to sex workers over workplace preferences and working conditions, possibly placing their personal safety in jeopardy.[4]

The proposed alternative to criminalisation is the regulation of the industry, whether by legalisation or decriminalisation, in order that industrial and legal recognition may be given to those working in the sex industry. Changing the legal status of prostitution from a criminalised practice to a legalised or decriminalised 'industry' is said

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2 Linda Banach and Sue Metzenrath, *Principles for Model Sex Industry Legislation* (2000) Scarlet Alliance, 8 <http://www.scarletalliance.org.au/library/model-principles>.

3 Robert Guthrie, 'Illegal Contracts: Impropriety, Immigrants and Impairment in Employment Law' (2002) 27(3) *Alternative Law Journal* 116, 120; Lauren Casey and Rachel Philips, *Behind Closed Doors: Summary of Findings* (November 2008), 29 <http://www.peers.bc.ca/education.html>.

4 Gamble & Mawulisa, *Occupational Health and Safety in the South Australian Sex Industry,* Scarlet Alliance, 6–7 <http://www.scarletalliance.org.au/library/gamble-mawulisa> citing Norah Fahy, Submission to the South Australian Health Commission, *Female Sex Workers in South Australia and Their Health Needs,* 1995, 6, 72.

to result in new rights and obligations which transform the debate from a moral concern to an issue relating to safety and health,[5] and remove constraints on harm minimisation approaches.[6]

Proponents of a regulated sex industry suggest that the following risks can be mitigated or eliminated by regulation:

- The location of sex work in a black economy;
- The stigmatised perception of those who provide the services;
- The often-limited power of sex workers to shape the terms and conditions of their employment; and
- The lack of practical means whereby abuse or exploitation can be exposed and remedied by legal means.

Within this new sex work paradigm, attention to the health and safety of all people working in the sex industry is said to enhance the quality of life of employees, while also improving the services offered to clients and the productivity and profitability of businesses in the industry overall.[7] Decriminalisation has been said to improve health and safety outcomes for sex workers,[8] while it is reported from

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5 Robert Guthrie, 'Sex in the city: decriminalisation of prostitution in Western Australia?' (2001) 7 *Journal of Contemporary Issues in Business and Government* 61, 69.

6 Priscilla Alexander, 'Sex Work and Health: A Question of Safety in the Workplace' (1998) 53(2) *Journal of American Medical Women's Association* 77, 77; Dr Antonia Quadara, 'Sex Workers and Sexual Assault in Australia; Prevalence, risk and safety' (2008) 8 *ACSSA Issues* 1, 7.

7 David Edler, *A Guide to Best Practice — Occupational Health and Safety in The Australian Sex Industry* (1999) Scarlet Alliance, 34 <http://www.scarletalliance.org.au/library/bestpractise>; David Edler, *Selling it in safety* Scarlet Alliance, 3 <http://www.scarletalliance.org.au/library/edler>.

8 Basil Donovan et al, Submission to the NSW Ministry of Health, *The Sex Industry in New South Wales,* (2012), 9; Prostitution Law Reform Committee, Gillian Abel, Cheryl Brunton and Lisa Fitzgerald, *The Impact of the Prostitution Reform Act on the Health and Safety Practices of Sex Work,* (2007) 15.

legalised jurisdictions that women in legal sex work appear to have better occupational health and are safer from the violence, harassment and intimidation that often exists in illegal or unregulated prostitution.[9]

The occupational exposures, hazards, injuries and diseases to be addressed within an industry-specific framework for OHS in sex work are wide-ranging and are not limited to sexually transmitted infections (STI) since sex work involves more than the direct acts of oral, vaginal and anal intercourse.[10]

A number of additional hazards identified in the research include:

- Repetitive stress injuries and other musculoskeletal problems;
- Bladder infections and the development of chronic cystitis;
- Kidney infections; and
- Physical injury.[11]

Other hazards attributed to sex work include emotional stress, alcohol and drug use, social stigma, discrimination, sexual assault, rape, violence and death.[12] The sex industry is also the only industry in

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9 Charlotte Woodward et al, *Selling Sex in Queensland 2003* (Prostitution Licensing Authority, 2004) 8.

10 Alexander, above n 6, 79.

11 Ibid 77, 79, 80–1; Sheryl Hann and John Wren, 'Decriminalisation: the key to health and safety in New Zealand sex industry' (2000) 7(12) *Safety at Work* 7, 8, citing Alexander, above n 6; J Cwikel, K Ilan and B Chudakov, 'Women brothel workers and occupational health risks' (2003) 57 *Journal of Epidemiology and Community Health* 809, 811; Sharon Pickering, JaneMaree Maher and Allison Gerard, Submission to Consumer Affairs Victoria, *Working in Victorian Brothels,* (2009), 19; Michael L Rekart, 'Sex-work harm reduction' (2005) 366 *Lancet* 2123, 2129.

12 Alexander, above n 6, 77, 79; Quadara, above n 6, 31; Hann and Wren, above n 11, 8, citing Alexander, above n 6; Cwikel, Ilan and Chudakov, above n 11, 811; Rekart, above n 11, 2129.

which unwanted pregnancy is considered to be an occupational hazard.[13]

In seeking to address these occupational hazards, industry-specific OHS guidelines for best practice have been developed by sex lobby groups and adopted by governments in jurisdictions where prostitution is regulated. Under these guidelines, the practice of safe sex is considered the basis upon which the workplace must operate.[14]

Guidelines created on this basis include:

- That employers are required to take all reasonable steps to provide information to employees regarding safe(r) sex;[15]
- Employees and clients are required to use adequate protection to minimise the risk of acquiring or transmitting a STI;
- Examination of all clients for visible signs of STI before service should be enforced as standard practice;[16] and that
- Employers should provide and maintain adequate supplies of personal protective equipment (PPE) free of charge to employees (including condoms, dams, water-based lubricants, latex gloves, disinfectant, and in the case of escort workers, items such as personal alarms and mobile phones).[17]

OHS also requires awareness of working conditions which will, over time, have an impact on a person's health and well-being, including:

- Making sure beds are in good repair and provide proper support;
- Ensuring that outfits worn by workers when seeing clients

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13 Edler, above n 7, 24.

14 Ibid 16.

15 Ibid; Abel, Brunton and Fitzgerald, above n 8, 24; Gamble & Mawulisa, above n 4, 9.

16 Edler, above n 7, 17.

17 Ibid 21; Gamble & Mawulisa, above n 4, 9; Occupational Safety and Health Service, Department of Labour New Zealand, above n 1, 35.

are comfortable and do not restrict circulation or affect posture; and

- That workers receive adequate breaks between clients and between shifts to avoid stress and fatigue.[18]

Industry guidelines also address ways to avoid repetitive and overuse injuries as well as the development of operational policies for members of staff who are pregnant to minimise harm to the worker and their baby.[19]

Regarding workers' safety, the stated purpose of OHS 'should be to eliminate potentially abusive situations, violence or intimidation from the workplace, whatever the source'.[20] The guidelines provide that employers and operators have an obligation to ensure workers' physical and emotional safety by identifying areas and tasks associated with risk, empowering and training workers to recognise and respond to potentially dangerous situations and supporting workers following a violent or dangerous experience.[21] 'Designing out risk' is considered the preferred action in all work place environments and 'the least preferred action is sole reliance on staff training as the causes of workplace violence are multi-factorial'.[22] Designing out risk in sex work involves strategies relating to effective environmental design including; solid security doors, peepholes and other means of viewing clients, safety devices, intercom communication and CCTV.[23] Employers and operators are required to identify high-risk procedures and areas and to develop control strategies to combat violence.[24]

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18 Edler, above n 7, 1.

19 Ibid 23, 24; Occupational Safety and Health Service, Department of Labour New Zealand, above n 1, 41.

20 Quadara, above n 6, 18.

21 Ibid.

22 Quadara, above n 6, 29, citing Claire Mayhew and Duncan Chappell, 'Violence in the workplace' (2005) 183(7) *Medical Journal of Australia* 346.

23 Ibid.

24 Rekart, above n 11, 2128.

III Examples of Current OHS Frameworks and Their Failings

Since legalised and decriminalised sex work is considered 'an occupation or trade involving exchange of sexual services for economic compensation',[25] sex workers possess the right not to suffer harm through carrying out the normal requirements of their work. Whether or not this right can at all be exercised in the context of prostitution, however, is rarely considered.

Consideration of this industry-specific framework of OHS and the practicalities of its application in various jurisdictions, including Victoria, Queensland, New South Wales and New Zealand, reveals that such a framework does not deliver a 'safe' workplace. It is not the intention of the authors to suggest that sex workers should be denied the right to a safe and healthy work environment. On the contrary, if a safe and healthy work environment *cannot be realised* for sex workers, a re-examination of the legal approach toward prostitution is necessary. The value of any OHS framework lies in its capacity to be implemented and enforced. In the case of sex work, failures are evidenced in both legalised and decriminalised jurisdictions.

A *Failures Under a Legalised Model*

Examples of the failure of OHS in legalised jurisdictions are found in Queensland and Victoria. In Queensland, the main focus of the regulatory regime has been the vetting of brothel owners and managers, with little capacity in the system for attention to the important workplace issues encountered by sex workers as licensed brothels have been established.[26] Provision is made for worker complaints to the Queensland Prostitution Licensing Authority (PLA), but there is little evidence that the PLA is able to respond

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25 Alexander, above n 6, 77.

26 Leslie Ann Jeffrey, 'Canadian Sex Work Policy for the 21st Century: Enhancing Rights and Safety, Lessons from Australia' (2009) 31(1) *Canadian Political Science Review* 57, 65.

meaningfully to those complaints.[27] Licensed brothels have been described as 'oppressive work environments' where significant power over brothel workers has been handed to the PLA and to brothel operators.[28]

In Victoria, Quadara notes that it is unclear how OHS protocols are actually implemented and monitored, despite being legally required.[29] Failure of the legalised system in Victoria is attributed in part to the lack of clear regulatory principles and different enforcement roles assigned to different agencies, where each agency has their own resourcing priorities and systems.[30] In a 2010 inquiry conducted by the Victorian Parliament into people trafficking for sex work, a submission was made by Project Respect[31] which highlighted that all women known to the organisation had been trafficked into *legal* brothels and that Victorian court cases to date concerned trafficking into *legal* brothels. The submission concluded that the *Prostitution Control Act (1994)* (Vic) is not meeting a number of its objectives, including:

- to seek to ensure that criminals are not involved in the prostitution industry (s 4(c));
- to maximise the protection of prostitutes from violence and exploitation (s 4(f)); and
- to promote the welfare and occupational health and safety

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27 Ibid.

28 Ibid.

29 Quadara, above n 6, 18–19.

30 Drugs and Crime Prevention Committee, *Inquiry into People Trafficking for Sex Work — Final Report June 2010* (2010) 144.

31 Project Respect is a non-profit, community-based organisation that aims to empower and support women in the sex industry, including women trafficked to Australia. Established in 1998, Project Respect began as a direct service conducting outreach and offering support to women in the sex industry across Victoria. Project Respect continue to be involved in outreach, education, supporting women in alternative employment pathways and advocacy.

of prostitutes (s 4(h)).[32]

Clearly the legalisation of prostitution in Victoria has not seen the improvement in OHS for sex workers that is claimed by advocates of legalisation.

Adding further weight to the findings about the failures of OHS within the Victorian system is a 2009 report published by Consumer Affairs Victoria (CAV). The report notes OHS efforts in Victoria are not supported by the current regulatory and compliance environment that exists in the State.[33] OHS within brothels seems to be informed by very limited compliance inspections rather than by any broadly informed best practice model of operation.[34] The CAV report confirms that WorkSafe Victoria, who manage Victoria's workplace safety system including the Occupational Health and Safety Acts, does not run a compliance and enforcement program specifically in relation to sex work.[35] Given the high risks to both physical and mental health associated with sex work, this omission on the part of WorkSafe Victoria is significant.

Surveys of licensed sexual service providers within the CAV report demonstrated varying levels of knowledge of the relevant regulations, Act and licensing arrangements. Compliance aspects of engaging with regulators and enforcement were clear (such as requiring certificates, panic buttons and the like), however the broader remit of the *Prostitution Control Act (1994)* (Vic) that focused upon harm minimisation, particularly in relation to protecting workers from exploitation, was not so well understood.[36] Licensees reported that lack of enforcement, including a low prosecution rate for illegal activity and few closures of unlicensed operations, lessened pressure for good practice.[37] Both licensees and survey respondents working

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32 Drugs and Crime Prevention Committee, above n 30, 145.

33 Pickering, Maher and Gerard, above n 11, vi.

34 Ibid.

35 Ibid 2.

36 Ibid 39.

37 Ibid vi.

for regulation and enforcement agencies in Victoria confirmed that the focus of enforcement or compliance measures was not firmly on the important issues of illegal activity that compromises worker autonomy and safety.[38]

B *Failures Under a Decriminalised Model*

Sex workers' lobby groups such as Scarlet Alliance argue that decriminalisation, rather than legalisation, enhances health and safety for sex workers. The examples of New South Wales and New Zealand, however, do not support this argument.

Despite prostitution having been decriminalised in New South Wales in 1995, compliance structures and enforcement of OHS principles remains poor. Various suggestions have been put forward to improve compliance, including that WorkCover manage compliance by implementing a system of active staff and performance management and developing a rigorous review and audit system for its compliance function overseen by high-level management, however any suggestions are yet to be implemented.[39] Local governments are also currently not resourced for the role of enforcing OHS.[40] Disinterest from industry operators and management continues to be an obstacle to the implementation of OHS and improvements to health and safety are limited by the 'one hazard approach' that equates OHS with safe sex practices and the prevention of sexually transmitted infections, rather than addressing other wide-ranging health and safety risks involved.[41] A decriminalised sex industry has now been operating in New South Wales for almost two decades without OHS enforcement, despite known risks to health and safety in sex work.

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38 Ibid 52.

39 Donovan et al, above n 8, 7.

40 Christine Harcourt et al, 'The decriminalisation of prostitution is associated with better coverage of health promotion programs for sex workers' (2010) 34(5) *Australian and New Zealand Journal of Public Health* 482, 486.

41 Michelle Toms, 'Health and workplace safety in the NSW sex industry' (2000) 7 *Safety at Work* 4, 5.

New Zealand provides another example of the failed implementation of OHS in sex work. Prior to decriminalisation, sex work was described as an 'invisible occupation' which meant that NZ's Occupational Safety and Health Service was unable to do anything about safety in the industry.[42] Following decriminalisation and the enactment of the *Prostitution Reform Act (2003)* (NZ) ('*PRA*'), the sex industry was required to operate under the same health and safety rules as any other industry operating in New Zealand. The Department of Labour's Occupational Safety and Health department went a step further to develop industry-specific guidelines intended for sex industry owner/operators, the self-employed, employers, managers and workers.[43] These guidelines included information on the roles and responsibilities of these groups under the relevant legislation, the *PRA* and the *Health and Safety in Employment Act 1992 (*NZ) ('*HSE Act*'). These guidelines also outlined requirements for sex worker health, workplace amenities and psychosocial factors such as security and safety from violence, alcohol, drugs, and smoking in the workplace, complaints, employee participation and workplace documents.[44]

Given these deliberate steps taken at a government agency level to address OHS, quite beyond those taken in the other jurisdictions previously mentioned, New Zealand might therefore be expected to demonstrate significant improvement in OHS compliance and workplace health and safety in the sex industry. This, however, is not the case. Research shows that improvement in employment conditions has generally been limited, with those brothels which had treated workers fairly prior to the enactment of the *PRA* continuing to do so,

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42 Hann and Wren, above n 11, 7–8.

43 Abel, Brunton and Fitzgerald, above n 8, 23–4, citing Occupational Safety and Health Service, Department of Labour New Zealand, above n 1.

44 Ibid.

while those with unfair management practices continuing with them.[45] Research indicates that there is a high level of awareness of OHS requirements in the sex industry; however, compliance is difficult to measure as there is currently no system of regular inspections of brothels by Medical Officers of Health and the Department of Labour.[46]

Public health services and Medical Officers of Health have not been resourced to take on their new statutory functions in monitoring the sex industry and almost all public health services have taken a largely reactive approach to implementation of the public health role under the *PRA*.[47] As well as underfunding, proactive monitoring of brothels is also hampered by the *PRA* which precludes the identification of licensed operators and premises.[48] This abject failure to identify brothels stands in contrast to other issues in relation to which Medical Officers of Health have responsibilities. For example under the *Sale of Liquor Act 1989* (NZ) the location of licensed premises and the contact details of owners and operators are readily available.[49] In this sense, despite decriminalisation, sex work can still be described as an 'invisible occupation' in New Zealand.

Confusion between agencies as to responsibility for OHS compliance and enforcement under the *PRA* has also emerged. The Labour Department's Occupational Safety and Health Service ('OSH Service') is responsible for administering legislation relating to the health, safety and welfare at work of all employees and other people

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45 New Zealand Prostitution Law Review Committee, *Report of the Prostitution Law Review Committee on the Operation of the Prostitution Reform Act 2003* (2008), 17.

46 Ibid 14.

47 Ibid 53–4; Abel, Brunton and Fitzgerald, above n 8, 151–2.

48 Section 41(1) of the *PRA* restricts access to information held by the Registrar of the Auckland District Court regarding successful applications for brothel certification. Inspectors wishing to go beyond a complaints-based regime must find brothels themselves: Prostitution Law Review Committee, above n 45, 54.

49 Ibid; Abel, Brunton and Fitzgerald, above n 8, 153–4.

affected by work activities more generally, but does not enforce the requirements of the *PRA*.[50] Instead the Ministry of Health is responsible for the inspectorate and health and safety requirements under ss 8 and 9 of the *PRA*.[51] As already mentioned, however, the public health services have not been resourced for this role and are prevented from identifying the brothels they are to inspect. So in summary, the OSH Service is not responsible for administering the industry-specific OHS framework and the Ministry of Health has not been resourced to do so. Therefore, sex workers in New Zealand are expected to and continue to, work in an OHS vacuum.

Since proactive inspection of brothel premises is not possible under the current scheme, Medical Officers of Health have acted reactively, responding to complaints as they have arisen. Complaints have, however, been infrequent and those complaints that have arisen have been about either unsafe sex practices or matters of hygiene, such as the unavailability of washing facilities, dirty sheets or towels.[52] Almost all complainants are anonymous, making it difficult for Medical Officers of Health to take action unless adequate detail has been provided.[53] None of the complaints that were investigated by Medical Officers of Health between 2003 and 2007 resulted in a prosecution.[54] Lack of complaints does not, however, indicate compliance with OHS requirements.[55] Brothel workers indicated that they would be unlikely to report a work related injury to the OSH Service, despite nearly one fifth of survey participants having experienced a work-related injury while doing sex work.[56] Reporting of violent attacks on sex workers to police in New Zealand also remains limited, despite decriminalisation.[57]

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50 Occupational Safety and Health Service, Department of Labour New Zealand, above n 1, 62.

51 Ibid 29.

52 Ibid 154.

53 Prostitution Law Review Committee, above n 45, 55.

54 Abel, Brunton and Fitzgerald, above n 8, 155.

55 Contra Prostitution Law Review Committee, above n 45, 55.

56 Abel, Brunton and Fitzgerald, above n 8, 161–2.

57 Ibid 167.

Additionally, many of the recommendations in sex industry specific OHS literature are unworkable. For example, the NZ Department of Labour's *Guide* states:

> Damage to reproductive health can be caused by factors in the work environment, including the work environment of the sex industry. Any occupational health and safety hazard that damages the fertility of people working in the sex industry must be removed from the workplace.[58]

Rekart notes that STI complications are common in sex workers, including pelvic inflammatory disease and ectopic pregnancy, and these complications have been linked to fertility issues.[59] How this hazard can be 'removed from the workplace' is unclear when such hazards are an unavoidable risk intrinsic to sexual intercourse. The limited value of inspecting clients for visual signs of STIs is highlighted by the statement contained in OHS guidelines that:

> Clients may have a sexually transmissible infection and not be displaying any visible signs of infection. Checking of clients by sex workers should not be seen as a guarantee that the client does not have an STI. Sex workers and clients need to be aware that most STIs are invisible to the naked eye.[60]

It therefore appears that the only way to 'remove' such a hazard from the workplace would be to remove sexual intercourse from sex work.

A further example of an unworkable OHS requirement is found in the NZ Department of Labour's *Guide*, as follows:

> Body fluids such as blood, vomit, urine, faeces, saliva and semen may contain infectious organisms. Special care must be taken in cleaning up spills of these fluids to avoid transmission of viruses such as Hepatitis A, B or C, HIV and others. All employees, not only cleaning staff, should be required to take the following precautions:

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58 Occupational Safety and Health Service, Department of Labour New Zealand, above n 1, 40.

59 Rekart, above n 11, 2124.

60 Occupational Safety and Health Service, Department of Labour New Zealand, above n 1, 85; Edler, above n 7, 41.

- Protective gloves must always be worn when dealing with these body fluids.
- Should any of these fluids come in contact with a person's skin, they should wash the area with warm water and soap.[61]

According to this OHS requirement, a significant proportion of sex work activity would require the wearing of protective gloves, a precaution which is unlikely to be accepted by clients, and implementation is therefore likely to be very low.

While hypothetically, the wearing of protective gloves to prevent viral transmission may seem a reasonable inclusion in sex industry specific OHS requirements, the futility of such a precaution is highlighted by the recommended action to be taken when a condom breaks, slips, is removed or broken by a client or when a sex worker is forced by the client to have sex without a condom. OHS guidelines advise sex workers to stop the service immediately and remove excess semen from the vagina by squatting and squeezing it out using vaginal muscle exertion. It is advised that fingers can be used to scoop out any excess semen that remains, however care must be taken to avoid scratching the lining of the vagina with nails or jewellery. It is advised that excess semen can be removed from the anus by sitting down on the toilet and bearing down, but that fingers should not be used in the anus.[62]

The occupational health and safety requirements considered above illustrate that OHS in sex work does not radically alter the inherent danger to health and safety involved in sex work. What OHS in sex work does do is place an expectation upon sex workers to modify their behaviour to adapt to this dangerous work environment. Sullivan explains it in this way:

> It can be argued that any measure that may minimise or at least decrease the harm of prostitution is beneficial. However … contemporary OHS research and policy is increasingly

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61 Occupational Safety and Health Service, Department of Labour New Zealand, above n 1, 45.

62 Ibid 86; Edler, above n 7, 43.

> developed within a human rights framework. This has meant that OHS standards must reflect the rights of all workers to a safe and healthy work environment based on the assumption that the workplace is not inherently harmful. When it was established that the use of asbestos in buildings lead to asbestosis, authorities recognised that workplaces where asbestos existed could not be made hazard free. As a result its further use was banned. OHS strategies must not expect workers to modify their behaviour so that dangerous work practices can continue. What other categories of workers have to accept STIs as an 'inevitable' rather than an accidental consequence of simply going to work? Defining STIs as an occupational health hazard does nothing to ameliorate the physical and psychological harm they cause to prostituted women.[63]

Sex work stands alone when compared to all other forms of employment in the risks to which its workers are exposed and the level of responsibility for which those workers are expected to bear for their own personal safety. Given this level of risk and the obvious unworkability of OHS measures in sex work, it appears counter-intuitive to the authors that governments have chosen to legislate, decriminalise and subsequently regulate this industry without considering this issue more comprehensively.

The response to these examples of failure in various jurisdictions might be that OHS could be 'done better' to improve health and safety for sex workers, and that what these jurisdictions evidence is not the failure of OHS in sex work but the failure of governments, agencies and operators in enforcing and implementing OHS. The authors of this paper argue, however, that OHS in sex work is unable to meaningfully improve working conditions for sex workers given the risks to safety and physical and mental health inherent to sex work. No jurisdiction can evidence significant improvement in health and safety through the introduction of an OHS framework and arguably 'full health and safety benefits' cannot be realised for sex workers. This is not solely evidence of government or management failure, but of the failure of OHS to translate into a 'safe' workplace in the sex industry, no matter how enthusiastically supported.

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63 Mary Lucille Sullivan, *Making Sex Work* (2007) 278.

IV The Inherent Risks of Prostitution

A *The Occupational Hierarchy*

When considering the efficacy of OHS frameworks in sex work it is important to recognise that the sex industry is made up of various sectors that sit within what some researchers have described as an 'occupational hierarchy'.[64] The ability of OHS to operate within the sex industry decreases the further down the hierarchy a sector is found. Much of the literature on the topic of sex work identifies legal indoor sex work, particularly in brothels, as being the safest option for sex workers,[65] with street work considered the least safe for workers.[66] This demonstrates that the preceding discussion of failures

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64 Jacqueline Lewis et al, 'Managing risk and safety on the job: The experiences of Canadian sex workers' (2005) 17(1/2) *Journal of Psychology and Human Sexuality, Special Issue* 147; Contra Woodward et al who state that 'In reality, there are two sex industries, and workers in only one are currently being protected': Woodward et al, above n 9, 14. There the authors are referring to legal indoor sex work ('safer' sex work) and street work (the riskiest sex work), however in practice there are many sectors ranging from legal/regulated indoor brothel work, legal/regulated private indoor work, escort services, illegal/unregulated brothel work, illegal/ unregulated private indoor work and street or outdoor sex work.

65 Jeffrey, above n 26, 64–5, citing Woodward et al, above n 9; Roberta Perkins, *Working Girls. Prostitutes, Their Life and Social Control* (Australian Institute of Criminology, 1991); Barbara G Brents and Kathryn Hausbeck, 'Violence and Legalised Brothel Prostitution in Nevada' (2005) 20(3) *Journal of Interpersonal Violence*, 270; Woodward et al, above n 9, 8, 14, 55, 57; Queensland, Crime and Misconduct Commission, *Regulating Prostitution: A Follow-Up Review of the Prostitution Act 1999* (2011), 44; Pickering, Maher and Gerard, above n 11, 3, citing Priscilla Pyett and Deborah Warr, 'Women at Risk in Sex Work: Strategies for Survival' (1999) 35(2) *Journal of Sociology* 183; J Groves et al, 'Sex Workers Working Within a Legalised Industry: Their Side of the Story' (2008) 84 *Sexually Transmitted Infections* 393.

66 Crime and Misconduct Commission, above n 65, 43; Woodward et al, above n 9, 55; Prostitution Law Review Committee, above n 45, 16.

in various jurisdictions relates to the ability (or inability) of OHS frameworks to be implemented within a limited sector — that of indoor legal or regulated prostitution — while the remaining sectors, including illegal or unregulated prostitution and outdoor sex work, fall entirely outside current OHS frameworks, in part perhaps because of a lack of focus by regulators on these sectors. Limited implementation of OHS principles is only possible in those sectors found at the top of the hierarchy, while the majority of sex workers continue to operate in sectors where OHS is not able to be formally implemented or enforced at all.

Putting aside, for the moment, any consideration of mental health, sex workers in legal indoor brothels are considered much less vulnerable to violence and sexual assault because of the presence of other staff, the increased possibilities for screening clients and the provision of alarms, adequate lighting and personal protective equipment.[67] The situation is very different, for example, for escort workers. Escort work is potentially more hazardous for the sex worker than other forms of indoor prostitution because the sex worker operates alone in a space that is controlled by the client.[68] Limited provision is made in the OHS literature relating to escort work for harm minimisation,[69] leaving the worker otherwise completely responsible for their own safety.

Other OHS provisions are entirely unworkable, for example, the provisions made for escort worker safety in *A Guide to Occupational Health and Safety in the New Zealand Sex Industry* introduced by the Department of Labour in New Zealand. That document provides that a 'principal' to a contract (in terms of the *HSE Act*) may also include a client who engages sex workers to provide services in a place other than a brothel, such as in a hotel room, vehicle or home.[70] A client of an escort worker may therefore be under a duty, under s 18 of the

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67 Jeffrey, above n 26, 65.

68 Donovan et al, above n 8, 20; Quadara, above n 6, 13.

69 Donovan et al, above n 8, 20; Edler, above n 7, 47–8.

70 Occupational Safety and Health Service, Department of Labour New Zealand, above n 1, 26.

HSE Act, to take all practicable steps to ensure that the sex worker is not harmed while carrying out their work, in addition to the 'safer sex' requirement of s 9 of the *PRA* and other protections under the criminal law.[71] How such duties are enforceable against a client is unclear. The *PRA* also provides that Medical Officers of Health have the power to enter and inspect any place where commercial sex services are being offered, to check that the *HSE Act* is being complied with.[72] *A Guide to Occupational Health and Safety in the New Zealand Sex Industry* provides that a home may be a 'place of work'.[73] Again, a provision for the inspection of a private home is unworkable and provides no real protection for the sex worker.

While proponents of legalisation and decriminalisation herald the introduction of OHS as an improvement for sex workers and the conditions they work in, this argument fails to acknowledge that a significant proportion of sex workers in any jurisdiction continue to work outside legislative or regulatory bounds and therefore outside any OHS framework. As such, research claiming the success of OHS in legalised and decriminalised jurisdictions is silent on the experiences of these sex workers.[74] The conditions under which sex

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71 Ibid.

72 Prostitution Law Review Committee, above n 45, 53.

73 Occupational Safety and Health Service, Department of Labour New Zealand, above n 1, 24.

74 For example, Harcourt et al acknowledged that their research was limited to urban female brothel-based sex workers and that data from unlicensed Melbourne brothels was restricted by the small number that they were able to access. Findings were therefore considered biased toward the licensed 'upper end' of the market: Harcourt et al, above n 40, 485. Woodward et al also admitted that their sample of women interviewed was largely made up of women from legal brothels and that very little contact was made with women from illegal brothels: Woodward et al, above n 9, 12. Casey and Philips acknowledge that persons working for abusive or controlling third parties are less likely to participate in research: Casey and Philips, above n 3, 22.
Quadara argues that there is not enough differentiation between sectors in research on prostitution and that too little is known about the experiences of violence in legal brothels, illegal brothels, escort work

workers operating outside legislative and regulatory frameworks are working is of concern. Illegal and unregulated industries continue to present a threat to workers because of the hidden nature of their operations, the barriers to sex workers disclosing assault and other hazards because of the sector they are involved in, and the fact that operators do not need to comply with any regulations for sex workers' safety.[75]

Illegal and unregulated sectors are found in both legalised and decriminalised sectors and represent a significant threat to worker health and safety, as the jurisdictions of Victoria and New South Wales illustrate. In Victoria, unlicensed brothels involving temporary facilities, a high rotation of workers between premises and the compromising of worker autonomy and safety are reported.[76] In particular, the health, employment and advertising restrictions imposed by legalisation has been said to force many operators and workers into the illegal sector.[77] Unlicensed brothels in Victoria represent a significant proportion of the sex industry and remain almost invisible and inaccessible for health promotion and support services.[78] Various reports identify a high level of interdependence between licensed and unlicensed sexual service providers and mobility of sex workers between sectors.[79] It is reported that within unlicensed brothels unsafe sex practices are more likely to be available.[80] Larger scale, loosely networked operations are seen as a significant threat to the licensed

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and private work in comparison to street-based work: Quadara, above n 6, 31. Arguably the illegal and unregulated brothel industry, being less visible than street work, would be the most difficult to engage in research, given the fact that these brothels operate outside legislative bounds.

75 Quadara, above n 6, 14.

76 Pickering, Maher and Gerard, above n 11, 12.

77 Peter Richardson, 'The Victorian brothel owners' perspective' (2000) 7 *Safety at Work* 12, 19, 20.

78 Harcourt et al, above n 40, 485–6.

79 Pickering, Maher and Gerard, above n 11, 42; Drugs and Crime Prevention Committee, above n 30, 133.

80 Pickering, Maher and Gerard, above n 11, 12, 19, 20.

industry by licensees, since worker safety is often perceived to be compromised, wages are lower and turnover is higher.[81] Licensees of legal brothels in Victoria report that these operations are not structured to promote worker autonomy or the ability to deliver effective worker safety yet may in fact be favoured by clients.[82]

Advocates of a decriminalised system criticise these legalised jurisdictions and proponents in New South Wales argue that the introduction of a legalised system naturally creates an illegal system where sex worker health and safety is compromised. In New South Wales, however, the decriminalisation of sex work has also seen the introduction of a system of regulation, where brothels must gain development approval from the local government. Due to difficulties in gaining development approval from local councils, many Sydney brothels operate without approval, masquerading as massage parlours, with poor occupational health and safety standards.[83] A significant proportion of the NSW sex industry comprises brothels operating without planning approval and private premises involving one to three women working independently. While these are legally defined as brothels they rarely seek council planning approval.[84] Despite decriminalisation, a large unregulated sector still exists in New South Wales where little is known about OHS conditions.

The introduction of legalisation or decriminalisation of sex work and the attendant introduction of OHS frameworks does not automatically mean that workers will move from the unsafe sectors into the safe(r) sectors. The New Zealand Prostitution Law Reform Committee considered that the purpose of the *Prostitution Reform Act (2003)* (NZ) could not be fully realised in the street-based sector and therefore considered that the street-based workers should be encouraged to either move to a safer, indoor setting, or leave sex work altogether.[85] In a similar vein, when the licensing of brothels was

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81 Ibid 40.

82 Ibid 40, 41.

83 Donovan et al, above n 8, vi.

84 Ibid 31.

85 Prostitution Law Review Committee, above n 45, 16.

first proposed by the Victorian government, it was argued that the availability of legal indoor work would encourage women to leave the street and illegal establishments.[86] The expectation of movement from unsafe to safe sectors is, however, not realistic. In the case of Victoria, licensed brothels only offer a small amount of employment in the sex industry.[87] Sanders and Campbell write:

> the growing recognition that indoor work (if well managed) is safer than street work often leads to calls for legalisation of indoor sex work with an assumption that women on the street will be directed to working indoors. This assumption misunderstands the dynamics of street sex work including the advantages it has for some people (eg, the lack of time and routine restrictions).[88]

Despite the introduction of OHS frameworks within higher tiered sectors, sex workers continue to operate in higher risk sectors further down the occupational hierarchy.

Mobility within and across venues is reported to be high in the sex industry.[89] The industry does not have a recognisable 'career ladder', with workers beginning in street work and then moving into 'safer' indoor sex work. Rather, sex workers may work in a variety of sectors at the same point in time or move from one sector to another.[90] Movement between licensed and unlicensed premises and into and out

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86 Jeffrey, above n 26, 66.

87 Ibid.

88 Teela Sanders and Rosie Campbell, 'Designing out vulnerability, building in respect: Violence, safety and sex work policy' (2007) 58(1) *The British Journal of Sociology* 1, 14, quoted in Quadara, above n 6, 13.

89 Casey and Philips, above n 3, 20, citing Cecilia Benoit and Alison Millar, Submission to the BC Health Research Foundation, *Dispelling Myths and Understanding Realities: Working Conditions, Health Status and Exiting Experiences of Sex Workers,* (2001).

90 Cecilia Benoit and Alison Millar, *Short Report: Dispelling Myths and Understanding Realities: Working Conditions, Health Status and Exiting Experiences of Sex Workers* (2001), 7 <http://www.peers.bc.ca/education.html>.

of private and/or escort work is not uncommon.[91] Notably, when faced with economic needs, the shift between occupations is most often from work in sectors further up the hierarchy to those lower down, which also means moving from 'safer' to more dangerous work.[92] Therefore pointing to the introduction of OHS frameworks in sectors at the top of the sex work hierarchy as an advance in sex work health and safety is misrepresentative, not only because the majority of sex workers operate outside those upper tiered sectors, but also because most sex workers do not work exclusively in one 'safe' sector but are exposed to various levels of health and safety risk depending upon factors such as economic necessity.

B *Violence in Prostitution*

While the transmission of sexual diseases is considered an important safety concern for sex workers (and their clients), the physical, verbal, sexual and emotional violence experienced by sex workers also presents a significant health and safety issue.[93] Violence in sex work represents what might be considered to be the most serious threat to the physical and mental health of sex workers and may include physical, verbal and sexual abuse; gang rape; traumatic intercourse; emotional trauma; robbery; confinement and murder.[94] The following section examines the causes of violence in sex work and how OHS frameworks inevitably fail to address that violence. Examples of OHS recommendations to avoid violence in and of themselves provide evidence that sex work is like no other profession. Even in the higher tiered sectors, where OHS frameworks are said to have been introduced and implemented, violence is experienced by sex workers at rates significantly higher than in any other profession.

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91 Pickering, Maher and Gerard, above n 11, 9.

92 Lewis et al, above n 64, 155.

93 Hann and Wren, above n 11, 8, citing Alexander, above n 6.

94 Rekart, above n 11, 2124.

Proponents of decriminalisation argue that violence in sex work is encouraged by criminalisation and the illegal status of sex work.[95] Sex workers are said to be forced to work from hidden locations where they have little control over their personal safety. The degree of choice available to sex workers over workplace preferences and working conditions is also said to be minimised.[96]

However, despite legalisation and decriminalisation in some jurisdictions, violence against sex workers continues to occur. Prostitution itself is an inherently high risk activity since most commercial sex contacts are between strangers and therefore contain a large element of unpredictability.[97] The process of identifying and 'training' new clients always carries some risk of violence because of interpersonal struggles over who, ultimately, controls the prostitution transaction.[98] Whittaker and Hart note that male client violence seems to occur as a result of conflicting notions about the exchange. That is, because a payment has been made, some clients believe that this entitles them to control over the sex worker's body and entitlement to services not paid for, to services that the sex worker is not willing to engage in, or to be as rough as they like.[99] Therefore the power

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95 Abel et al, above n 8, 133, citing Priscilla Alexander, 'Health care for sex workers should go beyond STD care' (1999) 2 *Research for Sex Work* 1; Hilary Kinnell, 'Murder made easy: The final solution to prostitution?' in Rosie Campbell and Maggie O'Neill (eds), *Sex work now*, (Willan Publishing, 2006).

96 Benoit and Millar, above n 90, 8–9; Gamble & Mawulisa, above n 4, 6–7, citing Fahy, above n 4, 6, 72.

97 Marina A Barnard, 'Violence and vulnerability: conditions of work for streetworking prostitutes' (1993) 15(5) *Sociology of Health & Illness* 683, 700.

98 Alexander, above n 6, 78.

99 Dawn Whittaker and Graham Hart, 'Research note: Managing the risks: the social organisation of indoor sex work' (1996) 18(3) *Sociology of Health & Illness,* 399 cited in Quadara, above n 6, 11; Martin Monto, 'Female prostitution, customers, and violence' (2004) 10(2) *Violence Against Women* 160, cited in Quadara, above n 6; Maggie O'Neill, *Prostitution and feminism: Towards a politics of feeling* (Cambridge, 2001); Resourcing Health and Education *Power*

relationship between the client and worker is considered a crucial factor in the safety of commercial sex encounters.[100]

Recognition that sex work is a type of labour is said to facilitate law reform objectives and lend a focus to human rights, occupational health and safety, and working conditions.[101] The institutional, legal and occupational organisation of sex work is also said to have a significant impact on shaping the safety or unsafety of commercial sex encounters.[102] This position was not supported in a survey of sex workers in New Zealand following the decriminalisation of sex work and introduction of an OHS framework, where the majority interviewed felt that the legislation could do little about violence that occurred in sex work.[103] In another survey, similarly relating to the effectiveness of the new legislation, a majority of NGOs, brothel operators and community groups also agreed that the legislation could do little about the violence that occurred, with one brothel operator quoted as saying that '[c]lients getting stroppy will always happen. This was the case before the Act and after it' and a health worker acknowledged that '[t]here has been no impact. There will always be ugly mugs.'[104] A cross-jurisdictional survey conducted by the authors of the NSW Kirby Report found that 8% of the survey participants reported being assaulted by clients, 10% had been threatened by clients and 33% reported being pressured by a client to do something

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(2002) Sex Worker, <http://www.sexworker.org.au/uploads/documents/RHED_ power.pdf>; Barnard, above n 97, 695.

100 Libby Plumridge and Gillian Abel, 'A "segmented' industry in New Zealand: Sexual and personal safety of female sex workers' (2001) 25(1) *Australian and New Zealand Journal of Public Health* 78, 78, cited in Quadara, above n 6, 33.

101 Banach and Metzenrath, above n 2, 4, citing Linda Banach, 'Sex workers and the official neglect of occupational health and safety' (1999) 18(3) *Social Alternatives* 17; Sue Metzenrath 'Prostitution law reform: Towards a human rights based Model' (1997) *Prostitution Law Reform in Queensland: Forum.*

102 Quadara, above n 6, 33.

103 Prostitution Law Review Committee, above n 45, 14.

104 Ibid 57.

they did not want to do. *These results did not vary significantly between a decriminalised jurisdiction, a legalised jurisdiction and a criminalised jurisdiction*.[105] This shows that the legal status of sex work does not impact as greatly upon violence in sex work as some would suggest. Violence in sex work is clearly a risk in all legal settings. The question then arises: how great is this risk?

1 *Rates of Violence Not Comparable With Any Other Industry*

While there is a potential for violence in any workplace, it is more likely in the retail and service industries where service providers come into direct contact with clients.[106] Quadara also notes that women who work alone, attend to the needs of others, or deal with difficult people are more likely to experience violence in their workplace.[107] She explains that it is possible that the sexual assault of sex workers is part of a continuum for women fulfilling the expectations of others and who are in close physical proximity to their clients.[108]

But what distinguishes sex work is the rate at which that violence occurs. For example, while the indoor sex work sector may be considered less violent than other sectors within this industry,[109]

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105 Donovan et al, above n 8, 26.

106 Woodward et al, above n 9, 21.

107 Quadara, above n 6, 12.

108 Ibid.

109 For example, Donovan et al compare reports of violence among brothel and private workers at 5% to 10% against street worker reports of upward of 50% having experienced violence at work: Donovan et al, above n 8, 13 citing Roberta Perkins and Francis Lovejoy, *Call Girl* (University of Western Australia Press, 2007); Frances Boyle et al, 'Psychological distress among female sex workers' (1997) 21(6) *Australian New Zealand Journal of Public Health* 643; Christine Harcourt et al, 'The health and welfare needs of female and transgender, street sex workers in New South Wales' (2001) 25 *Australia and New Zealand Journal of Public Health* 84; Amanda Roxburgh, Louisa Degenhardt and Jan Copeland, 'Posttraumatic stress disorder among female street-based sex workers in the greater Sydney area, Australia' (2006) 6(24) *BioMed Central Psychiatry* 12; Charlotte

a comparison of sexual assault rates with women in employment other than sex work shows that the rate of sexual assault of sex workers in this 'safer' sector is still *significantly higher* than in other occupations in which women are employed. Quadara cites a number of statistics relating to the forms of violence experienced by women in occupations other than sex work and notes that 0.2% had been sexually assaulted at work.[110] When this figure is compared with conservative sexual assault rates in indoor prostitution the results are significant:

- 3% of all brothel workers surveyed in Woodward et al (2004) reported having been raped — this figure is 15 times the 0.2% of women who have been sexually assaulted in employment outside of sex work;
- 13.4% of private workers surveyed in Woodward et al (2004) reported having been raped — this figure is 67 times the rate of sexual assault experienced by women in employment generally.

Relative to other sectors, Woodward et al argue that the main perceived benefits of working in a legal brothel are related to improved safety and security, confirmed by data showing the low rates of violence experienced by this group when compared with other sectors.[111] However, the above comparison evidences that sex

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Seib, Jane Fischer and Jackob Najman, 'The health of female sex workers from three industry sectors in Queensland, Australia' (2008) *Social Science and Medicine*. Donovan et al state that in respect to violence experienced in the workplace 'brothel workers appear to be much better off … than street-based sex workers': Donovan et al, above n 8, 26. Quadara also confirms that available comparative research indicates that street-based workers are the most vulnerable to all forms of workplace violence, including sexual assault: Quadara, above n 6, 8.

110 Quadara, above n 6, 12, Department of Victorian Communities, *Safe at work? Women's experience of violence in the workplace: Summary report of research* (2005) <http://www.wholewoman.org.au/resources/SafeatWorkPDF.pdf>.

111 Woodward et al, above n 9, 55.

workers employed in 'safer' legal brothels are at significantly higher risk when compared to rates of sexual violence in other employment contexts.

Research also shows that *attempted* rape is more common in indoor brothel work than the offence of rape itself and therefore a conclusion is drawn that the indoor brothel sector is the 'safer' workplace. Church et al found that women working outdoors experienced more violence overall from clients, while indoor workers cited more incidents of attempted rape, which Quadara suggests may mean that the elements of indoor work prevents sexual assault or at the very least interrupts it.[112]

In their survey of Queensland sex workers employed in legal brothels, Woodward et al also note that while 3.0% of brothel workers reported having been raped by a client more than once, 10.9% of brothel workers reported attempted rape (defined in the survey as 'Man attempted sexual intercourse when you didn't want him to by using force but intercourse did not occur').[113] However, attempted rape remains a criminal offence and still presents a significant risk to worker health and safety. The positive fact that rape is avoided because of the introduction of OHS recommendations such as alarms/security/setting does not diminish the significance of attempted rape for the sex worker. The experience of attempted rape carries with it its own consequences to mental health.

2 *Responses to Violence in OHS Frameworks*

Calls have been made for the potential for threats and assaults by clients to be addressed in the management plans of brothels and in the provision of OHS education and information to owners, managers and

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112 Stephanie Church et al, 'Violence by clients towards female prostitutes in different work settings: Questionnaire survey' (2001) 322 *British Medical Journal* 524, cited in Quadara, above n 6, 10.

113 Woodward et al, above n 9, 47.

workers in the sex industry.[114] A Queensland Prostitution Licensing Authority report, after noting the consistently high rate of violence against sex workers, called for an urgent examination of the specific work practices that are associated with increased and decreased rates of violence.[115] In response, an attempt has been made within OHS frameworks to address the high risk of violence inherent in sex work.

OHS guidelines hold employers, owners or managers responsible for eliminating potentially abusive situations, violence or intimidation from their workplace whatever the source.[116] These guidelines recommend employers carry out this responsibility by (amongst other things):

- identifying tasks or circumstances where employees may possibly be exposed to some form of abuse or violence;
- providing communication skills training as part of employee induction;
- organising training for employees on how to identify potentially dangerous situations and how to protect themselves;
- installing safety devices such as accessible alarm buttons in all rooms; and
- acknowledging that employees have the right to refuse particular clients on the basis of prior violent, abusive or threatening behaviour by that client.[117]

However the effectiveness of an OHS framework in addressing violence in sex work is impacted by a number of factors including:

- sex worker unwillingness to report violent incidents to enforcement and health agencies;
- the difficulty in distinguishing between sexual assault or simply whether a client has 'gone too far'; and
- the role of management and operators in accepting,

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114 Donovan et al, above n 8, 26.

115 Woodward et al, above n 9, 21.

116 Edler, above n 7, 25.

117 Ibid 25–6; Rekart, above n 11, 2128.

excusing, condoning and perpetrating sexual assault against workers.

Each of these issues is dealt with in turn below in assessing the ability of OHS frameworks to make any meaningful progress in creating a safe working environment for sex workers.

A *Reporting of Violent Incidents*

Despite the introduction of OHS frameworks together with reporting and investigation structures in some jurisdictions, reporting of violent incidents remains low, contributing to the inefficacy of OHS frameworks in sex work. An example of this is found in New Zealand where decriminalisation legislation provides that employers, the self-employed and principals have a duty to record accidents and must notify the Department of Labour's Occupational Safety and Health Service of occurrences of harm.[118] The purpose of the notification is so that the Occupational Safety and Health (OSH) Service can determine whether or not to investigate the harm and so that they can authorise the release of the accident scene.[119]

The Accident Compensation Scheme ('ACC') applies to all workers in New Zealand, including sex workers, and provides cover for injuries suffered at work including physical and some mental injuries. This may extend to sexually transmitted infection or infestation if the tests set out, in the *Injury Prevention, Rehabilitation and Compensation Act 2001* (NZ) ('*IPRC Act*') for workplace injury caused by work-related gradual process, disease or infection injury, are met. The ACC can also cover claims under the *IPRC Act* for mental or physical injury arising out of sexual abuse.[120]

Despite provision for these reporting and compensation structures, reporting of incidents and the making of complaints and claims for

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118 *HSE Act* (NZ) s 25(2), (3); Occupational Safety and Health Service, Department of Labour New Zealand, above n 1, 67.

119 Occupational Safety and Health Service, Department of Labour New Zealand, above n 1, 68.

120 Ibid 96–7.

compensation in the NZ sex industry remain extremely low. In a survey of sex workers in New Zealand, nearly one fifth (18.1%) of survey participants had experienced a work-related injury, with most injuries sustained through violent altercations with clients, or clients who had been too rough, causing vaginal or anal trauma.[121] Half of the participants who indicated that they had experienced a work related injury had reported this to someone, with managed workers the most likely (64.3%) to report an injury.[122] Three quarters of the managed workers said that they would report a work related injury to the owner, manager or receptionist at their work.[123] However, these notifications to employers and management are not translating into reports of harm to OSH Service, despite the duty to do so provided under the *Health and Safety in Employment Act 1992* (NZ).

Workplace incidents are not converting into compensation claims for sex workers, for either criminal injuries compensation or workplace accident compensation. Despite a willingness to report incidents to managers or receptionists, very few sex workers surveyed reported that they would approach the OSH Service for help.[124] Reporting of violent attacks on sex workers to the police also continues to be limited, despite decriminalisation.[125] Decriminalisation of the sex industry was intended to make it more likely that sex workers would report violent behaviour by clients to the police, increasing their safety as clients realised that they could no longer 'get away with it'. However, the problems that deter sex workers from reporting violent incidents still exist in New Zealand.[126]

Quadara notes that a principal reason why sex workers do not disclose sexual assault to police and other agencies is because of a rhetoric that accepts violence as part of the job.[127] She states that this rhetoric can

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121 Abel, Brunton and Fitzgerald, above n 8, 161.
122 Ibid.
123 Ibid 161–2.
124 Ibid.
125 Ibid 135.
126 Ibid; Prostitution Law Review Committee, above n 45, 58.
127 Quadara, above n 6, 22.

be expressed by police and other agencies in the criminal justice system, and in some instances by sex workers themselves who have taken on this dominant discourse.[128] Arguably the acceptance of violence as part of the job exists within the very principle of 'harm minimisation' central to OHS frameworks in sex work. For example, the NZ Department of Labour's *Guide to Occupational Health and Safety in the New Zealand Sex Industry* states the following:

> Employers, owners or operators are responsible under the HSE Act for managing hazards in the workplace, including violence. Their object should be to eliminate potentially abusive situations, violence or intimidation from the workplace, whatever the source. Where a hazard cannot be eliminated, it should be isolated; and if it cannot be isolated, it should be minimised.[129]

Abuse, violence and intimidation should not exist in any workplace. And yet, in sex work every interaction with a client carries with it the risk of harm and it is suggested that the best that can be done is to minimise how much of this harm occurs. In some sense then harm minimisation also contributes, unintentionally, to the discourse that violence is an unavoidable part of sex work.

Take, for example, this excerpt also from the Guide to Occupational Health and Safety in the NZ Sex Industry:

> Unfortunately, incidents occur where workers are forced by clients to have sex without a condom against their will (ie, rape). Sex without a condom can result where the client removes or breaks the condom during the service without the worker's knowledge.[130]

Rape is identified as, 'unfortunately', a part of the job. The *Guide* then refers readers to Fact Sheet 3 which provides information on action to be taken in the event of condom breakage or slippage in order to minimise the risk of STI and pregnancy. Even within industry-specific OHS literature, violence is identified as an inevitable part of sex work, undermining the core principle of OHS

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128 Ibid.

129 Occupational Safety and Health Service, Department of Labour New Zealand, above n 1, 52.

130 Ibid 37.

itself, that is, that all workers, no matter what industry they work in, have the right not to suffer harm through carrying out the normal requirements of their work.

B *Naming Sexual Violence*

Another challenge for the implementation of OHS frameworks in sex work is the identification of sexual violence as an occupational hazard, since it is difficult to distinguish between sexual violence and what may generally be expected to occur in a commercial sexual transaction. This difficulty in naming sexual violence has been addressed within OHS literature produced by sex worker organisations. For example, in *9 Lives: Surviving Sex Assault in the Sex Industry*, produced by the NSW Sex Workers Outreach Project (SWOP), the author writes 'Learning to recognise violence is the first step we can take in protecting ourselves'.[131] And yet further in the document it is acknowledged that 'it can sometimes be difficult to immediately tell the difference between when a client has "gone too far" and when a sexual assault has occurred'.[132]

The difficulty in identifying harm such as rape in sex work is also acknowledged in other research. In discussing the rape of sex workers by clients, Barnard notes that the potential always exists and cites the example that a client could refuse to pay and then try to force the worker into providing sex. She goes on to state that not all women would define such situations as rape.[133] For example, a sex worker surveyed in Barnard's research did not identify a client's refusal to pay and still expect sex to occur as rape. Further an incident she did define as rape involved a violent attack and the sense of being physically overpowered and not in control.[134] Barnard notes that research on rape victims has consistently shown a tendency for women to blame

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131 Madeleine Bridgett, *9 Lives: Surviving Sexual Assault in the Sex Industry*, Darlinghurst (Sex Workers Outreach Project, 1997) 2, quoted in Sullivan, above n 63, 319.

132 Ibid 5, quoted in Sullivan, above n 63, 320.

133 Barnard, above n 97, 696.

134 Ibid.

themselves for being raped and that this is no less likely to be the case among female prostitutes, particularly given the importance that is attached to the worker being in control.[135]

In a survey of sex workers in Queensland, Woodward et al report that 3.0% of legal brothel workers had been raped more than once by a client. This data was collected in a table entitled 'Number of respondents reporting ever having been raped or bashed by a client by current type of work'.[136] In a separate table entitled 'Unwanted sexual experiences during sex work by current sex industry sector', 5.0% of legal brothel workers identified themselves as having experienced 'Sexual intercourse when you didn't want to because you were overwhelmed by continual argument and pressure', 1.0% of legal brothel workers identified themselves as having experienced 'Sexual intercourse when you didn't want to because someone used their position of authority' and 4.0% of workers identified themselves as having experienced 'Sexual intercourse when you didn't want to because someone used force'.[137] Like Barnard's research, this demonstrates how sex workers are more likely to identify their experiences as 'unwanted sexual intercourse' than 'rape'.

Quadara argues that the naming of experiences as sexual assault or sexual abuse is significantly affected by the social support available and depends on how disclosure is received and responded to.[138] Efforts to identify and name sexual abuse in sex work is also hampered, however, by attitudes held by the sex industry as well as those organisations seeking to promote OHS and improve the health and safety of workers. In particular, OHS frameworks are hampered where workplace violence is indistinguishable from what is considered a common workplace experience.

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135 Ibid 697.

136 Woodward et al, above n 9, 47.

137 Ibid.

138 Quadara, above n 6, 20, citing Denise Lievore, *No longer silent: A study of women's help-seeking decisions and service responses to sexual assault* (Australian Institute of Criminology, 2005) 11.

C *The Role of Management and Operators*

Without the strength to enforce OHS requirements against employers, operators and managers, 'sex worker safety ends up depending on the benevolence of the manager rather than any consistent framework'.[139] Quadara notes that OHS principles are not consistently applied across the sex industry and that it is unclear how protocols are actually implemented and monitored. Using the example of Victoria, Quadara highlights that workers are still entering into highly problematic 'contracts' or agreements with management about the extent of their duties, to the point that they have little room to refuse a client.[140] This is occurring despite the fact that, as a legal industry, the sex industry is subject to occupational health and safety requirements. Sullivan reports that owners of licensed brothels in Victoria deny any employer-employee relationship and claim no obligation to implement OHS improvements for their workers' safety and most operators do not have workers' compensation coverage.[141] Quadara also confirms that denial exists among owners and operators that they have any OHS obligations to their staff.[142]

Consumer Affairs Victoria has also confirmed that workers in the licensed environment may still face coercion by employers which has the potential to compromise worker safety and the ability for the worker to regulate their own work.[143] For example, it is reported that some workers in licensed brothels are unable to insist on condom use.[144] In contrast to the claims made by owners and operators that sex workers are independent contractors not employees, it was noted in the 2009 Consumer Affairs Victoria report that '[w]orkers often described work conditions in this research, such as the obligation to work a full shift or to provide certain types of services, which indicate

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139 Quadara, above n 6, 19.
140 Ibid 18–19.
141 Sullivan, above n 63, 272.
142 Quadara, above n 6, 19.
143 Pickering, Maher and Gerard, above n 11, 3.
144 Ibid, citing Pyett and Warr, above n 65.

that these workers are treated as employees and not as independent contractors'.[145]

In New South Wales a needs assessment was conducted to measure the effectiveness of the WorkCover NSW and NSW Department of Health 1997 joint publication *Health and Safety Guidelines for Brothels in NSW*. This needs assessment found that sex industry owners and managers also considered their workers to be 'sub-contractors' rather than 'employees', as the above case in Victoria highlights, despite evidence to the contrary.[146] Additionally, sex workers identified disinterest from managers and owners as the most common obstacle to implementing health and safety in the workplace.[147] Clearly, improved health and safety standards are impossible to achieve under OHS frameworks where implementation and breaches cannot be enforced against operators and managers.

V Evidence of the Failure of OHS in Prostitution

That sex work is unlike any other form of employment is evidenced in the OHS guidelines adopted in jurisdictions where sex work is accepted as a legal industry. One of the personal strategies said to be employed by sex workers to minimise the risk of sexual assault and other assaults from occurring is 'always being aware of potential for violence'.[148] However, no further detail on what to do should that violence occur is provided. Well-kept floors in brothels are also recommended, for example, 'no bits of floorboard sticking up or fraying carpet that could hinder a worker escaping a violent encounter'.[149] Safety tips include 'Wear shoes that you can run in' and 'Avoid scarves, necklaces and bags that can be used to hold or choke you'.[150] That *any* of these risk reduction strategies are considered normal safety procedures for women in sex work exposes how this

145 Pickering, Maher and Gerard, above n 11, 21.
146 Toms, above n 41, 5.
147 Ibid.
148 Quadara, above n 6, 28–9.
149 Ibid 18.
150 Rekart, above n 11, 2127.

work environment is an inherently unsafe and high risk work environment that cannot be compared to other workplaces.[151]

Barnard argues that given the links between gender and power and its manifestation in violence, violence in the context of commercial sexual encounters may well have features in common with other kinds of violence against women.[152] She states that it is worthwhile pointing out that the potential for violence is not unique to the commercial sexual encounter, and in this she is correct. Where the similarity ends is in how the state addresses these forms of violence. Violence against women outside of sex work is identified as such, is not tolerated and is criminally sanctioned.

Domestic violence, sexual assault, sexual harassment and rape are not accepted by society in any public environment, although of course incidents do still occur. And yet, in sex work, despite the known and unacceptable risk of violence, the state fails to focus on its elimination. Instead OHS frameworks are introduced as a means of 'harm minimisation', with the understanding and acceptance that some harm will inevitably occur. This is contrary to other work environments where the starting principle when implementing OHS standards surrounds the elimination of the risk, not the minimisation.

In some cases the inevitability of harm occurring appears to have been ignored entirely, or in the very least inadequately considered. Despite Queensland Prostitution Licensing Authority data that up to 5.0% of sex workers in legal brothels are pressured or coerced by clients to provide 'unwanted sexual intercourse' (or what is better described as rape), that 3.0% of workers reported that they had been raped more than once by a client, and that sex workers are at least 15 times more likely to experience sexual assault in a legal brothel than in any other employment setting, the Queensland Crime and Misconduct Commission found that licensed brothels 'provide a healthy environment in which prostitution takes place' and 'provide a

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151 Sullivan, above n 63, 22.

152 Barnard, above n 97, 684.

safe workplace'.[153] They conclude, 'We are satisfied that the licensed brothel industry continues to provide the safest working environment for sex workers in Queensland'.[154] The 'safest', possibly, when compared with other sectors such as street work. But that the licensed brothel industry should be considered a 'safe workplace' is entirely unwarranted.

Of concern is that the Queensland Prostitution Licensing Authority note:

> The fact that many women viewed a safe work environment, good atmosphere and working conditions as advantages of working in legal brothels further suggests that *some women entered the industry because of the development of legal brothels*. It is relevant that women working in legal brothels continue to work in that sector despite the lower income they receive when compared to other sex workers.[155]

They also note that '[o]ver half the respondents working in legal brothels had started work in that sector, suggesting that *the introduction of legal brothels may have allowed a significant number of women to enter the sex industry*'.[156] What these comments from the PLA fail to recognise is that, as already discussed above, mobility between sectors of the industry is high, and what is more, when forced by financial or other circumstances, sex workers will move from 'safer' sectors to even more high risk workplace environments in other sectors lower down the occupational hierarchy. What these comments also reveal is an assumption at a government agency level that the introduction of OHS frameworks following legalisation has created an opportunity that would otherwise not have existed for women to work 'safely' in the sex industry, and an acceptance that women can be expected to work in conditions currently experienced in legalised brothels, despite the PLA's own data on the occurrence of rape in licensed brothels.

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153 Crime and Misconduct Commission, above n 65, 42.

154 Ibid.

155 Woodward et al, above n 9, 57 (emphasis added).

156 Ibid 56–7 (emphasis added).

The adverse impacts of violence and sexual assault on the physical and mental health of sex workers are serious. Violence results in morbidity, disability, emotional scarring, psychological distress and low self-esteem.[157] Quadara notes that sexual assault impacts on sex workers in the same way it impacts on other victim/survivors, including issues relating to multiple traumatisation, posttraumatic stress and substance abuse.[158] The experience of sexual assault is a source of significant trauma resulting in anxiety, depression, poor physical and reproductive health and an inability to trust or engage with others, as a large body of research has shown.[159] Returning to sex work following sexual assault, not having any 'time out' from the nature of the work, and barriers to disclosure and support are all reported to amplify the impacts of sexual assault.[160]

In a survey of Sydney brothel workers, 10.0% of sex workers were found to be severely distressed and likely to have a serious mental illness, based on psychological testing, a rate twice that of the general population.[161] Likewise, in a cross-jurisdictional study of brothel workers, respondents were asked a series of questions to assess their emotional well-being using the internationally-standardised Kessler 6 scale. Of the 154 respondents, 11.7% scored 13 or higher on the K6

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157 Rekart, above n 11, 2124.

158 Quadara, above n 6, 19–20.

159 Ibid 19.

160 Ibid 20.

161 Donovan et al, above n 8, vi, 26. The authors go on to rationalise the indoor brothel worker results by stating:

> Nevertheless brothel workers appear to be much better off in this respect than street-based sex workers where the majority report serious lifetime traumas, and a large number also report adult sexual assault and work-related violence, as well as drug dependence and depression. In one recent study nearly half had symptoms that met DSM-IV criteria for post-traumatic stress disorder (PTSD) and one third reported current PTSD.

Citing Harcourt et al, above n 109; Roxburgh, Degenhardt and Copeland, above n 109. Is the rate of mental illness among brothel workers, which is twice the rate of the general population, therefore more acceptable or of less concern because street workers experience much higher rates of mental illness?

scale, indicative of 'extreme distress', a rate that was similar between sex workers in Perth, Melbourne and Sydney but considerably higher than the general population (~4%).[162] This rate of extreme distress was consistent between criminalised, legalised and decriminalised legal settings.

Sex work is unlike any other profession and the high risk of sexual assault and rape, even in legal or decriminalised brothels, remains despite efforts to introduce OHS frameworks. Given the serious adverse health outcomes associated with sexual assault in sex work, a greater focus on elimination rather than harm minimisation should certainly be considered by OHS agencies.

VI Conclusion

The core principle of OHS, that all workers have the right not to suffer harm through carrying out the normal requirements of their work, is incapable of being effected in the sex industry under current legislation. In creating a legal sex industry governments are required to introduce OHS frameworks in order to somehow address the health and safety risks involved in prostitution. The authors of this paper argue that current OHS frameworks cannot provide a meaningful reduction in risk to the health and safety of sex workers, and that therefore legislators have a responsibility to reconsider legalising or decriminalising the industry and normalising prostitution as labour, at least until the inherent risks of the industry can be addressed. Recognition of the risks attendant to sex work should be acknowledged and whether persons involved in sex work should be expected to bear these risks in a legalised should be questioned.

It has been argued that under a criminalised system, the state contributes to the murder and harm of sex workers by promoting stigmatisation and exploitation of sex workers while alienating them

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[162] Basil Donovan et al, *The Sex Industry in Western Australia: A Report to the Western Australian Government* (National Centre in HIV Epidemiology and Clinical Research, 2010) 16.

from the security that should be provided by the police.[163] And so, where the state adopts a legalised or decriminalised model of sex work, and introduces OHS frameworks in an attempt to minimise risk to health and safety, the failure of those frameworks and the continuing harms experienced by sex workers should also be seen as the responsibility of the state. In arguing against the labour normalisation of prostitution as sex work, and identifying the failure of these industry specific OHS frameworks, the authors of this paper are not suggesting that persons involved in sex work should be denied the right to a safe and healthy work environment. Rather, the authors suggest that to continue to argue in favour of legalisation or decriminalisation of sex work ignores the violence and risk to the physical and mental health of sex workers that is inherent in prostitution, and fails to acknowledge that the right to a safe and healthy work environment cannot be met by current industry-specific OHS frameworks. As such the authors strongly believe that rather than the focus being on the legalisation or decriminalisation of the industry, attention should be turned to eliminating the inherent risks associated with prostitution and that a new model of legislation must be considered before health and safety standards in the industry will improve.

163 Donovan et al, above n 8, 13.

THE ZERO-RATED TREATMENT OF FOOD: STILL EQUITABLE? WAS IT EVER?

TOMAS FITZGERALD*

Abstract

This paper seeks to address the extent to which, in practice, the zero-rated GST treatment of fresh food meets its stated goal of improving the vertical equity of GST. To that end, it will discuss why GST on non pre-prepared food was zero-rated and examine the extent to which such a rationale is still congruent with contemporary data on consumption. Additionally, it will be suggested that when the standard measurements of a tax system's effectiveness; equity, efficiency and simplicity, are taken to include examination of a tax system's gender equity, the case for excluding food from GST becomes more difficult to mount. Considered from the perspective of gender-equity, the traditional arguments relating to vertical equity are left wanting as the tax break incentivises domestic duties which are disproportionately undertaken by women. It will be argued that the desirability of the zero-rated treatment of some food should be critically re-examined in light of changing patterns of consumption, but also to improve the tax system's gender equity.

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I INTRODUCTION

Throughout the world, countries that have adopted Goods and Services Tax ('GST') or Value Added Tax ('VAT') systems have, as a rule, carved out certain basic goods from attracting these taxes. Basic food items, such as food that is not pre-prepared, is routinely exempted from GST or VAT.[1] Indeed, in the Australian context, the zero-rated[2] treatment of basic food items was crucial to the passage of the GST legislation through the Senate.[3]

This paper seeks to address the extent to which, in practice, the zero-rated treatment of basic food meets its stated goal of improving the GST's vertical equity.[4] To that end, it will examine the existing arguments relating to the vertical equity of GST on food and examine the extent to which they marry with the existing data on consumption. Additionally, it will be suggested that when the standard measurements of a tax's effectiveness: equity, efficiency and simplicity, are taken to include examination of a tax's gender equity, the case for excluding food from GST becomes more difficult to mount. Considered from the perspective of gender-equity, the traditional arguments relating to vertical equity are left wanting. It will be argued that the desirability of a zero-rate GST on food should

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1 Senator Andrew Murray, *Senate Select Committee On A New Tax System Supplementary Report* <http://www.aph.gov.au/senate/committee/gst/report/d03.htm> which notes that at the time of the proposal of the GST bills in Australia some 23 of the then 27 OECD countries either zero-rated or had concessional tax rates on food items. See also Report, *Study on reduced VAT applied to goods and services in the Member States of the European Union Final Report*, 21 June 2007 <http://ec.europa.eu/taxation_customs/resources/documents/taxation/vat/how_vat_works/rates/study_reduced_vat.pdf>.

2 Note, that for the purposes of this paper, the term zero-rated is preferred to the term GST-free. This is to avoid confusion between an item being GST-free and being GST-exempt which is a distinct legal categorisation. Suffice it to say that the terms zero-rated and GST-free are interchangeable.

3 Murray, above n 1.

4 Ibid.

be critically re-examined in light of changing patterns of consumption, but also so as to improve the tax system's gender equity.

II GST AND FOOD — THE CASE FOR A ZERO-RATE

Kenny, in his paper 'The Goods and Services Tax and Food' notes that:

> The issue of exempting food in *A New Tax System (Goods and Services Tax) Act* 1999 [the Act] provoked intense debate within the community, with industry groups, professional bodies, the Business Coalition for Tax Reform and the Commissioner for Taxation calling for food to be taxed, whilst religious groups and welfare bodies argued for its exemption.[5]

An EU report on equivalent VAT systems noted the overwhelming tendency to exempt certain food items from VAT and summarised the case for the zero rated treatment food items as follows:

> Reducing VAT rates on food which constitutes a larger share of consumption for low income households than for high income households implies a cost saving that is particularly beneficial for low income households.[6]

Objections to the zero-rate of GST on basic food items are well known. Opponents point to an increased level of complexity, and therefore compliance costs to businesses, as well as costs in administering the tax. Examples of increased complexity and compliance costs are given by Saul Eslake who cites *Lansell House Pty Ltd v Commissioner of Taxation*,[7] demonstrated the 'need to determine whether, as Justice Richard Edmonds of the Federal Court pointed out earlier this month, Italian mini ciabatta is a "cracker" (and

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5 Paul Kenny, 'The Goods and Services Tax and Food' (2004) 3(6) *Journal of Australian Taxation* 424, see also Michael Carmody, 'Preparing for Tax Reform and the New Millennium: Don't Draw a GST Line around Food' (1999) 2(4) *Tax Specialist* 170.

6 *Study on reduced VAT applied to goods and services in the Member States of the European Union Final Report,* above n 1.

7 [2010] FCA 329.

therefore subject to GST) or "bread" (and therefore exempt from it)'.[8] Additionally, it is argued that zero-rating basic food distorts the market, and can lead to economic inefficiency.[9] Finally, it is contended that since the point of GST systems is to have a broad tax on consumption, exemptions that narrow the tax base are counter-intuitive and conceptually incoherent.[10]

Similarly well-known are the responses to these objections. Among them the position that zero-rating basic food items help to improve the GST's vertical equity, which is particularly important given that a broad GST by nature is a regressive tax regime.[11] Certainly in the Australian context, the argument that the zero-rated treatment of GST on food would improve the tax's vertical equity, as it would provide an effective tax break to lower income earners, was the driving force behind the exclusion of food from GST.[12]

Kenny notes that an Australian Bureau of Statistics survey shows that low income earners spend five times as much of their income on food as people in the highest income quintile, and also that lower income earners spend a greater proportion of their food expenditure on basic food rather than take-away or restaurant food.[13] This conclusion is not sustainable. The difficulty with Kenny's analysis is its expression as a proportion of total income, rather than as a proportion of expenditure. The significant difficulty with the ABS' HES data[14] set Kenny is

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8 Saul Eslake, 'Australia's Tax Reform Challenge' (Australian Parliamentary Library Lecture, Parliamentary Library, Parliament House, Canberra 2011) 4.

9 *Study on reduced VAT applied to goods and services in the Member States of the European Union Final* Report, above n 1.

10 Ibid.

11 Patricia Apps and Ray Rees, 'Raise top tax rates, not the GST' [online] *Australian Tax Forum*, Vol 28, No 3, 2013, 679–93, 680 <http://search.informit.com.au/documentSummary;dn=836410604146509;res=IELBUS>.

12 Murray, above n 1.

13 Kenny, above n 5.

14 See n 21.

using distorts an already lopsided analysis expression. Lopsided because it is well recognised that since higher income people save a greater proportion of their income, they proportionately spend less on food though not in real dollar terms. Additionally, the ABS' HES data misreports a general 'dissaving' among low-income earners, [15] meaning the expenditure on food, as a proportion of income will be artificially high.

It follows that, if expenditure on food is expressed as a proportion of income, rather than as a proportion of expenditure generally, it is inevitable that the distinction between high and low income families will be exacerbated by the known problems with the ABS' HES data; though it should be noted that economists disagree about how best to present the data in a meaningful way.[16] As a consequence of this method of analysing the data, Kenny overstates the problem, particularly when compared to considerations of food expenditure as a proportion of overall expenditure. Making this change has a significant impact on analysis.

Kenny also examines the data disclosed by other economic models, in relation to the expenditure on food. He notes that:

> Analysis using the STINMOD-STATAX model for 1996–97 suggests that the average Australian household spends 18 per cent of its total current expenditure upon food. However, the picture does differ significantly by income level. Thus, households with incomes below $450 a week spend 22.5 per cent of their total current expenditure upon food, while those with incomes above $450 a week spend 17.7 per cent of their total expenditure upon food.[17]

This data forms the basis of the economic argument that the zero-rating of GST on food is required to address issues of vertical equity.

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15 Richard Finlay and Fiona Price, *Household Saving in Australia*, Reserve Bank of Australia Research Discussion Paper, April 2014, 12, <http://www.rba.gov.au/publications/rdp/2014/pdf/rdp2014-03.pdf>.

16 Murray, above n 1.

17 Kenny, above n 5.

However, have these figures stood the test of time since Kenny's analysis in 2000?

III Food, GST and Changing Circumstances

It should be noted that the proportion of household income spent on food and non-alcoholic beverages has been dropping since 1984. In 2003–04 the lowest income quintile households spent, as a proportion of total expenditure on goods and services, 19% (18.3% in 2009–10) on food and non-alcoholic beverages represents. The earlier data from 1988–89 is expressed in income deciles, rather than quintiles, but still follows the downward trend demonstrated above; households in the lowest income decile spent 22.2% of their income on food and non-alcoholic beverage.[18] The expenditure on food for the highest income quintile has decreased only marginally from 17.7% to 16.5% in 2003–04 and to 15.2% in 2009–10. Once again, the earlier data, expressed in income deciles, confirms the trend. The highest income decile in 1988–9 spent 17.1% on food and non-alcoholic beverages. The gap between spending differentials on basic food between the highest and lowest income quintiles has narrowed from 4.8% to 2.5% and sits at 3.1% in 2009–10.[19] Again, this is consistent with the 1988–9 data, which demonstrated a differential between highest income decile and lowest income decile of 5.1%. While average household expenditure on food and non-alcoholic beverages has remained roughly stable, 18% in 1996–7, 17% in 2009–10, the differential in spending between

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[18] Australian Bureau of Statistics, *Household Expenditure Survey, Australia 1988–89*, 2 <http://www.ausstats.abs.gov.au/ausstats/free.nsf/0/A32040DCB5B2C7ECCA2574BF001E6856/$File/65300_1988-89_01.pdf>.

[19] Australian Bureau of Statistics, *Household Expenditure Survey, Australia 2003–04 (Re-issue)* <http://www.ausstats.abs.gov.au/ausstats/subscriber.nsf/0/BCCC8D4C89A64DBDCA25711500713DF1/$File/65300_2003-04%20(reissue).pdf>; Australian Bureau of Statistics, *Household Expenditure Survey, Australia: Detailed Expenditure Items, 2009–10 (Reissue)* <http://www.ausstats.abs.gov.au/ausstats/subscriber.nsf/0/CB07CC895DCE2829CA2579020015D8FD/$File/65300_2009-10.pdf>.

the highest and lowest income quintile has narrowed. This represents higher income households spending a relatively constant proportion of their income and lower income households spending a smaller proportion of income on food than was the case when the GST modelling was done. Effectively the gap between higher income and lower income households with respect to the proportion of expenditure on food has narrowed. This change is not explicable by reference to spending on foodstuffs that attract GST, since spending on 'Meals Out' and 'Packaged pre-prepared meals' remains roughly constant as a proportion of total expenditure:[20]

	1st	2nd	3rd	4th	5th	Average
% of total spend on Goods and Services attributable to 'meals out' and 'pre-packaged pre-prepared meals' 2009–10 by income quintile	4.03	4.64	5.28	5.74	6.03	5.45

The author acknowledges the inherent difficulty in extrapolating from the HES data, noted above.[21] As Harding and Warren point out: 'The HES is not, however, a perfect data source for undertaking tax reform analysis.'[22] Nevertheless, the HES is a useful tool for examining

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20 Australian Bureau of Statistics, *Household Expenditure Survey, Australia: Detailed Expenditure Items, 2009–10 (Reissue)* <http://www.ausstats.abs.gov.au/ausstats/subscriber.nsf/0/CB07CC895DCE2829CA2579020015D8FD/$File/65300_2009-10.pdf>.

21 Above n 13.

22 Ann Harding and Neil Warren, *An Introduction to Microsimulation Models of Tax Reform*, 15 December 1998, National Centre for Social and Economic Modelling, University of Canberra <http://www.aph.gov.au/Parliamentary_Business/Committees/Senate/Former_Committees/gst/report/~/media/wopapub/senate/committee/gst/report/e05_pdf.ashx>. Essentially, the ABS acknowledges that their data set misreports a general dissaving among the community, principally because of the way they define income for the purposes of the survey. This definition excludes, inter alia, non-recurring receipts. Additionally some items

trends across community expenditure and might be expected to demonstrate such trends accurately, even though the figures themselves might not be perfectly representative of community spending.

In any event, the direct consequence of this narrowing is that the case for zero-rating some food to help achieve vertical equity is no longer as relevant as it was in 1998, when the GST was taken to election by the then Howard Government. As noted in the EU report, this means that, in effect, 'subsidies on food, eg, in the form of lower VAT rates, are almost equally beneficial for rich as poor'.[23]

Indeed, the narrowing exacerbates a secondary difficulty with the real effects of the zero-rate GST on food; that since wealthy households spend more in real dollar terms on food, they receive the greater aggregate benefit, compared with households in the lowest income quintile, from the zero-rating. Responding to arguments that this reality undercuts the equity concerns, Sen Andrew Bartlett contended that:

> Some witnesses have argued that, while in percentage terms a food exemption would benefit low income earners, in actual dollar terms high income earners would gain the greater benefit because of their greater level of aggregate spending. However, tax policy, in looking at equity effects, has always worked in percentage terms rather than nominal terms.[24]

While technically correct, this position elevates consideration of tax theory above real practice, particularly since the gap between the lowest and highest income quintile's expenditure on food has

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classified as expenditure under the HES data might be better understood as savings — like payments into superannuation. Finally, the HES data generally under-reports the income of self-employed persons, particularly as compared to other national accounts data.

23 Report, *Study on reduced VAT applied to goods and services in the Member States of the European Union Final Report*, 21 June 2007 <http://ec.europa.eu/taxation_customs/resources/documents/taxation/vat/how_vat_works/rates/study_reduced_vat.pdf> 31.

24 Murray, above n 1.

narrowed in the intervening years. Further, it is arguable that in the 16 years since the introduction of the GST, Australian households have become more likely to purchase luxury food items for preparation at home; something of a 'Masterchef' effect, whereby the 1990s craze of DIY home construction projects has given way to a new generation of domestic would-be restaurateurs. This trend has been noted by the South Australian Government, in their report 'Food Consumption and Consumers; Who, What, Where and Why?' which finds:

> The direct flow through to featured products [on MasterChef] has been dramatic. The major sponsor of the show reported that in the week following products being featured on the show, sales of pink ling fish rose over 1400%, while red cabbage and pistachio nuts approximately doubled. Other supermarkets and specialist retailers also saw the direct influence, with featured cuts of meat and other products in strong demand following particular programs.[25]

Since the zero-rate of GST is attracted by all 'basic' or non pre-prepared foods, we are now left in the rather perverse position that the purchase of raw *foie gras* to be prepared for a luxury dinner party now attracts a concessional zero-rate of GST, with the overarching rationale being a need for vertical equity. In relation to luxury food items, this rationale seems wholly unsustainable.

As noted above, expenditure on packed and pre-prepared food, as a proportion of total household expenditure on food and non-alcoholic beverages, is relatively stable across all income quintiles.[26] This means that as a proportion of total income, households in lower income quintiles will spend more on packaged and pre-prepared

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25 South Australian Food Centre, *Food Consumption and Consumers; Who, What, Where and Why?*, September 2010 <http://www.pir.sa.gov.au/__data/assets/pdf_file/0005/165974/safood_consumers_report.pdf>.

26 Above n 16; cf Australian Bureau of Statistics, *Household Expenditure Survey, Australia: Detailed Expenditure Items, 2003–04 (Reissue)* <http://www.abs.gov.au/AUSSTATS/subscriber.nsf/log?openagent&6535055001_2003_04%20r%20feb06.xls&6535.0.55.001&Data%20Cubes&0B6D19EF51D50EABCA2571150076FCFA&0&2003-04%20(Reissue)&15.02.2006&Latest>.

foods than those in higher. Essentially, the portion of the family food budget which comprises pre-prepared food is subject to all the standard objections on the ground of vertical equity concerns, even though the reality of consumer behaviour is that those in the lowest income quintile spend more of their food budget, as a proportion of total income, on pre-prepared food. There appears to be no cogent rationale for such a distinction, other than that the 'line in the sand' had to be drawn somewhere.

Nevertheless this conceptual 'line in the sand' is drawn at pre-prepared food, and the distinction is problematic beyond simple economic analysis of which income groups spend what amount on pre-prepared food. Intended or not, this distinction necessarily implies a normative judgment; that is, those who prepare their own food deserve tax relief, while those who buy pre-prepared food do not.

Kenny deals with this objection by noting that:

> Under a GST that exempts basic food consumers can choose between 'basic food' and other taxable (ie, takeaway and restaurant) food, and thus will substitute one course of action for another. In this way it is argued that demand and market prices will be unjustifiably distorted resulting in a loss of economic efficiency. However the link between taxing or not taxing food to economic growth appears to be somewhat remote.[27]

Insofar as the objection relates to the narrow economic one, that distortions in the market will lead to less than optimal economic growth, Kenny's response to the criticism must stand against the position initially taken by the Treasury, in relation to the zero-rating of GST on food. The Senate Select Committee on the new tax system noted that Treasuries advice was:

> In the absence of other changes, the exclusion of food, clothing and shelter from a GST would result in less taxation revenue and higher disposable income across the community than would be the case if these goods were taxed. However, this would mean that the package was unsustainable as a whole, with likely highly

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27 Above n 5.

> adverse economic effects on the fiscal balance, monetary policy settings, growth and employment.[28]

The cost of a zero-rating on food, in terms of foregone revenue, is considerable. In their submissions to the Senate Select Committee, the National Institute of Accountants noted that the zero-rating 'will cost Government revenue an estimated $5 billion whereas direct compensation will cost the revenue an estimated $650 million'.[29] If the 'cost' of administering what amounts to a tax-break to lower income earners via the GST rather than a direct compensation model is some $4.35 billion in government revenue, we might reasonably query whether any analysis that such an exclusion has a 'remote' impact on economic growth is sustainable. This considerable foregone revenue cost is also at the heart of recommendations in relation to lower rate VAT in the European Union, whereby it was noted that, 'it is highly recommendable to investigate alternative policy tools for income distribution before turning to the VAT system'.[30]

Moreover, focus on the monetary issue rather than the equity one is inconsistent with the positions taken by proponents of a zero-rate GST on food. That is, since people who hold that food should attract a zero-rate of GST broadly accept that their argument is only sustainable to the extent that one considers that the equity concerns outweigh the concerns of simplicity and efficiency, it follows that any substantive defence of the zero-rate must have equitable considerations at its forefront. The problem with drawing the 'line in the sand' at pre-prepared food is that it either privileges those taxpayers who have the time and capacity to routinely prepare food, or encourages taxpayers to forgo other activities in favour of

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28 Report, *Senate Select Committee On A New Tax System Main Report* <http://www.aph.gov.au/senate/committee/gst/main/report.zip> para 5.7.

29 Ibid para 5.19.

30 Report, *Study on reduced VAT applied to goods and services in the Member States of the European Union Final Report*, 21 June 2007, <http://ec.europa.eu/taxation_customs/resources/documents/taxation/vat/how_vat_works/rates/study_reduced_vat.pdf>.

preparing food. For taxpayers who lack the capacity to prepare food, the elderly or infirm, this seems obviously inequitable. Likewise, given that the distinction is a blunt instrument, it leads to situations which may enhance vertical inequity; a high income earner purchasing luxury food items to prepare for a dinner party will not attract GST, but a time-pressured, low-income single-parent who gives their children money to buy lunch at the tuck-shop will. As we will see, when this issue is considered through the lens of gender equity, the objection becomes even starker.

IV GST, FOOD AND GENDER

Cass and Brennan point out that, overwhelmingly, issues of gender equity are absent from discussions of tax policy. Notwithstanding this absence, it is their position that such issues ought to be part of the framework of analysis for tax systems and potential tax reform. They opine that:

> While in both parts of the tax/transfer equation men and women appear to be treated equally, as individual tax-paying and benefit-receiving citizens in a liberal democracy, in fact, the Australian tax, social security and family payment systems are not 'sex-blind functions of citizenship' but are highly gendered.[31]

While tax laws ostensibly treat men and women equally, 'because the vast majority of people taking principal care of children are women, there is in effect, if not in legislation, a profound gender impact of the tax/family transfer payments system'.[32] That is, de jure equality often belies de facto discrimination.

Cass and Brennan are particularly concerned with gender equity, that is:

> the extent to which tax/transfer arrangements redistribute income to the principal carers of children, in recognition of the additional costs of child rearing which they bear, in terms of both direct

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31 Ibid 37.

32 Bettina Cass and Deborah Brennan, 'Taxing Women: the politics of gender in the tax/transfer system' (2003) 1(1) *eJournal of Tax Research* 31.

> costs and the indirect costs of their foregone workforce earnings — in Australia and all similar countries, a responsibility which is borne predominantly by women as mothers.[33]

While this is an excellent starting point for analysis, the author considers that examinations of gender equity might reasonably be construed more widely. Cass and Brennan contend that despite equal treatment at law, women nevertheless find tax and transfer systems operate inequitably by virtue of the fact that women are more likely to be engaged in 'non-market' work, such as child care. The extent to which tax and transfer systems are designed to influence taxpayer behaviour might similarly suffer from inequitable treatment of men and women to the extent that its policies impact more heavily on one gender.

In relation to the zero-rate of GST on food, the behaviour being influenced is the choice between 'basic' food, and pre-prepared food. The *Study on reduced VAT applied to goods and services in the Member States of the European Union Final Report* notes in broad terms that:

> some economic activities are by definition not taxable, for example do-it-yourself work (DIY-work) in private homes. By taxing what is taxable, for example labour income and consumption, it becomes more attractive for consumers to carry out DIY rather than buy the equivalent service on the market. We introduce a distortion that may lead skilled and highly productive persons to carry out DIY even though they are not very good at it. They choose to spend some hours on low productive DIY rather than on high productive activities in their job. Some of it may clearly be motivated by personal preferences, but some may be caused by taxation.[34]

In relation to the market-distortion argument, it must be noted that Kenny's objection, 'the link between taxing or not taxing food to economic growth appears to be somewhat remote' stands in the Australian context.[35] However, it is the author's position that the extant analysis ignores the equally pertinent issues of gender-equity

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33 Ibid 38.

34 Report, above n 30.

35 Kenny, above n 5.

in favour of addressing only the issue of efficiency. That is, to the extent that the report is correct in identifying taxation as a cause of consumers engaging in DIY, as opposed to seeking out services in the market, it must be acknowledged, at a policy level, that this is going to have a more substantial impact on women's participation in the market than men's.

Baxter notes, in 1997, data indicated that women spent 10 hours per week preparing and cleaning up after meals, as compared to an average of 5 hours a week for men.[36] Baxter also notes that there is an increase in proportion of labour carried by men, as compared to data from 1986, but also that there is evidence of a decline in average hours spent by men on this task. This apparently contradictory finding is explained by reference to, '[t]he trend toward greater consumption of pre-cooked, pre-prepared foods and take away foods …'.[37] These changing patterns of consumption have led, in Baxter's view, to both men's increased proportionate share of this activity (that is, by buying pre-prepared foods), and also the decline in time spent performing it. It follows to the extent that such activities are economically disincentivised, in favour of preparing meals from basic food, we can expect both an increase in time spent preparing and cleaning up after meals, and also an increase in women's proportion of time spent performing this task as compared to men's.

Further it is well documented that women face more barriers to workforce participation than men; foremost amongst these is issues of pay inequality.[38] To the extent that there is a stated policy goal of increasing women's participation in the workforce, it seems that any analysis of taxation that broadly focuses on equity ought to seriously consider gender equity alongside vertical and horizontal equity in

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36 Janeen Baxter, 'Patterns of change and stability in the gender division of household labour in Australia, 1986–1997' (2002) 38(4) *Journal of Sociology* 339, 413.

37 Ibid 414.

38 Judith Sloan, 'Mind the Pay Gap', *The Australian Newspaper* (online), 17 June 2010 <http://www.theaustralian.com.au/news/opinion/mind-the-pay-gap/story-e6frg6zo-1225880608515>.

order to give a full picture of the effect of the tax. This is particularly the case where the tax measure, in this case, the zero-rated treatment of GST on food, is substantially defended on the grounds of 'equity'. In order to get a full picture of the impact of the policy, gender equity must be considered seriously. In this case, to the extent that it incentivises further domestic work which will be borne substantially, and in increasing proportion by women, one must query whether the policy rationale can be sustained on 'equity' grounds.

It is regrettable, though not surprising, that more recent and detailed data surrounding women's increased burden of domestic work in Australia is not available. Such research would greatly assist those formulating policy in the area of taxation and women's issues in economics more generally.

V WHY DOES THE ZERO-RATE PERSIST?

Many commentators have suggested that the better mechanism for dealing with the vertical inequity inherent in the regressive nature of the GST is a model of direct-compensation. That is, rather than attempting to administer the GST in a way that decreases its regressive effect, it would be cheaper and simpler to instead recognise the regressive effect and compensate affected lower-income earners appropriately. Benge, among others, notes that offering tax credits, in lieu of a zero-rate GST on food, would substantially improve both the tax base and make the effect of the GST less regressive.[39]

This — and similar — suggestions were mooted during Government debates about the introduction of the GST and the implementation of the new tax system.[40] However, principally the Australian Democrats, on whose support the passage of the legislation depended, on the grounds that any compensatory package was apt to be removed by government at a later date, rejected them. Senator Bartlett contended,

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39 Matt Benge, 'How to Tax Food and Make the Tax System More Progressive at the Same Time' (1999) 6(1) *Agenda* 91.

40 Murray, above n 1.

however, that government's natural aversion to increasing 'taxes' would make it difficult for future governments to increase the rate of GST on food.[41] It seems that the latter part of Senator Bartlett's rationale for objecting to a direct-compensation model has proved opposite; when the then Government commissioned the Henry Review of Australia's tax system the terms of reference specifically prohibited investigation of raising the rate of GST. Indeed, commentator George Megalogenis has noted that, 'only a brave government would want to add food to the GST base'.[42]

Given, however, the increasing irrelevance of the vertical-equity objection to applying a 10% rate of GST to basic food, and the added gender equity concerns inherent in the exclusion of basic food from GST, perhaps such bravery is precisely what is needed.

VI FEDERAL BUDGET 2014 — CRAZY OR CRAZY-BRAVE?

The Abbott Government's first budget makes no mention or suggestion of raising the rate of GST or broadening its base. Nevertheless, many commentators have suggested that one of the key, though unspoken, intended outcomes of this budget was to push the States and Territories into a position where they would have to insist upon some increase to the GST to meet ongoing costs relating to health and education.[43] The political implications of the GST make

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41 Ibid.

42 George Megaolgenis, 'The tax devil is on the indirect side', *The Australian Newspaper*, 11 May 2011 <http://www.theaustralian.com.au/national-affairs/budgets/the-tax-devil-is-on-the-indirect-side/story-fn8gf1nz-1226053585425>.

43 Jessica Wright, 'Joe Hockey "daring" states to ask for a rise in the GST', *Sydney Morning Herald* (online) 14 May 2014 <http://www.smh.com.au/business/federal-budget/joe-hockey-daring-states-to-ask-for-a-rise-in-the-gst-says-labor-20140514-zrbwl.html>, see also Emma Griffiths, 'Budget 2014: States accuse Federal Government of forcing them to push for GST hike', *ABC News,* 15 May 2014 <http://www.abc.net.au/news/2014-05-14/budget-2014-states-react-to-health-and-education-cuts/5452234>.

overt suggestions about reform difficult, and it is therefore unsurprising that the Federal Government could be taking an indirect approach to suggesting that the GST be changed. This is a regrettable position as the political 'hospital pass',[44] as it has been described, proceeds on the basis that amendments to the GST are like Lord Voldemort's name, not to be spoken aloud.[45] The kind of serious, detailed and rigorous policy analysis and defence that accompanied the introduction of the GST under the Howard Government is sadly lacking in contemporary political debate precisely because of the bogey-man status changes to GST has earned in Australian political culture. It seems unlikely that such a robust debate can be had when the current Government feigns disinterest and agnosticism on the question GST reform.[46]

VII CONCLUSION

This paper has considered the case for a zero-rate of GST on basic food, and contended that the principal policy rationale for the exclusion of basic food — that is, concerns about vertical equity — are no longer as forceful as they were at the time of the passage of the GST legislation. The changing spending patterns of Australian consumers mean that there is a smaller distinction between the lowest and highest income earners when it comes to proportionate expenditure on food. As such, the zero-rate of GST has become, in

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44 Andrew Probyn et al, 'Hospital pass: No escaping GP tax', *The West Australian* (online) 12 May 2014 <https://au.news.yahoo.com/thewest/a/23429821/hospital-pass-no-escaping-gp-tax/>. NB. A 'hospital pass' is a term used by various football codes to describe off-loading the ball to a fellow player in such a way that inevitably subjects them to heavy physical contact.

45 See, JK Rowling's infamous character in the Harry Potter series. Note also that this analogy has also be used by Saul Eslake, see above n 7.

46 Emma Griffiths, 'Tony Abbott brushes aside call from Coalition backbencher for broadening of GST base to fresh food', ABC News, 20 May 2014 <http://www.abc.net.au/news/2014-05-20/abbott-brushes-aside-calls-for-broadening-of-gst-base/5464264>.

effect, as much of a boom for high-income earners, as it is a concession to low-income earners.

Additionally, this paper has contended that if issues of 'equity' in taxation are expanded to include consideration of gender equity, there are good reasons for not making a differentiation between 'basic' food and pre-prepared food. To the extent that any such differentiation encourages consumers to spend more time preparing food, the economic cost of that preparation will be born substantially, and in increasing proportion by women.

The time has come for a truly brave government to squarely address whether the rationale for the zero-rate GST on food is still sustainable and seriously consider replacing the compensation it offers with direct compensation to low-income earners.

VICTORY FOR THE COMMISSIONER OF TAXATION: PROMOTER PENALTIES UPDATE

RACHEL TOOMA*

Abstract

The purpose of this paper is to examine the contribution made by the recent decision of the Full Federal Court in Commissioner of Taxation v Ludekens [1] ('Ludekens') and the Federal Court in Commissioner of Taxation v Barossa Vines Ltd[2] ('Barossa Vines') to the interpretation of divs 290 and 284 of sch 1 to the Taxation Administration Act 1953 (Cth) ('TAA 1953') (the promoter penalty provisions). Ludekens was the first time a court has applied the civil penalties for the promotion of a tax exploitation scheme under s 290-50(1) of sch 1 to the TAA 1953. In Barossa Vines, the court found a contravention of s 290-50(2) of sch 1 to the TAA 1953 due to schemes being implemented in a way that was materially different from the description in the relevant product rulings.

The paper comprises five parts. Part Two provides some background to the enactment of the promoter penalties, and describes the operation of the provisions. Part Three examines the decision of the Federal Court of Australia[3] and Full Court[4] of the Federal Court in Ludekens, together with the High Court[5] of Australia's refusal of

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1 (2013) 214 FCR 149 ('*Ludekens*').

2 [2014] FCA 20 *('Barossa Vines').*

3 [2013] FCA 142.

4 (2013) 214 FCR 149.

5 [2014] HCATrans 86.

special leave. Part Four examines the Federal Court decision in Barossa Vines.[6] *Finally, Part Five provides some conclusions on the recent interpretations of the promoter penalty provisions.*

I TAX PROMOTER PENALTIES

A *Brief Background and History of the Provisions*

The tax promoter penalties were inserted [7] into the *Taxation Administration Act 1953* (Cth) (*TAA* 1953) in 2006.[8] The rationale for the introduction of the provisions was that the supply of tax schemes was a driver of tax avoidance and tax evasion.[9] Studies recommended that some responsibility for tax exploitation schemes be placed on the promoters of those schemes.[10]

In 2002, a Senate Report recommended that the Australian Taxation Office ('ATO') be provided with powers to allow it to apply to the courts for injunctive relief to prevent the sale of mass marketed schemes.[11] In 2003, the Federal Treasury first announced its intention to introduce measures to deter the promotion of tax exploitation schemes.[12] The Explanatory Memorandum to the legislation, which

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6 [2014] FCA 20.

7 Div 290 of sch 1 of the *TAA* 1953 was inserted by the *Tax Laws Amendment (2006 Measures No 1) Act 2006* (Cth).

8 See Robert Richards, 'Can solicitors be tax promoters?' (2013) 51(10) *Law Society Journal* 40: At the time the promoter penalty provisions were inserted, primary production schemes were at their heyday.

9 John Braithwaite, *Markets in Vice Markets in Virtue* (2005, Oxford University Press, Oxford, UK).

10 Kristina Murphy, 'An Examination of Taxpayers' Attitudes towards the Australian Tax System: Findings from a Survey of Tax Scheme Avoiders' (2003) 18(2) *Australian Tax Forum* 209.

11 Senate Economics Reference Committee, Parliament of Australia *Inquiry into Mass Marketed Tax Effective Schemes and Investor Protection* (February 2002) recommendation 1.30.

12 Promoter penalties were introduced in New Zealand in 2001, in ss 141EB and 141EC of the New Zealand *Tax Administration Act*

inserted the promoter penalty provisions into the *TAA* 1953,[13] stated the aim of the promoter penalty regime was to impose a direct financial risk upon promoters, in addition to providing injunctive measures enabling the ATO to stop the promotion of a scheme.[14] Prior to the introduction of the promoter penalties, it was only possible to deter promoters through relatively limited means[15] of: criminal prosecutions;[16] consumer protection legislation;[17] civil suits brought by the taxpayer against the promoter;[18] legislation applying to tax agents;[19] and professional standards.[20]

1994. The provisions are explained by the Internal Revenue Department in: Standard Practice Statement SPS INV-290.

13 Explanatory Memorandum to the *Tax Laws Amendment (2006 Measures No 1) Act 2006* (Cth).

14 Ibid [3.136].

15 Rachel Tooma, 'New Tax Laws to Deter Promoters of Tax Exploitation Schemes' (2006) 2(1) *Journal of the Australian Tax Teachers Association* 158.

16 Promoters of tax exploitation schemes may be guilty of an offence of aiding and abetting under the *Crimes (Taxation Offences) Act 1980* (Cth) s 6. The criminal burden of proof must be satisfied.

17 If a promoter misleads a taxpayer into believing that a scheme is compliant with the taxation legislation when it is not, then there may be a breach of s 18 of the *Australian Consumer Law* in sch 2 to the *Competition and Consumer Act 2010* (Cth) (previously *Trade Practices Act 1974* (Cth) s 52). See Vincent Morfuni, 'The Civil Liability of Tax Advisers' (2005) 34 *Australian Tax Review* 131, 141.

18 See ibid 141: Clients of promoters may bring an action against the promoter in either tort or contract.

19 At the time of the introduction of the promoter penalties, s 251M of the *ITAA* 1936 (now repealed) made a registered tax agent liable to pay to the taxpayer any penalty that the taxpayer is liable for on account of the registered tax agent's negligence. Section 251M of the *ITAA* 1936 was repealed from 1 March 2010 with the introduction of the *Tax Agent Services Act 2009* (Cth). The Explanatory Memorandum to the *Tax Agent Services Bill 2008* (Cth) notes that the new regime for Tax Agents, with its Code of Conduct, 'addresses the concerns that gave rise to the old provisions in a more direct way' (para 3.12 of the Explanatory Memorandum).

B *The Promoter Penalty Provisions*

The promoter penalties are contained in divs 290 and 284 of sch 1 to the *TAA* 1953.[21] Division 290 is divided into four parts. Subdivision 290-A provides the objects of the Division. Subdivision 290-B prescribes the civil penalties, which were recently considered in *Ludekens*[22] and *Barossa Vines*.[23] Subdivision 290-C provides for the Commissioner of Taxation to apply to the Federal Court of Australia for injunctions to support the aims of the promoter penalties. Subdivision 290-D allows the Commissioner of Taxation to accept voluntary undertakings given by an entity for the purposes of furthering the aims of the promoter penalties.

1 *Subdivision 290-A: Objects*

Subdivision 290-A provides that the objectives of the Division are:[24]

(a) to deter the promotion of tax avoidance schemes and tax evasion schemes; and
(b) to deter the implementation of schemes that have been promoted on the basis of conformity with a product ruling in a way that is materially different from that described in the product ruling.

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20 The Explanatory Memorandum to the *Tax Agent Services Bill 2008* (Cth) notes at para 3.4: 'Currently, some — but not all — tax agents have to comply with a code of conduct through their membership of a professional association. Each association has a separate code and not all tax agents are members of a professional association.' (The Explanatory Memorandum states that the aim of the code introduced is to remedy this situation by setting out the conduct expected of tax agents and BAS agents).

21 Division 284 provides definitions for where a matter is 'reasonably arguable' (284-15) and 'scheme benefits' (284-150).

22 *Ludekens* (2013) 214 FCR 149.

23 *Barossa Vines* [2014] FCA 20.

24 *Taxation Administration Act 1953* (Cth) s 290-5(a) and (b).

2 *Subdivision 290-B: Civil Penalties*

The prohibited behaviour is prescribed as follows in s 290-50:

> (1) an entity must not engage in conduct that results in that or another entity being a promoter of a tax exploitation scheme.
>
> (2) an entity must not engage in conduct that results in a scheme that has been promoted on the basis of conformity with a product ruling being implemented in a way that is materially different from that described in the product ruling.

If, on application by the Commissioner of Taxation, the Federal Court of Australia is satisfied that an entity contravened s 290-50(1) or s 290-50(2), then the court may order the entity to pay a civil penalty to the Commonwealth.[25] The amount of the penalty is prescribed in s 290-50(4) as the greater of:

> (1) 5,000 penalty units (for an individual) or 25,000 penalty units (for a body corporate); and
> (2) twice the consideration received or receivable … by the entity … in respect of the scheme.

Section 290-50(5) prescribes the principles to which the Federal Court may regard in deciding what penalty is appropriate. These include the amount of the consideration received or receivable in respect of the scheme.[26] Section 290-55 provides exceptions.[27]

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25 Ibid s 290-50(3).

26 It also includes factors such as: the deterrent effect that the penalty may have; the amount of loss or damage incurred by scheme participants; the nature and extent of the contravention; the circumstances in which the contravention took place; the period over which the conduct extended; whether the entity took any steps to avoid the contravention; whether the entity has previously engaged in similar conduct; and the degree of cooperation with the Commissioner.

27 Exceptions include: (1) where the entity satisfies the court that it made a reasonable mistake or took reasonable precautions when acting; (2) where the entity acted in reliance on advice from the Commissioner; (3) where 4 years or more have elapsed since the act occurred.

Section 290-60 provides the meaning of 'promoter' of a tax exploitation scheme. Merely providing advice [28] about a scheme should not make an entity a promoter (s 290-60(2)).[29] Rather, an entity is a promoter if:

- the entity markets the scheme or otherwise encourages the growth of the scheme or interest in it;[30] and
- the entity (or an associate of the entity) receives consideration in respect of that marketing or encouragement (directly or indirectly);[31] and
- having regard to all the relevant matters, it is reasonable to conclude that the entity has had a substantial role in respect of that marketing or encouragement.[32]

Section 290-65 provides the meaning of 'tax exploitation scheme'. There are two alternative definitions of tax exploitation schemes, depending on whether or not the scheme has yet been implemented.[33] Where a scheme has been implemented, it is a 'tax exploitation scheme' if:

- it is reasonable to conclude that an entity that entered into or carried out the scheme did so with the sole or dominant purpose of that entity or another entity getting a scheme

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28 The ATO have examined the 'advice exclusion' in PS LA 2008/7 [140-168], with examples.

29 An employee exception is also provided in s 290-50(3). This provision is discussed in PS LA 2008/7, [169-170].

30 *Taxation Administration Act 1953* (Cth) s 290-60(1)(a).

31 Ibid s 290-60(1)(b).

32 Ibid s 290-60(1)(c). The 'marketing or encouragement' element is discussed, using an example, in [125]–[130] of PS LA 2008/7. The ATO considers (at [125] of PSLA 2008/7): 'The inclusion of the broader phrase *otherwise encourages the growth of, or interest in, the scheme* clarifies that the promoter penalty laws are not restricted to marketing in a commonly understood sense'.

33 The requirements for both scenarios are the same — just one is written as if the scheme was implemented and the other is written in the future tense.

benefit[34] from the scheme; and

- it is not reasonably arguable[35] that the scheme benefit is available at law.

In deciding whether it is reasonably arguable that a scheme benefit would be available at law, it is necessary to consider everything the Commissioner of Taxation can do under a taxation law.[36] The legislation provides the example that the Commissioner of Taxation may cancel a tax benefit obtained by a taxpayer in connection with a scheme under s 177F of the *Income Tax Assessment Act 1936* (Cth) ('*ITAA* 1936').

The Explanatory Memorandum[37] to the Bill, which introduced the promoter penalties in 2006, noted in relation to the definition of tax exploitation scheme:

> The terms and concepts used to define a tax exploitation scheme in this Bill are taken from the anti-avoidance provisions in the *ITAA* 1936, the *ITAA* 1997 and the *TAA* 1953. These terms are well established in case law and administrative practice.

At the time of the introduction of the promoter penalties, commentators suggested that it may have been preferable for the definition of tax exploitation scheme to have followed the definition of 'scheme' in pt IVA of the *ITAA* 1936, and included a list of factors indicative of the purpose of the scheme.[38]

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34 'Scheme benefit' is defined in s 284-150 of the *TAA* 1953. Broadly, an entity gets a scheme benefit from a scheme if its tax liability for an accounting period is less than it would be apart from the scheme, or, the Commissioner must pay a credit to the entity for an accounting period that is more than it would be apart from the scheme.

35 'Reasonably arguable' is defined in s 284-15 of the *TAA* 1953. Broadly it means about as likely to be correct as incorrect, or more likely to be correct than incorrect, having regard to relevant authorities.

36 *Taxation Administration Act 1953* (Cth) s 290-65(2).

37 Explanatory Memorandum to the *Tax Laws Amendment (2006 Measures No 1) Act 2006* (Cth), [3.52].

38 As in s 177D of the *ITAA* 1936, see David Williams, 'Promoter Penalties' (paper presented at the Tax Institute of Australia, 21 March

On their introduction, there was also concern that the promoter penalty provisions would be used 'in terrorem'.[39] That is, that there was the potential for a conflict of interest between the taxpayer and their advisor if the ATO were to tell an advisor to accept their client breached pt IVA of the *ITAA* 1936, or the promoter penalties would be applied.[40] At the time of the introduction of the promoter penalties, the Commissioner of Taxation noted that the ATO was committed to ensuring that the promoter penalties would not apply in an unintended way. It was noted that the ATO agreed to co-design important aspects of the administration of the promoter penalties, including the types of cases that should come under ATO focus, to ensure that the promoter penalties are applied fairly.[41] The ATO website contains a 'Promoter Penalties Charter'.[42] The stated reason for the Charter is as follows:

> Tax professionals have requested that the ATO develop controls to ensure the [promoter penalties] laws are applied in a fair and reasonable manner. The Commissioner has since committed to a co-design process with tax professionals for the administration and governance arrangements within the ATO.

The Charter provides for the National Tax Liaison Group Promoter Penalty Co-design sub-committee to co-design ATO administrative and governance arrangements for the promoter penalties. Such an approach appears to be consistent with the idea of the promoter penalties as operating to ensure symmetry between the penalties faced

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2006). Note that s 177D was recently replaced with amendments contained in the *Tax Laws Amendment (Countering Tax Avoidance and Multinational Profit Shifting) Act 2013* (Cth).

39 Gordon Cooper, 'Promoter Penalties' (2006) 4(2) *eJournal of Tax Research* 117.

40 Ibid.

41 Ibid. See, eg, Richards, above n 8. This is similarly important in relation to the promoter penalties being applied to promoters rather than advisers. Much has been written on the potential for the promoter penalties to apply to advisers.

42 <https://www.ato.gov.au/Tax-professionals/Consultation--Tax-practitioners/In-detail/Technical-and-special-purpose-working-groups/Promoter-Penalty-Working-Group/About/Promoter-Penalties-Charter/>.

by taxpayers and promoters. The ATO's Practice Statement PS LA 2005/24 'Application of General Anti-Avoidance Rules (GAARs)'[43] provides that the Commissioner of Taxation has established a GAAR Panel to advise on the application of GAARs (including pt IVA of the *ITAA* 1936) to particular arrangements. The stated purpose of the Panel is to ensure that GAARs are applied objectively, and consistently. Practice Statements PSLA 2008/7[44] and 2008/8[45] discuss a Promoter Penalty Review Panel. Tim Dyce, Deputy Commissioner of Taxation, recently discussed the Promoter Penalty Review Panel.[46] The Panel comprises senior tax officers and professional persons external to the ATO. It provides advice on the strengths and weaknesses of a case and the appropriateness of remedies.

3 *Subdivision 290-C: Injunctions*

Where an entity has engaged in conduct, or is proposing to engage in conduct, to which the subdivision applies, the Commissioner of Taxation can apply to the Federal Court of Australia for an injunction restraining the entity from engaging in the conduct, and where appropriate, requiring the entity to do something.[47] Injunctions may be used in conjunction with civil penalties.[48]

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43 The Practice Statement is currently under review.

44 Application of the promoter penalty laws (div 290 of sch 1 to the *TAA 1953*) to promotion of tax exploitation schemes.

45 Application of the promoter penalty laws (div 290 of sch 1 to the *TAA* 1953) to schemes involving product rulings.

46 Tim Dyce, 'Administration of the Promoter Penalties Regime and recent Court decisions', NSW 7th Annual Tax Forum, Thursday 22 May 2014, Dalton House Sydney.

47 Section 290-125 of sch 1 to the *TAA* 1953. Note that under s 290-130, the court may grant an interim injunction. However, where an entity has applied to the Commissioner in writing for a product ruling in relation to a scheme, and the Commissioner has not advised on the outcome of the application for the product ruling, then, the Commissioner cannot seek an injunction under s 290-125.

48 Explanatory Memorandum to the *Tax Laws Amendment (2006 Measures No 1) Act 2006*, [3.79]. The Explanatory Memorandum

4 *Subdivision 290-D: Enforceable Voluntary Undertakings*

Subdivision 290-D provides that the Commissioner of Taxation may accept a written undertaking given by an entity in connection with furthering the objectives of the Division.[49]

Under subdiv 290-200:

- the entity may withdraw or vary the undertaking, but only with the consent of the Commissioner of Taxation; and
- if the Commissioner of Taxation considers that the entity who gave the undertaking has breached any of its terms, the Commissioner of Taxation may apply to the Federal Court for an order:
  - directing the entity to comply with that term of the undertaking; and/or
  - any other order that the Court considers appropriate.

The ATO provides, on its website, a template for enforceable voluntary undertakings,[50] and examples of the types of voluntary undertakings that it will accept.[51] Examples of terms accepted by the Commissioner of Taxation in enforceable voluntary undertakings include:

- the entity will not promote the arrangement;
- the entity will make reasonable endeavours to retract

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described the statutory injunctions as having a 'real time' impact, stopping the promotion of schemes before investors participate.

49 The ATO's template for enforceable voluntary undertakings notes that acceptance by the Commissioner of an enforceable voluntary undertaking offer does not mean that the Commissioner cannot make an application to the Federal Court for a civil penalty and/or an injunction against the entity responsible for the prohibited conduct.

50 <https://www.ato.gov.au/General/Tax-planning/In-detail/Promoter-penalties/Voluntary-undertakings/>.

51 <https://www.ato.gov.au/Tax-professionals/Compliance-for-tax-professionals/In-detail/Promoter-penalty-laws/Good-governance-and-promoter-penalty-laws/?page=17>.

publicly available information that would encourage another entity to participate in the arrangement; and

- the entity will implement internal governance arrangements to minimise future potential exposure to the promoter penalty laws.

The ATO discusses in the explanatory notes to the enforceable voluntary undertaking template that, except if breached, the content of an enforceable voluntary undertaking will be kept confidential. The ATO's template undertaking allows for the inclusion of a disclaimer, so that the entity giving the undertaking need not admit that they have engaged in conduct that is in breach of div 290 of the *TAA* 1953. However, in practice, the undertaking is unlikely to be accepted by the Commissioner of Taxation, unless it contains 'meaningful undertakings relating to the cessation of marketing or encouragement of the growth of a scheme or schemes and to actions designed to prevent future involvement in tax exploitation schemes'.[52]

The ATO discusses, in the explanatory notes to the enforceable voluntary undertaking, that the Commissioner of Taxation cannot require an entity to furnish an enforceable voluntary undertaking. However, the Commissioner of Taxation may:

- suggest that the entity consider offering the Commissioner of Taxation an enforceable voluntary undertaking; and
- discuss terms that are likely to be acceptable.

However, tax practitioners have argued, that in practice, an entity may feel compelled to offer the Commissioner of Taxation an enforceable voluntary undertaking,[53] because:

- commercially, an undertaking may be preferable to the entity having to allocate resources to deal with an ATO investigation; and

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52 Note 1 to the explanatory notes in the ATO's template for enforceable voluntary undertakings.

53 Kirsten Fish, 'Promoter Penalty Laws: Developments and Issues', 2013 Financial Services Taxation Conference, 13–15 February 2013, Hyatt Regency Sanctuary Cove, Gold Coast, 5.

- an undertaking may be preferable to the risk that an ATO investigation of the entity becomes public (which may be harmful to the reputation of the entity).

It appears that the circumstances in which the Federal Court may accept a written enforceable voluntary undertaking are broader than those in which the Federal Court may make an order for a civil penalty or grant an injunction.[54] This is because subdiv 290-D does not require that the relevant entity is a 'promoter' or that the relevant arrangement is a 'tax exploitation scheme' as defined.[55] Rather, an enforceable voluntary undertaking may be accepted by the Commissioner of Taxation if it would further the objectives of div 290 of sch 1 of the *TAA* 1953.

C *Applications of the Civil Penalties*

The courts considered the application of the civil penalties in two recent decisions. Those decisions will now be examined in Parts Three and Four, particularly for their contribution to:

- the meaning of 'promoter';
- the meaning of 'tax exploitation scheme' and its purpose; and
- promoting a scheme on the basis of conformity with a product ruling, but implementing the scheme in a materially different way.

II DECISION IN *COMMISSIONER OF TAXATION V LUDEKENS* [2013] FCAFC 100

A *The Facts*

The Commissioner of Taxation argued that Ludekens and Van de Steeg promoted a tax exploitation scheme in contravention of s 290-50 of sch 1 to the *TAA* 1953 in 2007. The contravention of the

54 Ibid.
55 Ibid.

promoter penalties was said to occur in their initial acquisition of the woodlots[56] by registered partnerships (with GST refunds) and in their dealings with secondary investors.

Ludekens (director of Lotus) held a financial services licence. Ludekens came to an arrangement with Gunns Ltd to be paid 15% commission on investments procured by him in their woodlots managed investment scheme (MIS).[57] Van de Steeg, a financial investment advisor, had equity in a foreign exchange trading business (Meloka Pty Ltd).[58] In May/June 2007, Ludekens and Vab de Steeg developed a plan to acquire fully financed woodlots (worth $20 million) through separate partnerships, and then on sell some woodlots (worth $13 million) to secondary investors. The partnerships comprised different combinations of Ludekens, Van de Steeg and employees of Van de Steeg and his business partner. The signatories were told they had no obligations and that their names would be removed once the woodlots were on-sold to secondary investors.[59]

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56 Broadly, a woodlot is rights in relation to land in a forest (or farm) for the growing of trees. The Australian Taxation Office Product Ruling PR 2006/8, 'Income tax: Gunns Plantations Ltd Woodlot Project 2006–2007 Growers' describes the woodlots at issue. Growers access the land to establish, maintain and ultimately harvest the 'Woodlot'. Growers will also contract with a manager (in this case, Gunns Plantations) to have 'Trees' planted on their 'Woodlot(s)' for the purpose of eventual felling and sale in approximately 13, 20 or 25 years. Investors may apply for one or more hectare 'woodlot' by accepting an offer through a Product Disclosure Statement.

57 ATO Decision Impact Statement: *Commissioner of Taxation v Ludekens*, <http://law.ato.gov.au/atolaw/view.htm?rank=find&criteria=AND~decision~basic~exact:::AND~impact~basic~exact:::AND~statement~basic~exact:::AND~ludekens~basic~exact&target=CY&style=java&sdocid=LIT/ICD/VID264of2013/00001&recStart=1&PiT=99991231235958&Archived=false&recnum=3&tot=3&pn=ALL:::ALL>.

58 Ibid.

59 Ibid.

Loan obligations were to be met by investing in Meloka Pty Ltd a fund comprising:

(a) commissions received by Ludekens from Gunns ($3 million);
(b) GST refunds in respect of the registered partnerships ($2 million); and
(c) income tax refunds receivable by secondary investors and paid to Lotus ($6 million).

Profits from investing in the fund were to be returned to Meloka Pty Ltd (foreign exchange trading business).

Secondary investors were told by Ludekens that:

(a) Investors would nominate an amount of money to put towards the acquisition of woodlots in a Gunns MIS.
(b) A loan would be obtained to finance the acquisition of the woodlots.
(c) Investors would, in their tax returns, claim the amount paid in respect of the woodlots as a deduction (such a deduction was permitted under the Gunns Ltd MIS where a product ruling had been obtained, (PR 2006/8).)
(d) Investors pay the tax refund to Lotus, who would use the refund to pay the principal and interest on the loan.
(e) Secondary investors were told that they would only have to pay the amount of their tax refund to participate in the investment, rather than having to find the money elsewhere, or borrow it.
(f) After 10 years there would be a payout of the proceeds of an initial cropping of the trees, and after 25 years there would be a final payout.

The secondary investors were provided with 'welcome kits' which included partnership financial statements, tax returns, and other materials including a cover letter instructing investors to forward their tax refund to Lotus.

The Commissioner of Taxation argued that:

- there was a 'scheme' (the initial acquisition of the woodlots and the GST refunds in connection with this, and, the making of offers to secondary investors who paid tax refunds to Lotus);
- the scheme was a 'tax exploitation scheme' (it was reasonable to conclude that the respondents entered into the scheme with the sole or dominant purpose of getting scheme benefits of: increased income tax refunds for secondary investors, and, GST refunds in respect of partnership acquisitions of the woodlots);[60]
- it was not reasonably arguable that the scheme benefit was available at law (secondary investors were not entitled to claim tax deductions as they did not sign the agreements the subject of the product ruling[61] which provided for the refunds; and, the partnerships claiming GST input tax credits were not entitled to the credits as they were not carrying out an enterprise for the purposes of the GST legislation); and
- Ludekens and Van de Steeg were promoters of the tax exploitation scheme (by delivering material, including partnership financial documents, to secondary investors).[62]

B *The First Instance Decision of the Federal Court of Australia*

The Federal Court of Australia first heard the matter on 4 March 2013, with Middleton J finding in favour of Ludekens and Van de

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60 *Commissioner of Taxation of the Commonwealth of Australia v Ludekens* [2013] FCA 142, [238]: the income tax refunds were 'the major part of the fund' to be invested in a foreign exchange trading business from which loan obligations would also be met, and, the GST refunds in respect of the acquisition of woodlots were an integral part of the plan.

61 PR 2006/8.

62 *Commissioner of Taxation of the Commonwealth of Australia v Ludekens* [2013] FCA 142, [196].

Steeg, that there was no breach of s 290-50(1) or (2) of sch 1 to the *TAA* 1953.

Important to the findings in this first instance decision, Middleton J considered that it was necessary to determine the meaning of key terms used in div 290 by reference to other provisions of the *TAA* 1953 and the *Income Tax Assessment Act 1997* (Cth) ('*ITAA* 1997').[63] This was because s 3AA(2) of the *TAA* 1953 provides that expressions used in sch 1 have the same meaning as in the *ITAA* 1997.[64] Further, the Explanatory Memorandum to the legislation introducing the promoter penalties states that the terms and concepts used to define a 'tax exploitation scheme' in div 290 are taken from the anti-avoidance provisions of the *ITAA* 1936, *ITAA* 1997 and the *TAA* 1953, and such concepts are 'well established in case law and administrative practice'.[65]

1 *The Definition of Promoter (s 290-60(1)(a))*

In order for an entity to be a promoter, the entity must market the scheme or otherwise encourage the growth of the scheme or interest in it. At first instance, Middleton J found that a person was a promoter only where they market or encourage growth in a scheme, and not where they merely design and implement the scheme.[66]

In reaching this conclusion, Middleton J discussed principles of statutory interpretation to be applied where s 290-60 does not define 'marketing' or 'encouraging the growth of or interest in a scheme'. It was first noted that under s 15AA of the *Acts Interpretation Act 1901* (Cth) the preferred interpretation of 'promoter' is that which would best achieve the purpose or object of the *TAA* 1953. In carrying out this inquiry, s 15AB of the *Acts Interpretation Act 1901* (Cth) provides that the court may refer to extrinsic material, such as

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63 Ibid [13].
64 Ibid.
65 Ibid.
66 Ibid [19]–[36].

explanatory materials.[67] Further, Middleton J cited *Project Blue Sky*[68] in noting that the starting point for statutory interpretation is the ordinary and grammatical meaning of the words in the provision in question.[69]

Middleton J concluded that the ordinary meaning of 'marketing' would encompass active promotion or 'selling' of a scheme to the public or one or more investors.[70] Middleton J considered to 'encourage the growth' of a scheme or interest in it, to be a more general concept. The Explanatory Memorandum to the legislation enacting the promoter penalties describes the phrase as making it clear that 'the civil penalty regime is not restricted to schemes that are directly marketed in a conventional sense'.[71] Middleton J considered that this meant for example, 'schemes that are marketed through conduct which might not amount to expressly making offers to investors to participate, but which otherwise encourages participation in a scheme'.[72] It did not mean merely developing or implementing a scheme.[73] After reviewing the amendments to the proposed definition of 'promoter' during the consultation period for the draft legislation imposing the promoter penalties, Middleton J concludes that 'the deliberate exclusion of design and implementation conduct from the definition of 'promoter' prior to it being enacted in its present form'

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67 Ibid [22].

68 *Project Blue Sky Inc v Australian Broadcasting Authority* (1998) 194 CLR 355.

69 *Commissioner of Taxation of the Commonwealth of Australia v Ludekens* [2013] FCA 142, [23].

70 Ibid [27].

71 *Commissioner of Taxation of the Commonwealth of Australia v Ludekens* [2013] FCA 142, [28].

72 Ibid [29].

73 Ibid [30], noting that s 290-50(1) concerns 'promotion', and separately, s 290-50(2) concerns 'implementation'. '[E]ach subsection is intended to address a distinct type of mischief in respect of schemes'.

means that design and implementation, without more, is not promotion.[74]

2 *The 'Nexus of Consideration' to the Marketing Activities (s 290-60(1)(b))*

In order to be a 'promoter', the entity (or an associate of the entity) must receive (directly or indirectly) consideration in respect of that marketing or encouragement. The Commissioner of Taxation argued that Ludekens and Van de Steeg had received three types of consideration.[75]

- the payment of commission to Ludekens by Gunns Ltd;
- the GST refunds received by partnerships acquiring woodlots; and
- the promises by secondary investors to pay their tax refunds to Ludekens/Lotus.

Middleton J considered that a broad reading of 'consideration' best achieves the object of the Division, being to deter the promotion of tax exploitation schemes.[76]

The respondents argued that the Commissioner of Taxation had not demonstrated the necessary connection between the consideration received and the marketing or encouragement in respect of which that consideration must have been received.[77] Section 290-60(1)(b) requires that the consideration be received 'in respect of' the marketing or encouragement referred to in s 290-60(1)(a). After consideration of case law on the meaning of 'in respect of' Middleton J concluded that the phrase is 'not limitless'.[78] Rather, 'in respect of' narrows the scope of the section by requiring a material connection

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74 *Commissioner of Taxation of the Commonwealth of Australia v Ludekens* [2013] FCA 142, [35].

75 Ibid [39].

76 Ibid [46].

77 Ibid [41].

78 Ibid [51].

between the consideration received and the marketing and encouragement engaged in.[79]

3 *Tax Exploitation Scheme with the Sole or Dominant Purpose of Obtaining a Scheme Benefit*

The interpretation of 'tax exploitation scheme' was considered, and it was found that the ATO needed to prove an 'alternative postulate' in forming the 'scheme benefit'.[80] That is, the Commissioner of Taxation was required to prove what an entity would have done if it had not entered into the scheme, and what the hypothesised tax position would have been in such circumstances.[81]

Middleton J stated that, in order for the Commissioner of Taxation to demonstrate the existence of a scheme benefit under s 284-150 of the *TAA* 1953, the Commissioner of Taxation needed to show:[82]

- in respect of the reduced income tax liability for secondary investors: that the tax-related liability of one or more of these entities is less than it would be apart from the relevant scheme;

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79 Ibid [54]. Middleton J noted that it would have been procedurally unfair for the Commissioner to rely on the tax refund promises, as consideration received — as this issue of consideration was only raised by the Commissioner in final submissions [222]–[227]. The Full Court (2013) 214 FCR 149, [299] agreed: 'In the context of a civil penalty hearing, it is essential that the material allegations and particulars related to them be stated with clarity at the earliest opportunity'.

80 EY Australia – Tax Insight Promoter Penalties, 'Commissioner wins first promoter penalties case in the Full Federal Court', December 2013, <http://www.ey.com/Publication/vwLUAssets/EY-Tax-Insights-promoter-penalties/$FILE/EY-Tax-Insights-promoter-penalties.pdf>.

81 Tony Kuhn, Jonathan Joseph and Sarah Gittus, Allens Linklaters, 'Focus: Threshold for successful prosecution of promoter penalty claims lowered' in *Litigation and Dispute Resolution*, 11 September 2013, <http://www.allens.com.au/pubs/1dr/foldr11 sep13.htm>.

82 *Commissioner of Taxation of the Commonwealth of Australia v Ludekens* [2013] FCA 142, [242].

- in respect of the increased tax refunds for secondary investors, and the GST refunds for partnership entities that acquired the woodlots: that the amounts are more than they would be apart from the scheme.

Middleton J noted that the definition of 'scheme benefit' in the *TAA* 1953 is similar to the definition of 'tax benefit' in s 177C of the *ITAA* 1936, which forms part of the GAAR in pt IVA.[83] Middleton J therefore accepted that case law on the interpretation of s 177C was relevant to the analysis of s 284-150 of the *TAA* 1953.[84]

Middleton J considered that it is well-established in case law relating to s 177C of the *ITAA* 1936 that determining whether there is a 'tax benefit' requires a comparison to be undertaken between the relevant scheme, and an alternative postulate.[85] An 'alternative postulate' requires a reasonable prediction of events that would have taken place if the scheme had not been entered into.[86] Middleton J noted: 'Despite the fact that s 177C is not in identical terms to ss 284-150 and 290-65 of the *TAA* 1953, I find these principles to be instructive'.[87]

Middleton J concluded that the Commissioner of Taxation — by not pleading an alternative postulate in respect of the reduced income tax liability of the secondary investors, or the GST credits in respect of the partnership interests in the woodlots — had not discharged the burden of proof in respect of what would have happened apart from the scheme.[88] That is, Middleton J considered that the Commissioner of Taxation was required to show what the secondary investors, and

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83 Ibid [243]. Note that s 177C was recently amended by the *Tax Laws Amendment (Countering Tax Avoidance and Multinational Profit Sharing) Act 2013* (Cth).

84 *Commissioner of Taxation of the Commonwealth of Australia v Ludekens* [2013] FCA 142, [243].

85 Citing *Federal Commissioner of Taxation v Hart* (2004) 217 CLR 216.

86 *Commissioner of Taxation of the Commonwealth of Australia v Ludekens* [2013] FCA 142, [244].

87 Ibid [246].

88 Ibid [247].

the partnership entities would have done, if the scheme had not been entered into or carried out.[89]

Middleton J then found, putting aside the issue of whether the Commissioner of Taxation made out the elements of scheme benefits — it cannot be said that Ludekens and Van de Steeg entered into or carried out the scheme with the sole or dominant purpose of getting either the secondary investors, or the partnership entities, a scheme benefit.[90] Rather, the prevailing purpose of Ludekens and Van de Steeg was to make a profit. Middleton J found that it was not sufficient for the Commissioner of Taxation to assert that the income tax refunds and the GST refunds were integral. Rather, the Commissioner of Taxation needed to prove that this was the sole or dominant purpose. Middleton J concluded that the Commissioner of Taxation did not discharge this burden.[91]

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89 Ibid [249]. Middleton J concluded 'it cannot simply be assumed that, in the absence of the relevant scheme, the investors in the Secondary Investment would not have undertaken other activities that led to the same reduction in income tax liability or increase in tax refunds'. And at [250] Middleton J concluded that, in respect of the GST refunds, there was again no submissions by the Commissioner of Taxation about what would have happened in the absence of the relevant scheme: 'To this end, counsel for Dr Ludekens submitted that the Commissioner has not established that the entities in question would not have entered into some other transaction under which GST refunds would have been clearly and legitimately available. I accept this submission'.

90 *Commissioner of Taxation of the Commonwealth of Australia v Ludekens* [2013] FCA 142, [257].

91 Ibid [260]. Middleton J notes, in reaching this conclusion: 'In so concluding, I do not consider that I fall into the trap of the false dichotomy warned of by the High Court in *Spotless Services* (1996) 186 CLR 404 — namely, to ignore the fact that a person may enter into a scheme … with the dominant purpose of enabling the relevant taxpayer to obtain a tax benefit in circumstances where that purpose is entirely consistent with the pursuit of commercial gain in the course of carrying on a business (at 415).'

4 *Not Reasonably Arguable that the Scheme Benefit Would be Available at Law*

In order for there to be a tax exploitation scheme, s 290-65 requires that it is not reasonably arguable that the scheme benefit is available at law. Middleton J noted that, as he found that there was no scheme benefit, it was unnecessary to consider the requirement that the scheme benefit is not available at law.[92] However, he did note that the Commissioner of Taxation had shown that it was not reasonably arguable that the scheme benefits were available at law[93] (but as the Commissioner of Taxation did not make out the other aspects of the definition of tax exploitation scheme, this finding had no impact).[94]

5 *Implementing a Scheme Otherwise Than in Accordance with Ruling (s 290-50(2))*

Independent from the submissions under s 290-51(1), the Commissioner of Taxation also submitted that Ludeken and Vann de Steeg contravened s 290-50(2) of the *TAA* 1953 by engaging in conduct that resulted in a scheme that was promoted on the basis of conformity with a product ruling being implemented in a way that

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92 *Commissioner of Taxation of the Commonwealth of Australia v Ludekens* [2013] FCA 142, [263].

93 Re the secondary investors and their tax refunds, the Commissioner argued that secondary investors never signed the agreements that are the subject of the income tax refunds approved in PR 2006/8, or incurred the fees relating to this project, or commenced the business of the carrying on a business of primary production. Therefore the reduced income tax liabilities and the increased income tax refunds were not available at law to the secondary investors: ibid [269].
Re the GST refunds, the Commissioner submitted that the partnership entities that acquired the woodlots were not carrying on an enterprise for the purposes of the GST legislation. Therefore, GST refunds were not available: ibid [272].

94 *Commissioner of Taxation of the Commonwealth of Australia v Ludekens* [2013] FCA 142, [275].

was materially different from that described in the ruling.[95] The Commissioner of Taxation argued that:

- the secondary investments were promoted on the basis of conformity with PR 2006/8;
- the tax outcome for participants in the secondary investment were materially different from the tax outcomes described in PR 2006/8; and
- therefore, the steps taken to carry the secondary investment into effect involved Ludekens and Van de Steeg engaging in conduct that resulted in the scheme being promoted on the basis of conformity with PR 2006/8, but implemented in a materially different way to that described in PR 2006/8.[96]

Middleton J found that there was no contravention of s 290-50(2) of the *TAA* 1953.[97] The Gunns Ltd scheme was implemented exactly as described in PR 2006/8 — that is, the woodlots were planted and allocated according to the terms set out in the ruling. However the secondary investors do not fall within the scope of (and are not entitled to take advantage of the tax benefits) the product ruling (PR 2006/8). This is not sufficient to enliven s 290-50(2). The secondary investment did not have a product ruling covering its participants, and there needs to be a product ruling in order to enliven s 290-50(2).[98]

B *Findings of Middleton J*

Middleton J dismissed the case against Ludekens and Van de Steeg.

The Decision of the Full Court of the Federal Court

The Commissioner of Taxation appealed to the Full Court of the Federal Court. The Full Court decision, before Allsop CJ, Gilmour and Gordon JJ, was decided on 29 August 2013. The Full Court found

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95 Ibid [280].
96 Ibid [281].
97 Ibid [296].
98 Ibid [306].

that Ludekens and Van de Steeg had contravened s 290-50(1) of the *TAA* 1953, but not s 290-50(2).

The Full Court made some notable statements on proceedings seeking to impose a civil penalty. In noting a lack of precision in the Commissioner of Taxation's case against Ludekens and Van de Steeg, the Full Court discussed the entitlement of those accused of breaching the promoter penalties to a 'fair trial'.[99] The court considered that a fair trial includes 'a clear and tolerably stable body of allegations of contraventions of law'.[100] Citing *Forrest v ASIC*,[101] the Full Court noted that the Commissioner of Taxation was obliged to put his case clearly and distinctly, requiring a pleading stated with sufficient clarity, the cause of action supporting the relief sought.

There were six issues[102] on appeal:[103]

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99 *Commissioner of Taxation v Ludekens* (2013) 214 FCR 149, [19]–[24].

100 Ibid [20].

101 (2012) 247 CLR 486 [25]: 'This is no pleader's quibble. It is a point that reflects fundamental requirements for the fair trial of allegations of contravention of law. It is for the party making those allegations (in this case ASIC) to identify the case which it seeks to make and to do that clearly and distinctly. The statement of claim in these matters did not do that'.

102 *Commissioner of Taxation v Ludekens* [2013] FCAFC 100, [16]–[17], [223]–[331].

103 The respondents also filed a notice of contention arguing that Middleton J ought to have found that, under s 290-65(1)(b) of the *TAA* 1953, it was reasonably arguable that the partnership entities that acquired the woodlots were entitled to input tax credits and GST refunds. This argument was also rejected by the Full Court. In order to make a claim for input tax credits, the entity making the claim must acquire the woodlot in carrying on that entity's enterprise: *Commissioner of Taxation v Ludekens* (2013) 214 FCR 149, [331]. (The respondents did not contend that it was reasonably arguable that the income tax deductions claimed by the secondary investors were available at law — *Commissioner of Taxation v Ludekens* (2013) 214 FCR 149, [325]).

(1) Middleton J's construction of the definition of 'scheme benefit' in s 284-150 for the purposes of s 290-65 of the TAA 1953 (Issue One: 'scheme benefit').
(2) Middleton J's conclusion that, for the purposes of s 290-65(1)(a), the scheme was not carried out with the dominant purpose of a scheme benefit (Issue Two: 'dominant purpose').
(3) Middleton J's narrow construction of the definition of 'promoter' in s 290-60 of the TAA 1953 (Issue Three: 'promoter').
(4) Whether, even if Middleton J was correct on the construction of 'promoter', the evidence satisfied the narrow definition of 'promoter' (Issue Four: evidence satisfied narrow definition of promoter).
(5) Whether Middleton J's construction of the relationship between consideration and marketing or encouragement through the phrase 'in respect of' in s 290-60(1)(b) of the TAA 1953, was too narrow (Issue Five: relationship between consideration and marketing).
(6) whether Middleton's J construction of s 290-50(2) to only cover schemes formally covered by a product ruling, was too narrow (Issue Six: construction of s 290-50(2)).

1 *Issue One: 'Scheme Benefit'*

The Full Court of the Federal Court found that Middleton J erred in finding that the definition of 'scheme benefit' required the Commissioner of Taxation to establish what would have been the tax liabilities of the relevant entities apart from the scheme. Subsection 290-65(1) of the *TAA* 1953 does not require analysis of an 'alternative postulate'.[104] Rather, s 290-65(1) is concerned with the purpose for which an entity has entered into or carried out a scheme.[105]

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104 *Commissioner of Taxation v Ludekens* (2013) 214 FCR 149, [233].
105 Ibid [227], [231].

Commentators have argued that the finding of the Full Court that no 'alternative postulate' is required to be proven by the Commissioner of Taxation before a 'scheme benefit' may be alleged, creates a disconnect between the anti-avoidance provisions applying to taxpayers, and the tax promoter penalties.[106]

2 *Issue Two: 'Dominant Purpose'*

The dominant purpose of the respondents entering into the scheme was to get the scheme benefits. The additional purposes of profit making did not affect that conclusion.[107] The GST refunds from the acquisition of the woodlots by the partnership entities, and the income tax refunds of the secondary investors were integral to the scheme. The Full Court found that Middleton J erred in finding that the dominant purpose was profits rather than the gaining of scheme benefits.

3 Issue Three: 'Promoter'

The Full Court found that the construction of the definition of 'promoter' in s 290-60 of the *TAA* 1953 by Middleton J was too narrow. The words 'otherwise encourages the growth of the scheme or interest in it' in s 290-60(1)(a) are wide, and not limited to making offers to participate in a scheme, and could include conduct of

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106 Clayton Utz, 'Victory for Australian Commissioner of Taxation in the First Promoter Penalties Appeal', 6 September 2013, <http://www.claytonutz.com/publications/news/201309/06/victory_for_australian_commissioner_of_taxation_in_the_first_ promoter_penalties_appeal.page>.
Arguably, this is still the case, even following amendments to pt IVA of the *ITAA* 1936 by the *Tax Laws Amendment (Countering Tax Avoidance and Multinational Profit Shifting) Act 2013* (Cth), see Gordon Cooper and Tim Russell, 'The New "Improved" Part IVA — with Extra Tax "benefit"!' (2013) 42 *Australian Tax Review* 234.

107 *Commissioner of Taxation v Ludekens* (2013) 214 FCR 149, [244].

developing and implementing a scheme.[108] Encouragement could include forwarding financial statements and tax returns to investors.[109] Important for commenting about the adviser exclusion from the promoter penalties, the Full Court noted:

> It is an express legislative directive that 'mere advice' is itself insufficient to satisfy s 290-60(1)(a). However, that legislative directive does not preclude the possibility that advice, in combination with other conduct, may satisfy s 290-60(1)(a). The circumstances of each case must be considered.[110]

4 *Issue Four: Evidence Satisfied Narrow Definition of Promoter*

The Full Court found that Middleton J ought to have found that the conduct of the respondents in procuring the signatories to the partnership entities, encouraged growth of the scheme.[111]

5 *Issue Five: Relationship Between Consideration and Marketing*

The Full Court found that the construction by Middleton J of consideration 'in respect of' marketing or encouragement in s 290-60(1)(b) was too narrow.[112] Further, there was no consideration received by the respondents in respect of marketing or encouragement.[113] And Ludekens and Van De Steeg had a substantial role in the promotion of the scheme, satisfying the requirements of s 290-60(1)(c).[114]

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108 ATO Decision Impact Statement: *Commissioner of Taxation v Ludekens*, [4], <http://law.ato.gov.au/atolaw/view.htm?docid=%22LIT%2FICD%2FVID264of2013%2F00001%22>.

109 *Commissioner of Taxation v Ludekens* (2013) 214 FCR 149, [269].

110 Ibid [258].

111 Above n 108, [4], citing (2013) 214 FCR 149, [248]–[278].

112 Ibid [5]

113 Ibid.

114 *Commissioner of Taxation v Ludekens* (2013) 214 FCR 149, [261]. (ie, 'having regard to all relevant matters, it is reasonable to conclude that the entity has had a substantial role in respect of that marketing or encouragement.')

6 *Issue Six: Construction of s 290-50(2)*

The Full Court agreed that s 290-50(2) did not apply. Middleton J was correct in finding that s 290-50(2) operates only in relation to a scheme that has a product ruling.[115]

C *High Court Special Leave Application Refused*

An application for special leave to appeal to the High Court was made by Ludekens and Van de Steeg,[116] who argued that the Full Court of the Federal Court erred in finding a tax exploitation scheme within the meaning of s 290-65, by characterising the dominant purpose of the scheme as deriving 'scheme benefits' within the meaning of s 995-1 of the *ITAA* 1997[117] read with s 284-150(1) of sch 1 of the *TAA* 1953. The applicants argued that the Full Court of the Federal Court ought to have found that the dominant purpose of the scheme was to make a profit for the purchase of woodlots, and not to derive scheme benefits.

That application was refused on 11 April 2014. French CJ noted that the decision of the Full Court involved characterisation of the purposes of the scheme in a way that did not raise a question of construction that would warrant special leave to appeal to the High Court.[118]

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115 *Commissioner of Taxation v Ludekens* (2013) 214 FCR 149, [304].

116 *Ludekens v Commissioner of Taxation* [2014] HCATrans 86 (11 April 2014) <www.austlii.edu.au/au/other/HCATrans/2014/86.html>.

117 The definition of 'scheme' is found in s 995-1(1) of the *ITAA* 1997, which provides a scheme is any arrangement (agreement, understanding, promise or undertaking, whether or not enforceable) or any plan, proposal, action, course of action or course of conduct, whether unilateral or otherwise.

118 *Ludekens v Commissioner of Taxation* [2014] HCATrans 86.

D *Conclusions: Interpretation of the Promoter Penalties in Ludekens*

The decision in *Ludekens* has provided some clarification on when an entity is a promoter of a tax exploitation scheme. The Full Court decision was also significant in terms of the comments made by the judiciary on procedural fairness. The implication is that, where an entity is accused of promoting a tax exploitation scheme, but has not been accurately informed of the cause of action against them, the entity should raise arguments of natural justice and procedural fairness. The entity is entitled to know the case against it, and to be given an opportunity to reply to it.[119]

The promoter penalties are primarily concerned with protecting the revenue. Empirical evidence illustrates that procedural fairness is a key factor in influencing taxpayer compliance.[120] That is, compliance behaviour is linked to views about justice.[121] It is significant then, that the Full Court made the observations it made in relation to procedural fairness during its first opportunity to interpret the promoter penalty provisions.

III Decision in *Commissioner of Taxation v Barossa Vines Ltd* [2014] FCA 20

The Federal Court decided the second promoter penalty decision on 3 February 2014. It concerned a contravention by Barossa Vines of s 290-50(2) of the *TAA* 1953. Barossa Vines was the responsible entity for a number of managed investment schemes for which

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119 See *Kioa v West* (1985) 159 CLR 550, [582].

120 See Matthew Leighton-Daly, 'Criminal law without the conventional safeguards: Are the procedural dispensations in relation to prescribed taxation offences fair?' (2014) 43 *Australian Tax Review* 86.

121 Ibid 89–90, citing Ross Parsons, 'Income Taxation — An Institution in Decay' (1986) 12 *Monash University Law Review* 77 at 99; 'a tax will not have respect, and will not deserve respect, unless it is coherent in principle and has a claim to fairness'.

product rulings were issued by the ATO.[122] It was held that Barossa Vines had implemented schemes in a way that was materially different from that described in the product ruling.[123]

The court found that Barossa Vines failed to prepare adequately or plan the development of vineyards, and that these omissions, although arising from incompetence rather than being deliberate, left scheme participants vulnerable.[124] Vineyard lots were abandoned, resulting in the project being implemented in a way that was materially different from the project described in the tax ruling. Scheme participants whose vineyard lots were abandoned could never expect to produce assessable income.[125] The Commissioner of Taxation wrote to the taxpayers inviting them to lodge self-amended assessments, removing their claims to income tax deductions under the scheme.[126]

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122 ATO Decision Impact Statement: *Commissioner of Taxation of the Commonwealth of Australia v Barossa Vines Ltd*, <http://law.ato.gov.au/atolaw/view.htm?rank=find&criteria=AND~decision~basic~exact:::AND~impact~basic~exact:::AND~statement~basic~exact:::AND~barossa~basic~exact:::AND~vines~basic~exact&target=CY&style=java&sdocid=LIT/ICD/SAD146of2012/00001&recStart=1&PiT=99991231235958&Archived=false&recnum=1&tot=2&pn=ALL:::ALL>.

123 A civil penalty of $625 000 was imposed on the responsible entity (Barossa Vines Ltd), and a civil penalty of $125 000 was imposed on each of the four individual respondents (directors of Barossa Vines Ltd).

124 *Commissioner of Taxation v Barossa Vines Ltd* [2014] FCA 20, [74].

125 Ibid [60]–[61]. When the Commissioner of Taxation withdrew the Product Ruling PR 2007/32, it was noted:

> Growers were originally entitled to claim a deduction for the decline in value of the grapevines from the time the grapevines enter their first commercial season. However, the grapevines did not enter into their first commercial season before the Project leases were surrendered and therefore, there is no entitlement for growers to claim a deduction for the decline in value of the grapevines.

See PR 2007/32W, <http://law.ato.gov.au/atolaw/view.htm?docid=%22PRR%2FPR200732% 2FNAT%2FATO%2F00001%22>.

126 Ibid [72].

In a media release issued on 5 February 2014, the Deputy Commissioner of Taxation Tim Dyce said that the judgment sent a strong message that the courts will penalise scheme promoters who do not implement schemes in accordance with the product ruling:

> We issue product rulings to give investors certainty about the tax consequences of their investment. However the scheme must be implemented as it was described.[127]

The decision in *Barossa Vines* is also significant in that it involved the interpretation by the court of s 290-50(5) of the *TAA* 1953, which prescribes the principles to which the Federal Court may have regard in deciding the appropriate penalty. Matters, which prompted the court to impose greater penalties, included: lack of care in the management of schemes; failure to take steps to avoid the contravention; and, the div 290 objet of general deterrence.[128] However, in their favour, the respondents resolved the matter by agreeing facts.

IV Conclusions

The decisions in *Ludekens*[129] and *Barossa Vines Ltd*[130] have provided some insight into how the promoter penalties provisions will be interpreted by the courts. In both cases it appears that the promoter penalties achieved the purpose for which they were introduced, that is, to ensure symmetry between the penalties faced by taxpayers and promoters. The findings of the Full Court of the Federal Court on the meaning of 'encouragement' may cause concern for some tax advisors, in that encouragement was said to include procuring investors to sign documents, and forward financial statements and tax returns to investors.[131] However, the ATO's formation of a Promoter

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127 ATO Media Release No 2014/5 issued 5 February 2014, cited by TIA, 5 February 2014, <http://www.taxinstitute.com.au/news/vineyard-schemes-implemented-materially-differently-from-product-rulings-barossa-vines>.

128 ATO Decision Impact Statement, above n 122.

129 *Ludekens* (2013) 214 FCR 149.

130 *Barossa Vines* [2014] FCA 20.

131 Richards, above n 8, 40–1.

Penalties Panel, together with the discussion of procedural fairness and the need for the Commissioner of Taxation to clearly state the case against the alleged 'promoter' by the Full Federal Court in *Ludekens*,[132] must provide advisors with some level of comfort.

132 *Ludekens* (2013) 214 FCR 149.

REFORM OF THE CAPITAL GAINS TAX IN AUSTRALIA: IS A CGT NECCESSARY AND COULD IT BE IMPROVED?

ANDREW SMAILES*

Abstract

This paper examines whether there are any reforms that can be made to the Capital Gains Tax in Australia to improve on the current situation which features a number of negative outcomes in terms of simplicity, efficiency and compliance costs. Possible options identified include — (1) a different structure; (2) a move to accruals features; (3) a Capital Gains Tax specific tax-free threshold; (4) the removal of grandfathering; and (5) the restriction of the main residence exemption. Bearing in mind there are dangers from continual 'tinkering' with the system, which this article explores.

I INTRODUCTION

In 1975 the Commonwealth Taxation Review Committee, chaired by Justice Asprey ('*Asprey Commission*'), recommended a Capital Gains Tax ('*CGT*').[1] The commission noted that:

> [A Capital Gains Tax] is a tax which, in any administrable form, must be complex and difficult, and produce some anomalies and inequities of its own. There is no doubt that any revenue it raises

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1 Commonwealth Taxation Review Committee, *Full Report* (1975).

> could be more cheaply and easily raised in other ways. By the criterion of simplicity it fails.[2]

Over time, the conflict between these two positions had become, if anything, more profound. On the one hand, CGTs have become not just recommended, but ubiquitous; to the modern reader, CGTs have become the norm.

In terms of budgetary impact, concessions from CGT make up some of the largest tax expenditures,[3] while receipts from capital gains taxation make up some of the largest sources of revenue.[4] Accordingly, the CGT has become a large part of the tax landscape. However, this does not mean that the issues identified by the Asprey commission did not eventuate. As noted by Leonard Burman in '*Labyrinth: Capital Gains Tax Policy*', even the thawed out caveman portrayed by Phil Hartman on *Saturday Night Live* had an opinion about capital gains taxation; and it was not good. In point of fact, CGTs, perhaps like all taxes, are flawed. However, there is no need to accept that such flaws are irredeemable. To do so would be to apply absolutism in the pragmatic field of revenue policy.

It is the intent of this paper to confront, and attempt to answer, two questions. First, the paper will examine why a CGT should be persisted with considering the myriad of issues that can and do eventuate from such taxes. Such a question is a necessary starting point, as we should not accept the status quo as invariable. The whole issue of reform, as opposed to removal, is predicated on its resolution. Second, this paper will examine whether there are any reforms that can be made to the CGT in Australia to improve on the current situation. These questions have become more relevant as Australia continues to confront a daunting fiscal situation of reducing revenue.

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2 Ibid.

3 See, eg, Commonwealth Treasury, *Tax Expendtiures Statement 2013* (2014). The Main Residence Exemption, which will be discussed later, is estimated to be $14 billion in tax expenditure for 2012–13.

4 Australian Taxation Office, *Taxation Statistics 2011–12* (2014).

This process will be supported by comparisons of different overseas jurisdictions and their methods of capital gains taxation. While this paper will focus on what could be done with the CGT in Australia, some portion will inevitably deal with capital taxation more broadly. Care should be taken, however, not to equate absolutely capital gains taxation with capital taxation. While capital gains taxation can often be seen as a sub-set of the taxation of the basic concept of capital, as opposed to labour, there are too many exceptions to this rule to apply it in all cases. Before this paper turns to the first and necessary question posited above, some groundwork will be laid about the CGT in Australia and its history.

II Overview of Capital Gains Taxation in Australia

An overview of the CGT in Australia, and its history, is a prerequisite for the subsequent questions in this paper. However it is not the purpose of this paper to provide a detailed technical description of the system in Australia. Due to the complexity of the CGT provisions, which will be dealt with further below, such an endeavour would take 100s if not 1000s of pages to examine the provisions and associated case law. It is sufficient to note for the purposes of this paper that the key features of the Australian CGT are:

(1) There is a comprehensive definition of 'capital gains' taxed under Income Tax Legislation (this can be contrasted with a separate tax, or a scheduler or specific definition of capital gains, which delineates 'capital gains' by reference to certain assets such as shares);
(2) A realisation system which taxes gains as they are realised through sale, transfer or fundamental change to the asset (as opposed to an accruals system which taxes nominal changes in the value of an asset before irrespective of whether such an event occurs);
(3) Partial concessional tax rates (50% discount for individuals and 33% for super funds); and
(4) A range of key exemptions (for main residences and pre-1985 assets for instance) that partially reverse the

> comprehensive definition of capital gains or further add to the existing concessional tax rates.

This system has largely been present in Australia since 1985, subject to some changes between the original CGT in the *Income Tax Assessment Act 1936* (Cth) ('*ITAA 1936*')[5] and the revised legislation in pts 3-1 and 3-3 of the *Income Tax Assessment Act 1997* (Cth) ('*ITAA 1997*'),[6] which was implemented in 1998.[7] However, the idea of a CGT in Australia was substantially driven by the Asprey Commission report, which presented a fully formed capital gains tax proposal in 1975.[8] The 10-year delay after the report for this proposal to become law is a reflection of the resistance that is habitually felt in relation to broad scale base broadening of tax systems.[9] The significant — and ultimately politically fatal — reaction to Prime Minister Thatcher's poll tax is an example of this, as is the more modern example of the process of implementation of the GST in Australia.

The Asprey Commission was an independent non-parliamentary committee, which carried out a comprehensive public inquiry into the tax system over three years, so it is not possible to label its conclusions either rushed or politically based. Therefore, the delay in implementing this recommendation cannot really be traced to the commission that made it. Instead, it can be traced to the fact that there was an anticipated resistance or friction to taxing that which was previously untaxed. While taxing previously untaxed amounts through broad scale base broadening is naturally more efficient economically, such approaches experience natural conflict with

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5 *Income Tax Assessment Act 1936* (Cth).

6 *Income Tax Assessment Act 1997* (Cth), pts 3-1, 3-3.

7 Chris Evans, *Taxing Personal Capital Gains: Operating Cost Implications* (Australian Tax Research Foundation, Research Study No 40, 2003).

8 Commonwealth Taxation Review Committee, above n 1; Chris Evans, 'The Australian Capital Gains Tax: Rationale, Review and Reform' (1998) 14 *Australian Tax Forum* 288; Evans, above n 7.

9 Cedric Sandford, *Why Tax Systems Differ: A Comparative Study of the Political Economy of Taxation* (Fiscal Publications, 2000).

established patterns of what is and what isn't 'fair game' for the Government. This was what the CGT really was; a fundamental base broadening, which brought into the income tax a whole range of capital gains and losses. While grand changes were not lacking with the eventual CGT, perhaps alacrity was; CGTs had been present in the UK and a range of other countries for a number of decades past.[10]

With this history established, the paper will now turn to the first question posited above; why should a CGT be persisted with, considering the myriad of issues that can and do eventuate from such taxes? Inherent as part of this approach, there must first come consideration of what these issues are.

III EVALUATION OF THE CGT

It has been observed in a range of studies that there are issues with the CGT in Australia. For instance, in 2003 Evans noted that the CGT in Australia, while broadly drafted, has a much narrower incidence in practice:

> Net capital gains in Australia tend to be made by about 10% of the taxpaying population, but contribute only a relatively small amount (roughly 2%) to Treasury coffers. They tend to be made by taxpayers from all ranges of taxable income, but with the largest proportion of the gains and the tax deriving primarily from those on higher taxable incomes. Financial assets, predominantly shares, comprise by far the largest source of capital gains.[11]

While this conclusion was based on revenue statistics from over a decade ago, there is no indication that there has been a broad scale base shift since.[12] An illustrative publication in this regard is the

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10 Ibid. Sandford notes that Norway (1911), USA (1913), Denmark (1920) and Sweden (1928) had CGTs prior to World War II; Evans, above n 7; OECD, *Revenue Statistics 1965–2011* (20 November 2012); OECD, *Tax Administration in OECD and Selected Non-OECD Countries: Comparative Information Series 2010* (2011).

11 Evans, above n 7.

12 Australian Taxation Office, *Taxation Statistics 2011–12* (2014); Kim Wyatt, Jon Phillips and Paul de Lange, 'Tax Reform: An International

Australian Taxation Office's '100 people' summary, which reduces the broad statistics into a representative group of 100 taxpayers.[13] Of this group, just 4 of the 100 would report a capital gain. In the most recent taxation statistics,[14] there are only 344 975 taxpayers (individuals, companies and superannuation funds) reporting a net capital gain in 2010–11 totalling $22 billion. This means that the CGT is less general than it appears and taxes a relatively small group of taxpayers, who often share certain socio-economic similarities.

From an economic perspective, the more targeted a tax, the more distortions that will occur, though this is always predicated on notions of substitutability. In the case of capital gains, there is always substitutability in the form of income producing assets that do not have capital appreciation, though this is not always perfect. However, the CGT is not only less than general in relation to taxpayers, but also in relation to assets. As a practical matter, 'spotlights' on certain groups or assets tend to create 'shadows' at the edges where there is more scope for unintended consequences (at best) or evasion (at worst).

Other papers have noted that there are high operating costs associated with CGT, which are not commensurate with the revenue return.[15]

Comparison of the Effectiveness of Changes to Australia's Capital Gains Tax' (2003) 6(1) *Journal of Australian Taxation* 113; Maheswaran Sridaran, 'An Evaluation of Whether the Australian Regime of Income Tax on Capital Gains Satisfies the Macro-Level Policy Objective of Horizontal Equity' (2007) 4 *Macquarie Journal of Business Law* 213; Chris Evans, 'CGT — mature adult or unruly adolescent' (2005) 20(2) *Australian Tax Forum* 291.

13 Australian Taxation Office, *100 People* (27 May 2011) <https://www.ato.gov.au/About-ATO/Research-and-statistics/In-detail/Tax-statistics/Taxation-statistics--100-people/>.

14 Australian Taxation Office, *Taxation Statistics 2011–12* (2014). The 2010–11 statistics are used because the 2011–2012 figures in this publication are only up until October 2013 and are therefore not necessarily complete.

15 Evans, 'The Australian Capital Gains Tax', above n 8; Roisin Arkwright, 'Henry — An opportunity to Reform the Individual CGT

This largely stems from the fact that the CGT is highly complex.[16] These operating costs cover the costs incurred by taxpayers and tax administrations to operate the tax. This includes real monetary costs as well as psychological and less tangible costs, which are just as 'real' to those who incur them. The simplest example of such costs are the tax agent fees a taxpayer pays to complete their tax return but they can include the cost of valuations for CGT as well as the opportunity cost of the time taken to complete these processes. For administrators, there are direct staff costs as well as infrastructure costs to factor into the equation. In the words of Kirchner, 'CGT raises little revenue but comes at a substantial cost in terms of economic welfare'.[17]

Although, it is beyond the scope of this paper to provide any more detailed analysis of the many studies that evaluate the CGT in Australia, it would suffice to say that there are three reoccurring themes in relation to the CGT having:

(1) Broad application but limited incidence and narrow base;[18]

Regime' (2009) 44(2) *Taxation in Australia* 81; Stephen Kirchner, *Reforming Capital Gains Tax: The Myths and reality behind Australia's Most Misunderstood Tax* (12 November 2009) Centre for Independent Studies < http://www.cis.org.au/publications/policy-monographs/article/897-reforming-capital-gains-tax-the-myths-and-reality-behind-australias-most-misunderstood-tax>; Christopher Taylor, 'CGT Reform and the Reduction of Tax Law Complexity' (2008) 23 *Australian Tax Forum* 427.

16 Ibid; Australian National Audit Office, 'Administration of Capital Gains Tax Compliance in the Individuals Market Segment' (Audit Report No 16, Australian Taxation Office, 20 December 2006); Chris Evans, 'Taxing personal capital gains in Australia: causes of complexity and proposals for reform' (2004) 19(3) *Australian Tax Forum* 371.

17 Kirchner, above n 15; Paul Kenny, 'Australia's Capital Gains Tax Discount: More Certain, Equitable And Durable?' (2005) 1(2) *Journal of The Australasian Tax Teachers Association* 38.

18 See, eg, Wyatt, Phillips and de Lange, above n 12.

(2) High operating costs (both administrative and compliance);[19]
(3) Complexity (perhaps unjustifiable complexity).[20]

The third issue of complexity is the most heavily argued problem with CGT legislation in Australia. As a concept, and at its legislative core, the CGT is a simple 'A minus B' calculation. Such a concept is easily understood as 'profit'. It is easily understood across different taxpayers with different educations, different cultural backgrounds and, importantly, different levels of support from tax agents or lawyers. It is also worth noting it is an ingrained concept, as familiar to the accountants of renaissance Venice or Florence, as it is to today's taxpayers.

However, as one gets further away from the basic principle of CGT and applies it in practice, there is significant complexity, especially so where the CGT interacts with other provisions. For instance, where the CGT interacts with the TOFA provisions dealing with financial arrangements, there can be significant issues as assets shift in and out of one set of rules to the other and back again. With this internal complexity and intra-rule complexity, the chance of unintended consequences either in favour of the taxpayer or the tax administration is increased. Simply put, it is impossible to draft a set of application rules, exclusions and transition rules to adequately cover the permutations of taxpayer situations, while retaining the underlying intent.

Australia is not alone in dealing with these issues. For instance, the CGT in the United Kingdom features this same limited incidence, revenue return and complexity in a way that is almost identical to that

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19 See, eg, Evans, above n 7.

20 See, eg, Australian National Audit Office, 'Administration of Capital Gains Tax Compliance in the Individuals Market Segment' (Audit Report No 16, Australian Taxation Office, 20 December 2006); Chris Evans, 'Taxing Capital Gains: One Step Forwards or Two Steps Back?' (2002) 5(1) *Journal of Australian Taxation* 114.

in Australia.[21] To pre-empt later considerations, as Australia is not alone, much is to be gained from a comparison of other jurisdictions' responses. With these issues established, it is now time to turn to the core of the first question posited above; that is, considering the negatives of a CGT, should it be even retained?

IV RATIONALE FOR A CGT

It is apparent to the retrospective observer, as it was to the contemporary of the Asprey Commission, that a CGT is not a reform primarily targeting simplification;[22] the CGT provisions account for over 500 pages of legislation and growing. However, simplicity is not just about basic volume, but internal complexity as well; the CGT provisions also have a high degree of such complexity. Take for instance, the small business concessions, which rely on the definition of small business (small business entity test) established for other provisions such as time limits for amending assessments. However, there is a second alternative definition of small business just for the concessions (net asset value test). Instead, the other great frames of reference for revenue systems, equity and efficiency as well as contributing to fiscal adequacy,[23] are closer to the heart of the rationale for a CGT.

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21 Evans, above n 7; Robin Boadway, Emma Chamberlain and Carl Emmerson, 'Taxation of Wealth and Wealth Transfers' in J Mirrlees et al (eds), *Dimensions of Tax Design: the Mirrlees Review* (Oxford University Press, 2010); J Mirrlees et al (eds), *Tax by Design* (Oxford University Press, 2011); Malcolm Gammie, 'Taxing Capital Gains — Thoughts from the UK' (2000) 23(2) *University of New South Wales Law Journal* 309.

22 Evans, 'The Australian Capital Gains Tax', above n 8; Kirchner, above n 15; Evans, above n 7.

23 Australian Taxation Office, *Taxation Statistics 2011–12* (2014). The tax on net capital gains for individuals in 2011–12 is estimated to be $2.8 billion, $1.4 billion for companies and $200 million for superannuation funds.

In terms of efficiency, it is argued that a failure to tax capital gains leads to efficiency distortions. This is because with capital appreciation not taxed there is a great stock of preferentially taxed investments,[24] causing a less than optimal investment in such assets. Conversely, it is argued that a CGT hinders investment in Australia,[25] with resulting capital flight, as other jurisdictions appear more inviting,[26] and that there is a 'lock in' of capital[27] in potentially underperforming assets, thus distorting the free flow of capital. This lock in occurs because of the taxation of any gains in one event, meaning there can be a significant tax liability, which is not matched necessarily by cash flows. This, in turn, inhibits realisation. Furthermore, there is potential for a further distortion in favour of appreciating assets, rather than income earning assets, which have deferred taxation.[28] This is due to the simple concept of the time value

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24 Evans, 'The Australian Capital Gains Tax', above n 8; M Benge, 'Capital Gains and Reform of the Tax Base' in John Graeme Head and Richard Krever (eds), *Taxation towards 2000* (Australian Tax Research Foundation, 1997).

25 Ibid; Kirchner, above n 15.

26 Jack M Mintz, 'Is There a Future for Capital Income Taxation' (Working Paper No 108, OECD, 1992); George R Zodrow, 'Capital Mobility and Source Based Taxation in Small Open Economies' (2006) 13 *International Tax and Public Finance* 269; Wolf Wagner and Sylvester Eijffinger, 'Efficiency of Capital Taxation in an Open Economy' (2008) 15 *International Tax and Public Finance* 637.

27 Taylor, above n 15; Benge, above n 24; Kirchner, above n 15; Rachel Griffith, James Hines and Peter Birch Sorensen, 'International Capital Taxation' in J Mirrlees et al (eds), *Dimensions of Tax Design* (Oxford University Press, 2010); Reuven Avi-Yonah, Nicola Sartori and Omri Marian, *Global Perspectives on Income Tax Law* (Oxford Scholarship Online, 2011); Joel Slemrod, 'The Lock In Effect of the Capital Gains Tax: Some Time Series Evidence' (Working Paper No 257, the National Bureau of Economic Research, July 1978).

28 Avi-Yonah, Sartori and Marian, above n 27; Joseph Stiglitz, 'Some Aspects of the Taxation of Capital Gains' (1983) *NBER Working Paper* 1094; James Poterbam, 'How Burdensome at Capital Gains Taxes' (1986) *NBER Working Paper* 1871.

of money, meaning tax paid later is preferable to tax paid today, even if they are the same nominal amount.

Thus arguments in terms of efficiency can be put forward in favour of a CGT, but the contra is also the case.[29] Therefore, such arguments were not the decisive factor. Nor could they be as a practical matter; a capital gains tax is a highly emotive matter and it is difficult to explain the rationale for such taxes in pure economics. Undoubtedly, some taxpayers may have seen the new capital gains tax as unwarranted because the right of the government to a share of such sums had not been established and had not become an accepted part of taxation.

A more decisive role was taken by equity arguments.[30] By equity arguments, it is meant the interrelated concepts of fairness, equality and — dare it be said — justice that determine who should pay what share and how much another person should pay in comparison. These concepts are generally explained along two axes — horizontal and vertical.

Horizontal equity compares what people pay at the 'same' level while vertical equity refers to the comparison between what people pay at higher levels. While this is a relatively simple concept, it is complicated by the fact that there is not one absolute frame of reference with which to group people into levels. For instance, it is possible to group people by income or wealth (which are themselves difficult to objectively determine) or a more abstract concept such as wellbeing or overall quality of life. While the grouping of people can be difficult, these underlying contentions are rather straightforward; it is equitable to tax capital gains which were, in terms of economic substance, the same as income as per the Haig-Simons view,[31] which

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29 Evans, 'The Australian Capital Gains Tax', above n 8.

30 Ibid; Kirchner, above n 15; Evans, above n 7; Sandford, above n 9; Kenny, above n 17.

31 Robert Haig, 'The Concept of Income — Economic and Legal Analysis' in Robert Haig (ed), *The Federal Income Tax* (Columbia University Press, New York, 1921); Henry Simons, *Personal Income*

is often glibly summarised as 'a buck is a buck'. Arguably, horizontal equity is improved by a CGT because taxpayers in receipt of the same amount of income or capital gains are both taxed.[32]

Similarly, vertical equity is improved by a CGT because taxpayers with larger capital gains are taxed more than someone with less.[33] However, these arguments can only be taken so far. When looking at what the CGT in Australia covers, it includes significant coverage of unrealised gains and, as a basic premise, often taxes something far removed from a simple gross gain. Thus, while equity equivalence arguments provide an entry point towards arguing for a CGT, the CGT in practice is not just about equivalence. In fact, a strong argument for a CGT is integrity, though this is normally not a separate consideration but part of equity and efficiency.

It was taken into account at the time that a CGT is a key integrity measure that prevents easy 100% tax avoidance by the re-characterisation of income as capital.[34] Furthermore, it is not difficult to see how it could be perceived as unfair and even slightly illogical that prior to the CGT, a transaction yielding $100 million profit could be characterised as capital and be non-taxable, as it was not part of a business or profit-making scheme. On the other hand, one of the law's certainties was that amounts paid by an employer to an employee were, irrespective of label, taxable. Thus, the CGT provisions, as integrity measures, were intended to prevent some taxpayers gaining access to tax planning devices, through characterisation, that are not open to all. As a side note, it would be odd, therefore, if the CGT provisions allowed or increased such opportunities. Thus, many of the points of departure from simple gross gains and 'buck is a buck' thinking, such as the market value

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Taxation (The University of Chicago Press, 1938); Evans, 'The Australian Capital Gains Tax', above n 8; Kirchner, above n 15; Jack M Mintz, 'Is There a Future for Capital Income Taxation' (Working Paper No 108, OECD, 1992); Sandford, above n 9.

32 Evans, 'The Australian Capital Gains Tax', above n 8; Kirchner, above n 15; Sandford, above n 9.

33 Ibid.

34 Ibid; Evans, above n 7.

substitution rules, are themselves integrity measures to ensure that the capital gains tax provisions are not used in ways which derogate from this overall integrity focus.

Contrary equity arguments relate to the fact that a capital gain may cause 'bunching', as a taxpayer is liable to tax on all the capital gain in one year,[35] and the issue of inflation, which means part of a capital gain is not a 'real' return.[36] However, these are merely microcosms of the same trend occurring largely with all taxes. For instance, in absence of perfect withholding systems, which spread taxation over the time that income is derived, an income tax causes income tax to be paid and bunched at the end of the year on amounts paid to the taxpayer up to a year earlier. Further, the Goods and Services Tax (GST) allows taxpayers to have a refund of credits a number of months after a purchase in the first place. Unless a tax features the impractical step of a final tax on each inflow and an immediate credit on each outflow, there will always be bunching and inflationary issues. Therefore, these issues are factors that must be built into the design of the tax and its associated administration, rather than decisive factors in relation to the decision to have the tax in the first place.

Despite the proposed economic equivalence, some argue that capital gains are inherently different, in the recipient's mind, to other types of income and that this leads to different behaviour.[37] This argument is not better illustrated by the fact that capital gains are often 'passive' income. It is not difficult to predict different reactions if a sum is

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35 Taylor, above n 15; Kirchner, above n 15; IMF, 'What are the Options for Taxing Capital Gains', *IMF Tax Law Note* (2005).

36 Taylor, above n 15; Sandford, above n 9; Leonard Burman and David White, 'The Henry Review Recommendations to Reform the Taxation of Capital Gains in Australia: A Preliminary Assessment' in Chris Evans, Richard Krever and Peter Mellor (eds), *Australia's Future Tax System: The Prospects After Henry* (Thomson Reuters, 2010).

37 Sandford, above n 9; Henry Wallich, 'Taxation of Capital Gains in the Light of Recent Economic Developments' (1965) 5 *National Tax Journal* 1.

earned through hard labour, such as employment income, or if the sum is the result of a one off decision to make an investment, which may have occurred many years previously.

Finally, there is arguably a deferral of taxation under a capital gains tax, which can lead to inequities.[38] Despite countervailing arguments, the CGT was chiefly promoted as a measure that would improve equity with a specific influence on integrity. Because of this, it is possible to finally answer the first question posited in this paper; despite the issues identified above, a CGT should be persisted with. This is because the argument for a CGT in principle is based on sound but not absolute footings of equity, efficiency and fiscal adequacy, but to remove it would go back to the 'bad old days' of simple evasion by characterisation. Thus, the next step is to turn to the second question in this paper and explore what possibilities exist for improving the CGT.

V Alternative Structures for Capital Gains Taxation

There are ranges of different structures for the taxation of capital in various jurisdictions around the globe. The major things to consider with all of these structures are the scope of capital gains in the tax base and the tax rate applied rather than simply the name. 'Flat', 'comprehensive', 'dual' and 'hybrid' are just labels, and sometimes misleading labels at that.[39] For instance, Australia's system is often labelled comprehensive, however, there is a near dual tax system due to the discounts available for capital gains. Despite this, such names are useful to group similar approaches to base and rate.

First, there is the 'comprehensive' approach of the United States, which generally brings all capital gains to account as part of a global

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38 Taylor, above n 15.

39 For example, Australia has a partial 'dual' system with the CGT discount but is lumped with the 'hybrid' systems.

income definition in a global tax code.[40] Section 61(a) of the *Internal Revenue Code* states that:

> [G]ross income means all income from whatever source derived, including (but not limited to) the following items: …
> (3) Gains derived from dealings in property; …[41]

Conversely, there is the common law and statute 'hybrid' approach[42] with a common law based definition of ordinary income that already includes some capital gains as ordinary business income and patchy statutory intervention,[43] as in the United Kingdom, Canada or Australia (prior to modern CGTs in each country). Often the statutory interventions were reactionary, in response to individual adverse case decisions about what sums legally were taxable and what were seen to be right to tax. It is not difficult to see that such an approach will likely result in complex legislation that does not fit well together to form an operational whole.

Canada, United Kingdom and Australia all share a common legal history and all found that the common law based concept of ordinary income did not extend sufficiently into the realm of capital gains without significant statutory addition.[44] The solution was either a separate tax, as in the United Kingdom,[45] or a substantial additional category of statutory income, as in Australia and Canada.[46] The US approach, is similar to that of Civil Law countries such as France or

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40 Hugh Ault, *Comparative Income Tax: A Structural Analysis* (Kluwer Law, 1997); Avi-Yonah, Sartori and Marian, above n 27; Evans, 'The Australian Capital Gains Tax', above n 8; Leonard Burman, *Labyrinth: Capital Gains Tax Policy* (Brookings Institution Press, 1999).

41 *Internal Revenue Code* 26 USC, s 61(a).

42 Ault, above n 40.

43 *Income Tax Assessment Act 1936* s 26 AAA; *Income Tax Assessment Act 1997* s 15-15 for instance, in Australia which existed prior to the CGT and brought some capital gains within taxation in a less than pleasing way.

44 Evans, above n 7.

45 Avi-Yonah, Sartori and Marian, above n 27.

46 Evans, above n 7.

Germany,[47] which have a codified approach to income definition, which usually include capital gains. This is appealing in some ways, as there is a unity and simplicity to it. On the other hand, Australia, Canada and the United Kingdom had to 'suffer' through a patchwork of different legislative instruments, case law and inevitable complexity. However, anyone familiar with the US system will note that there are just as many concessions as in any other western country, which means the issue of the taxation of capital gains is far from simple.[48] This comparison only serves to illustrate how any CGT is ultimately in thrall to the most basic of concepts under a country's laws.

Both approaches are comprehensive in that generally all capital gains are included. This can be contrasted with the approach of New Zealand[49] and countries such as Austria or Belgium,[50] which choose to impose capital gains on specific assets in specific circumstances, such as shares. Therefore, many countries adopt a more targeted approach; taxing the capital gains first that they think should be taxed first. Under such an approach there is no striving for comprehensiveness, which in practice is an elusive concept even under a comprehensive tax.

Such an approach also has some appeal, as it may be possible to selectively impose a capital gains tax, which is generally complex and costly to comply with, on the most revenue productive asset classes or desired taxpayer groups. Therefore, there is both an economic

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47 Jean-Jacques Dethier and Christoph John, 'Taxing Capital Income in Hungary and the European Union' *World Bank Policy Research Working Paper* 1903 (1998); Evans, 'The Australian Capital Gains Tax', above n 8.

48 Burman, above n 40.

49 Avi-Yonah, Sartori and Marian, above n 27. The system that is present in New Zealand for financial instruments only is also an accruals based system.

50 Dethier and John, above n 47.

argument about such partial approaches,[51] as well as an argument about equity and simplicity. Further, under such an approach, it is not generally necessary to provide for concessions in relation to the application of the CGT for assets such a main residences.

While some may say that the result is the same (ie, main residences are not taxed), the likelihood of unintended consequences occurring is increased by applying tax in the first place. As well, the complexity is increased because there needs to be provisions of application and the concession, and both need to interact effectively. In other words, it is more elegant to not apply the tax in the first place than to apply it needlessly. However, the targeted approach does create greater opportunities for tax avoidance and arbitrage through re-characterisation and potential distortions between asset types.

Two emerging approaches to taxing capital gains, and capital income more broadly, are dual tax and flat tax systems.[52] The Scandinavian countries, Finland and Sweden, championed the dual tax in the early 1990s.[53] This approach involves a flat, low rate on capital income, including capital gains, and a progressive rate on labour income.[54] This reflects optimal tax theory and an attempt to prevent capital flight. [55] A variety of other countries, such as Hungary, have

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51 Griffith, Hines and Sorensen, above n 27, 'By choosing a low tax rate on those forms of capital income which can in fact be taxed, the government reduces the inter-asset distortions to the savings pattern that arise when some types of capital income go untaxed'.

52 Christopher Heady, 'Directors in Overseas Tax Policy' (Paper presented at Australia's Future Tax and Transfer Policy Conference, Melbourne, June 2009).

53 Dethier and John, above n 47; Peter Sorensen, 'Dual Income Taxes: A Nordic Tax System' in Iris Claus, Norman Gemmell and Michelle Harding (eds), *Tax Reform in Open Economies* (Edward Elgar, 2010); Doina Radulescu, *CGE Models and Capital Income Tax Reforms: The Case of a Dual Income Tax for Germany* (Springer-Verlag, 2007).

54 Sorensen, above n 53; Radulescu, above n 53.

55 Jack M Mintz, 'Is There a Future for Capital Income Taxation' (Working Paper No 108, OECD, 1992); Griffith, Hines and Sorensen, above n 27; François Delorme, Lawrence Goulder and Philippe

effectively adopted this approach.[56] The largest issues with the dual tax are the problems of characterising self-employment and entrepreneurial activities and whether it is progressive or not.[57]

A flat tax, conversely, as the name suggests, is driven by simplicity and imposes one, often low, tax rate on all income types.[58] For instance, the tax rate in Russia, which has been the standard bearer for flat tax systems, is only 13%.[59] Flat taxes have been used in Jersey, Guernsey, Jamaica, in former soviet republics in Europe and in Iraq and Paraguay.[60] Thus, the list of adherents to the flat tax is not designed to instil confidence, including mainly developing, transition or post-conflict countries apart from Russia.

There are thus many questions in relation to whether such a proposal is viable in relation to the larger scale revenue contexts of developed countries. Perhaps there is also a perception issue in relation to adoption of such a proposal because the list of adherents contains a number of potential tax havens, and for a developed country to 'follow' the lead of a tax haven is ideologically problematic. Furthermore, just because there is a flat tax does not mean that capital

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Thalmann, 'The International Spillovers of Capital Income Taxation: An Applied General Equilibrium Analysis' (OECD Economics Department Working Paper 127, 1993); Thomas Piketty and Emmanuel Saez, 'A Theory of Optimal Capital Taxation' (National Bureau of Economic Research Working Paper, 17989, 2012); Bernard Salanié, *The Economics of Taxation* (2011).

56 Dethier and John, above n 47; Sorensen, above n 53.

57 José María Durán Cabre, 'The Dual Tax as a Flat Tax With a Surtax on Labour Income' (Institut d'Economia de Barcelona Working Paper 4/03, 2003); Sorensen, above n 53.

58 Sandra Hadler, Christine Moloi and Sally Wallace, 'Flat or Flattened? A Review of International Trends in Tax Simplification and Reform' (United States Agency for International Development Working Paper, 2006); Griffith, Hines and Sorensen, above n 27.

59 Anna Ivanova, Michael Keen and Alexander Klemm, 'The Russian Flat Tax Reform' (IMF Working Paper 05/16, 2005).

60 Hadler, Moloi and Wallace, above n 58.

gains are included in the applicable definition of income.[61] Thus, flat taxes are perhaps more 'untested' in a developed context than dual taxes, but the core argument for such proposals (ie, simplicity) is perhaps an easier sell to voters than the economic efficiency of a dual tax.

To institute an alternative structure in Australia, such as those outlined above, would require a significant reform across all income types.[62] To institute such a structure to merely reform the CGT seems ludicrous, and therefore, this paper does not recommend such. However, with the diversity of systems, there is also a diversity of tax rates. Australia can look at the effective tax rate (including discount) applied to capital gains in Australia to ensure it is competitive.[63] As well, if any of these structures are possible, it creates a more targeted CGT, which could potentially ensure that the CGT is imposed on those asset classes, which yield the biggest portion of current revenue and shield others from its impost. Australia, thus, may be able to look at a more targeted CGT; however, the political goodwill required to transition from a comprehensive definition of capital gains to something more tailored may be substantial and elusive. At a minimum, a significant amount of bargaining is likely to be required over what should and should not be targeted. As history has shown, this process is likely to lead to a range of inclusions and exclusions that have as much to do with pragmatic trade-offs rather than revenue efficiency. As well, the economic distortions of assets potentially moving in and out of taxation would have to be dealt with as well as the flow on effect in other areas of taxation, which are linked to the CGT as it stands, such as consolidations.

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61 Ibid.

62 *Australia's Future Tax System: Report to the Treasurer* (2009). The Henry review had such an opportunity but recommended retaining the current hybrid system — Australia's Future Tax System Review Panel.

63 Geremia Palomba, 'Capital Income Taxation and Economic Growth in Open Economies' (IMF Working Paper 04/91, 2004); Ray Rees, 'A New Perspective on Capital Income Taxation' in Evans, Krever and Mellor (eds), above n 36, 129–144.

Being realistic, the CGT, in largely its current form, has become an established part of the revenue landscape so it is 'here to stay' in the medium term. CGT events, cost base and other basic CGT concepts have become part of the commercial lexicon and practice and that imbues them with a degree of inertia, and perhaps rightly so as changes to basic concepts, which erode business confidence, should be embarked on rarely and then only with extensive forethought. Therefore, these changes to the structure should be considered over a number of years. But that does not mean that there are no reforms that cannot be considered now for more short term implementation.

VI Accruals Method of Capital Gains Taxation

An accruals system of taxation of capital gains would, simply put, be a more perfect system in terms of economics.[64] Such a system would prevent 'lock in' distortions[65] and would minimise the effective deferral of tax that comes with a capital gains tax on realisation.[66] Therefore, one possible improvement for the CGT in Australia would be to implement elements of accrual taxation. A number of

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64 OECD, 'Taxation of Capital Gains of Individuals' (2006) *OECD Tax Policy Studies* 14.

65 The research into such systems is decidedly US centred as their comprehensive income tax which included capital gains meant that such systems have been relevant there far longer than in other countries. See, eg, Alan Auerbach, 'The Future of Capital Income Taxation' (2006) 27(4) *Fiscal Studies* 399; Alan Auerbach, 'Retrospective Capital Gains Taxation' (1991) 81 *American Economic Review* 167; Alan Auerbach and David Bradford, 'Generalised Cash Flow Taxation' (2004) 88 *Journal of Public Economics* 957; David Bradford, 'Fixing Realisation Accounting: Symmetry, Consistency and Correctness in the Taxation of Financial Instruments' (1986) 50 *Tax Law Review* 731; William Vickrey, 'Averaging of Income For Income Tax Purposes' (1939) 47 *Journal of Political Economy* 379.

66 Taylor, above n 15; Richard Krever, 'Structural Issues in the Taxation of Capital Gains' (1984) 1(2) *Australian Tax Forum* 1; John Minas, 'Taxing Personal Capital Gains in Australia — Is the Discount Ready for Reform?' (2011) 6(1) *Journal of The Australasian Tax Teachers Association* 59.

commentators are unequivocal in stating that the realisation system needs to be retained[67] with compensatory elements to make it neutral with an accruals system.[68] While there is a practical issue with accruals, due to the fact that there would be a separation between taxation and cash flow to pay tax,[69] and due to the problem of valuations,[70] this should not be seen as definitive in all cases as the implementation of the accruals based Taxation of Financial Arrangements ('TOFA') system shows.

For those not familiar with the TOFA provisions, a précis of such is that for certain entities that either opt in or have sufficient turnover or assets, gains and losses from financial arrangements, such as debt facilities, must be taxed on a yearly basis. The gains or losses are calculated through a number of default or additional methods, which generally involve accruals often under accounting standards. In fact, an accruals based system could in some ways lead to simplification, as with TOFA, due to the merger of management and taxation accounting. The author understands that this may be a thin line to draw as TOFA merges management and taxation accounting but is a lengthy legislative enactment. Though no country has moved to a systematic accruals system,[71] perhaps there is good scope for accruals in relation to specific assets for which valuation is eminently possible such as listed shares, options and securities.[72] As Auerbach argues,

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67 Not least the Henry Review — Australia's Future Tax System Review Panel, *Australia's Future Tax System: Report to the Treasurer* (2009).

68 Taylor, above n 15.

69 Ibid; Evans, above n 7; Sandford, above n 9.

70 Ibid; Avi-Yonah, Sartori and Marian, above n 27.

71 Dethier and John, above n 47; Victoria University of Wellington Tax Working Group, *A Tax System for New Zealand's Future* (2010).

72 Benge, above n 24; Avi-Yonah, Sartori and Marian, above n 27; Victoria University of Wellington Tax Working Group, *A Tax System for New Zealand's Future* (2010); Edward Kleinbard, 'Designing and Income Tax on Capital' in Henry Aaron, Leonard Burman and C Eugene Steuerle (eds), *Taxing Capital Income* (The Urban Institute Press, 2007).

'[t]here is little to argue against accrual taxation in the case of securities traded in a liquid market'.[73]

The United States,[74] France and Sweden have partial accruals or 'mark to market' systems.[75] Italy and Canada did experiment with partial systems, however, from the outset it is important to note that both systems were repealed.[76] Under the Italian system, investors were able to opt-in to an accruals based system when portfolios of investments were managed by financial intermediaries and mutual funds,[77] with the exception of substantial holdings.[78] Taxpayers paid a 12.5% tax on *risultato di geslio*, or operating income, which was measured by the change in mark to market value.[79] After implementation in 1997–98, the portion of capital tax revenue relating to operating income quickly grew to €7.86 billion revenue in 2000 out of €17.26 billion in total for all capital taxation. There was 'an impressive performance in terms of revenue in the first three years of implementation due to the exceptional upsurge of equity markets in 1998 through early 2000'.[80] However, revenue plateaued in the following years as trading volumes stabilised.[81]

Despite this history, it may be possible to use such a partial system in Australia because, as noted, there are already accruals based systems (ie, TOFA). Thus, how much marginal complexity would there be if

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73 Alan Auerbach, 'The Future of Capital Income Taxation' (2006) 27(4) *Fiscal Studies* 399; Avi-Yonah, Sartori and Marian, above n 27.

74 These include mark to market taxation of dealers in securities under s 475 of the *Internal Revenue Code* and elective mark to market taxation for marketable securities in passive foreign investment companies under s 1296 of the *Internal Revenue Code*.

75 Avi-Yonah, Sartori and Marian, above n 27.

76 Julian Alworth, Giampaolo Arachi and Roni Hamaui, 'What's Come to Perfection Perishes: Adjusting Capital Gains Taxation in Italy' (2003) 56(2) *National Tax Journal* 197; Benge, above n 24.

77 Alworth, Arachi and Hamaui, above n 76.

78 More than 2% of voting rights in underlying entity.

79 Alworth, Arachi and Hamaui, above n 76.

80 Ibid.

81 Ibid.

accruals were already an established practice in both taxation and accounting? Furthermore, with accruals firmly entrenched as a practice in accounting and an emerging trend in taxation, the conceptual hurdle to implementation of an accruals based CGT system has been passed. While a number of writers have proposed accruals-equivalent systems,[82] such systems may also create additional complexity. They may bring with them all of the complexity of an accruals system,[83] without the conceptual purity. In other words, why imitate an accruals system when it is possible to implement one, even on an opt-in basis? While opt-in systems generally lead to more complexity,[84] further study should be instigated to see if the economic benefits from an accruals system might be decisive. Using the words of Auerbach, 'I think we can do better, but then again, I am not sure of this'.[85]

VII A CGT TAX FREE THRESHOLD

One feature, which is common in other jurisdictions[86] but not in Australia, is a tax-free threshold or quantum based exemption from capital gains taxation.[87] Thus, if a taxpayer has only a minimal capital gain, they are often spared the application of this complex provision.[88] The revenue forgone from such a threshold would not be massive, as most CGT payments are concentrated from larger taxpayers. Thus, such a threshold would shield many taxpayers from

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82 Taylor, above n 15; John Head, 'Capital Gains Taxation — An Economist's Perspective' (1984) 1 *Australian Tax Forum* 1.

83 Kirchner, above n 15.

84 Evans, 'The Australian Capital Gains Tax', above n 8.

85 Alan Auerbach, 'The Future of Capital Income Taxation' (2006) 27(4) *Fiscal Studies* 399.

86 OECD, 'Taxation of Capital Gains of Individuals' (2006) *OECD Tax Policy Studies* 14.

87 Evans, above n 7, 84.

88 Chris Evans and Binh Tran-Nam, 'Controlling Tax Complexity: Rhetoric or Reality' in Evans, Krever and Mellor (eds), above n 36.

the CGT — and its regressive compliance costs[89] — who are not critical revenue sources anyway.

In a way, a threshold would maintain the equity considerations behind the CGT because it would still mean large-scale re-characterisation is not possible. Furthermore, the addition of a tax-free threshold would potentially mean the CGT could actually be simplified to remove a large number of current exemptions (such as the personal use asset exemption) because a sufficient portion of such assets, to satisfy underlying policy objectives, would be exempted under the general threshold. The concept would mean that, when combined with the main residence exemption (in whatever form), a large number of taxpayers would not have to worry about the CGT at all, perhaps ever. It may sound like a slightly outlandish idea, but with a tax-free threshold, the CGT provisions can become something like the Thin Capitalisation, TOFA or Transfer Pricing rules; namely, more complex provisions that are only relevant for more complex larger taxpayers. As the CGT is at least as complex, in parts as any of these other provisions, such an approach of matching the complexity of the tax with the complexity of the taxpayer's affairs has some inherent appeal.

The ideal form of this threshold would be based on purchase (or even sale) price of the asset in question, or another metric other than capital gain, so that there is no need to go through the calculation process. However, it may also be possible to have an annual allowance approach, similar to the United Kingdom, which means the first amount of capital gains, up to the allowance, is exempted.[90] France (€15 000 sale price for immovable property),[91] Germany (€600 for different property types held for certain periods),[92] Russia

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89 Arkwright, above n 15; Evans and Tran-Nam, above n 88; Evans, above n 20.

90 Avi-Yonah, Sartori and Marian, above n 27; Dethier and John, above n 47.

91 Avi-Yonah, Sartori and Marian, above n 27.

92 Above n 90. This is so low because private transactions are exempt anyway due to source model of income.

(depending on holding period and asset type)[93] and the UK (£10 600 annual capital gain) [94] all have tax-free thresholds or annual allowances, so being an early adopter is no hurdle to implementation.

As the experience of these countries show, having a holding period and asset class requirements can be used to ensure there is minimised use of the exceptions for aggressive tax planning. However, there is a danger that such qualification criteria can become a significant source of complexity, as with the Small Business Concessions in Australia. Furthermore, there is always a danger of pretend swarf syndrome, wherein larger entities may wish to either appear smaller or break up their operations in order to gain more benefit from the threshold. These issues could be dealt with by the elegant solution of only allowing individuals access to the threshold or annual allowance. In summary, while these sorts of measures may increase complexity for those on the limit of the threshold, they represent a significant, if not total reduction in complexity for those within them. Therefore, Australia should investigate shielding non-critical, low value CGT contributors from the CGT through a tax-free threshold.

VIII Recommendations for Exemptions

There is a range of policy-based exemptions integrated into the system in Australia.[95] These exemptions, as previously discussed, are a commonly noted source of complexity[96] and distortions. Thus, these are a section of the CGT that are possible improvements as they provide a means of dealing with some of the issues and problems surrounding the CGT without drastic structural reform. CGT exceptions of pre-1985 assets, grandfathering, and the main residence exemption are among the exemptions of the current CGT that could be improved.

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93 Avi-Yonah, Sartori and Marian, above n 27; Evans and Tran-Nam, above n 88.

94 Above n 90.

95 Taylor, above n 15.

96 Ibid; Sandford, above n 9.

Turning to the first of these, Evans has argued that as Australia is unique in its approach of absolute grandfathering of assets[97] acquired before the CGT, such an approach could be eliminated.[98] The Henry Review supports this approach.[99] Many countries, such as Canada,[100] have instead adopted the valuation or 'V date' approach, such that assets subject to a new capital gains tax were valued at commencement and then the capital gains from the 'V date' included within the tax.[101] In fact, this was one of the options advocated for in the original Australian CGT but subsequently dropped in the face of political opposition.[102]

It is argued that grandfathering is a source of complexity.[103] Furthermore, this grandfathering also exacerbates the lock in effect.[104] Australia could adopt a valuation date in lieu of grandfathering,[105] with a significant lead-time for fairness' sake.[106] Such an approach would also lead to informational advantages to the ATO, as taxpayers are required to value various assets and, therefore, provide a better picture of their wealth. Over time, it would potentially be possible to remove such CGT provisions as div 149 (which deems a pre-CGT asset to be a post CGT asset) and event K6 (which relates to dealings in pre-CGT shares) and thereby reduce complexity, if all assets eventually become post-CGT assets deemed acquired on the V date. Furthermore, a range of provisions such as div 130 (which deals with

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97 OECD, 'Taxation of Capital Gains of Individuals' (2006) *OECD Tax Policy Studies* 14.

98 Evans, 'The Australian Capital Gains Tax', above n 8; Evans, above n 7.

99 Australia's Future Tax System Review Panel, *Australia's Future Tax System: Report to the Treasurer* (2009).

100 CCH Australia, *International Master Tax Guide* (2010).

101 Burman and White, above n 36.

102 Evans, 'The Australian Capital Gains Tax', above n 8.

103 Ibid.

104 Benge, above n 24; Evans, 'The Australian Capital Gains Tax', above n 8.

105 Benge, above n 24.

106 Australia's Future Tax System Review Panel, *Australia's Future Tax System: Report to the Treasurer* (2009).

the tax treatment of investments) and the separate asset rules in div 108, which have to establish parallel rules for pre and post CGT assets, could be significantly streamlined for similar reasons. In short, the removal of pre-CGT assets from a certain date would remove the need for a bi-furcation of the provisions between pre and post-CGT assets. With the number of taxpayers holding pre-CGT assets naturally declining, only a small declining portion of taxpayers would be affected by the changes, which only heightens the argument for a removal of grandfathering.

Such an approach is not without precedent in Australia, with a similar approach of 'locking in' pre and post date capital gains applying in relation to a change of residency status under CGT event I1 and I2. Such an approach has also been proposed in the 2012 budget in relation to the removal of the general 50% discount for non-residents (which allow a valuation to be made at 8 May 2012 to lock in discount and non-discount gains).[107] However, adopting such an approach would not be without its trade-offs;[108] including the effects on taxpayers who have to pay capital gains on increases from a valuation date, despite overall losses from purchase date.[109]

Turning now to the main residence exemption, it has been argued that this specific feature contributes towards investment distortions and housing affordability issues.[110] However, Kirchner, among others, disputes this claim and considers that the one off effect of CGT exemption does not adequately explain ongoing price appreciation of housing and that abolishing it would not deal with supply side

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107 As per the date of this article, *Tax Laws Amendment (2013 Measures No 2) Bill 2013*, which contained these changes had passed both House of Representatives and Senate.

108 Burman and White, above n 36.

109 Benge, above n 24; Burman and White, above n 36.

110 Burman and White, above n 36; Judy Yates, 'Housing and Tax: The Triumph of Politics over Economics' in Evans, Krever and Mellor (eds), above n 36.

issues.[111] In fact, Kirchner claims that imposing CGT on all main residences would actually reduce turnover of housing stock and would establish tax deductibility of mortgage payments for principal residences and, thus, extend negative gearing.[112] While the argument surrounding turnover of stock is logically appealing and extends the 'lock in' issue, the second point is less robust, considering the negative limbs to deductibility in Australia;[113] mortgage payments on a personal private residence are arguably private and domestic and, therefore, not deductible.

There are also (perhaps stronger) equity arguments in relation to the repeal or otherwise of the main residence exception. Wealthier taxpayers, who are also more likely to own their own home in the first place, gain more benefit from it; thus, it is regressive.[114] Furthermore, in reality, the family home *is* an investment for many people and to not tax it like other investments is potentially distortionary. A further problem is the revenue leakage in relation to non-residents and temporary residents who are taxed as non-residents taking advantage of the exception.

While having a main residence and, therefore, a physical presence in Australia would often lead to sufficient connection with Australia to constitute residency, under s 6 of the *Income Tax Assessment Act 1936*,[115] the main residence exemption remains available to non-residents. Therefore, while perhaps rare, it is possible that non-residents can hold land in Australia, which is subject to the CGT provisions on the occurrence of any CGT event, as Taxable Australian Real Property under div 855[116] *and* claim the main residence exemption. For such parties, having insufficient connection

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111 Kirchner, above n 15; Burman and White, above n 36; Peter Abelson, 'Commentary: Housing and Tax: The Triumph of Politics over Economics' in Evans, Krever and Mellor (eds), above n 36.

112 Kirchner, above n 15.

113 *Income Tax Assessment Act* 1997 (Cth) s 8-1(2).

114 Kirchner, above n 15.

115 *Income Tax Assessment Act 1936* (Cth) s 6.

116 *Income Tax Assessment Act 1997* (Cth) div 855.

with Australia to be a resident and, therefore, likely living a substantial portion of time outside Australia, a main residence in Australia may well be an investment in actuality.

While creating national boundaries in relation to the taxation of assets leads to economic distortions, the equity arguments in relation to providing the concession to such parties has less weight, simply because the property in question is more likely to become an investment rather than the permanent home. It is trite, but often true, that when a concession is aimed at 'helping' taxpayers, as the main residence exemption is, it is often politically acceptable to only help residents, so there would be no political boundary to restricting the main residence exemption to residents only.

It is worth noting that the scope of the CGT provision's application to non-residents has been a topic of recent discussion and has been dealt with in two consecutive Budgets. *Tax Laws Amendment (2013 Measures No 2) Act 2013* (Cth)[117] was passed on 29 June 2013 and gave effect to a 2012 Budget measure to restrict the general 50% exemption for non-residents. The enacted legislation has retrospective application to 8 May 2012 and will require non-residents to either follow a fairly complex formula to determine the discount rate or produce a valuation, at the application date, to effectively 'lock in' pre and post-application discount and non-discount gains. The budget has forecasted that the new measures will provide a $55 million increase to the budget bottom line. It is outside the scope of this article to consider in depth these new provisions, suffice to say two things; first, as the topic is more to the fore in the collective consciousness, it would be a good time to consider the main residence exemption in relation to non-residents, and second, that the revenue increase would likely be significantly larger if the main residence exemption were similarly removed.

Similarly, continuing the trend in the 2013 Budget, a 10% non-final withholding tax was proposed with effect from 1 July 2016 in relation

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117 *Tax Law Amendment (2013 Measures No 2) Act 2013* (Cth).

to non-residents disposing of Taxable Australian Property. The proposal states that, '[t]his measure will not apply to residential property transactions under $2.5 million'.[118] A non-final withholding tax should not of itself result in increased revenue, but should be seen as an integrity measure. More detail about the measure has not yet been released so it is not possible to definitively state how this will interact with the main residence exemption. However, if properties that are considered main residences are carved out of the withholding tax it will make the situation difficult for purchasers. As with a withholding tax, the onus is on the purchaser of the property (or their bank) to withhold. Therefore, the purchaser has to either trust a vendor's claim of a main residence or withhold anyway. The practical outcome, even when there is a main residence exemption used by the vendor, is that there will be a full withholding. Even if this is not the case, the budget measure further reinforces the currency of the non-resident CGT topic, and the timeliness of dealing with the main residence exemption at the same time, which would be seen as a more comprehensive reform.

Thus, in summary, Australia has three options in order to deal with the complexity, distortions and unfair outcomes caused by the main residence exemption:

(1) Removal of the exemption (excision);
(2) Placing a quantum cap on the exemption (limitation); or
(3) Requiring roll over to a new main residence (control).

The excision option would be largely unprecedented when compared with other countries, which generally feature some form of CGT relief for main residences.[119] For instance, Canada and France have similar total exemptions,[120] although, the wealth tax in France means that there is an effective 'cap'.[121] However, the policy considerations

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118 Budget 2013–14, *Budget Paper No 2* (2013).

119 OECD, 'Taxation of Capital Gains of Individuals' (2006) *OECD Tax Policy Studies* 14.

120 Avi-Yonah, Sartori and Marian, above n 27.

121 CCH, *International Master Tax Guide (2010)*; Deutshe Bank, *Income and Wealth Taxes in the Euro Area* (2012).

underpinning the main residence exception, which counsel against total removal, could be partly ameliorated by a tax-free threshold, like that explored above, so that the first portion of a gain on a main residence is exempted. The excision option could significantly reduce distortions in the housing and investment markets.[122] However, from a pragmatic perspective, as the prompt and unequivocal rejection of the Henry Review's recommendation of land tax on family homes[123] shows, it would take an unprecedented level of political capital and will to implement.

The limitation option is far more politically acceptable and would deal with the equity issues of an effectively regressive exemption.[124] It would increase complexity for those on the cusp of whatever cap was chosen, however, it is not without precedent. The United States,[125] amongst others, imposes a cap on the main residence exemption of $250 000 for singles and $500 000 for couples. This option would also prevent inordinate use of main residences as effective investments. Finally, the control option may limit some of the revenue leakage from the exemption, primarily the temporary resident issue, and would prevent taxpayers getting tax-free access to the investment component of main residences, which are not used to purchase a new residence. Brazil, for instance, requires roll over of any funds covered by such an exemption to a new residence within 180 days.[126] However, as the Australian experience shows, rollovers are a great source of complexity.[127] Even so, the control option is appealing; if only to prevent using family homes as unlimited tax free

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122 However, as noted above, some dispute the magnitude that CGT changes can have on the housing market distortions.

123 Treasury Press Office, *Joint Media Release with The Hon Kevin Rudd MP, Prime Minister — Stronger, Fairer, Simpler: A Tax Plan for Our Future* (2 May 2010).

124 Burman, above n 40.

125 Avi-Yonah, Sartori and Marian, above n 27.

126 Ibid.

127 Board of Taxation, *A Post-implementation Review of the Quality and Effectiveness of the Small Business Capital Gains Tax Concessions in Division 152 of the Income Tax Assessment Act 1997* (2005).

investments, which again, tends to be of more worth to wealthier taxpayers. Therefore, Australia should investigate both the limitation and control options to give more legitimacy to the equity arguments underpinning the CGT, though, as a practical matter, any change to the taxation of family homes is likely to cause political ruction.

IX Conclusion

As this paper has examined, there are a range of issues with Australia's CGT, chiefly being its regressive nature and substantial compliance costs, low revenue yield,[128] various economic distortions and tax base concentration. Despite these issues, it would be a drastic and unwarranted step to do away with the CGT in its entirety. While the argument for a CGT rests on some conflicting equity and efficiency considerations, which argue one way or the other, as an integrity measure or as a contributor to fiscal adequacy, the CGT is an integral part of the tax system. With this in mind, this paper turned to a survey of what can be done to improve the CGT in Australia. Comparisons with other jurisdictions suggest there may be some possible options for reform including:

(1) A different structure (potentially based on more specific higher yielding assets);
(2) Use of accruals systems where possible;
(3) A CGT specific tax-free threshold;
(4) The removal of grandfathering; and
(5) Restriction of the main residence exemption.

These suggestions all deal with particular equity or economic issues of the CGT as it stands. Conversely, these suggestions could potentially increase complexity; however, when dealing with CGTs, complexity is practically a given. This is freeing in some ways, as while there must be a focus on minimising what complexity can be minimised with a CGT, it provides scope to focus more on the other

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128 The approximately $5 billion revenue yield in 2011–12 outlined above is low once the extensive expenditures are taken into account but it is not insignificant however.

reasons for a CGT. Possibly what is needed regarding CGT in Australia is a focus on the underlying original rationale of equity considerations.

Australia's CGT, as with many CGTs, has a comprehensive structure, applying to paupers and maharajahs alike. However, based on a comparison of Australia's revenue 'peers', such as the United States, United Kingdom and many European countries, the Australian CGT is fairly unique in failing to protect as many people as possible from its imposition. In particular, options for reform one, three and five, as outlined above, may serve to redress the balance so that those taxpayers who contribute little revenue through the CGT are spared as much of the heavy compliance burden as possible. It is often lamented that the CGT has been one section of income tax regulation that has been almost constantly tinkered with and, sadly, this trend may have to continue.

Case Notes

BCM v THE QUEEN [2013] HCA 48

JOSHUA MULJOHARDJO*

I INTRODUCTION

In this case the respondents are D C Shepherd and J Lodziak and the appellants are A W Moynihan QC and C M Kelly. The legal issue concerns the contention that the Court of Appeal failed to assess the evidence and to give adequate reasons for its conclusion that the verdicts were supported by evidence; and that it erred in failing to conclude that the verdicts were unreasonable and unsupported by the evidence. Thereby, failing to reach the conclusion that there was guilt beyond reasonable doubt for each offence.

II FACTS

This particular case began in the District Court of Queensland, went on to appeal of the Supreme Court of Queensland and finally reached the High Court. It concerns two counts of unlawfully and indecently dealing with a child under 12 who was for the time being under the appellant's care. This occurred when E was 6-years-old and was under the care of the appellant and viewed them as grandparents. Her stepfather is the appellant's stepson. The three offences were alleged to have occurred on the one occasion when E was having a 'sleepover' at the appellant's home. The prosecution case was wholly dependent on E's evidence. E's first complaint was made to her mother when she was 9-years-old. The following day E was interviewed by Detective Enright about these offences. The interview was video-recorded. When E was 10-years-old, she told her mother about a further indecent dealing that had occurred on the occasion of the sleepover at the appellant's home. E participated in a second

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interview with Detective Enright about this alleged offence. The video recordings of the two interviews were in evidence at the trial. E's evidence was pre-recorded and admitted pursuant to the provisions of ss 21AK and 21AM of the *Evidence Act 1977* (Qld). She was 10-years-old at the date of giving evidence.

III HOLDING

(1) In determining a ground of appeal which challenges the sufficiency of the evidence to support a conviction, the appellate court is required to disclose, in its reasons, its assessment of the capacity of the evidence to support the verdict. The Court of Appeal's observation that the jury was entitled to accept the complainant's evidence and act upon it was insufficient to discharge that obligation.
M v The Queen (1994) 181 CLR 487; *MFA v The Queen* (2002) 213 CLR 606; *SKA v The Queen* (2011) 243 CLR 400, applied.
R v BCM [2012] QCA 333, disapproved.

(2) It was not in the interests of justice to remit the proceedings to the Court of Appeal for it to determine afresh the challenge to the reasonableness of the verdicts. This was a short trial that lasted not more than two days and in which the evidence was in short compass. The court was in a position to determine that challenge itself.

(3) On a review of the whole of the evidence, it could not be said that the verdicts were unreasonable or not supportable by that evidence. None of the appellant's criticisms of the evidence led to a conclusion that it was not open to the jury to convict.
The appeal was dismissed

IV BACKGROUND OR DISCUSSION OF PRIOR LAW

A *Criminal Code (Qld) s 210(1)(a), (3), (4).*

210 Indecent treatment of children under 16
(1) Any person who—

(a) unlawfully and indecently deals with a child under the age of 16 years; or …

(3) If the child is under the age of 12 years, the offender is guilty of a crime, and is liable to imprisonment for 20 years.

(4) If the child is, to the knowledge of the offender, his or her lineal descendant or if the offender is the guardian of the child or, for the time being, has the child under his or her care, the offender is guilty of a crime, and is liable to imprisonment for 20 years.

B *Evidence Act 1977 (Qld) s 93A*

(1) In any proceeding where direct oral evidence of a fact would be admissible, any statement tending to establish that fact, contained in a document, shall, subject to this part, be admissible as evidence of that fact if—

(a) the maker of the statement was a child or a person with an impairment of the mind at the time of making the statement and had personal knowledge of the matters dealt with by the statement; and

(b) the maker of the statement is available to give evidence in the proceeding.

(2) If a statement mentioned in subsection (1) (the main statement) is admissible, a related statement is also admissible as evidence if the maker of the related statement is available to give evidence in the proceeding.

(2A) A related statement is a statement—

(a) made by someone to the maker of the main statement, in response to which the main statement was made; and

(b) contained in the document containing the main statement.

(2B) Subsection (2) is subject to this part.

(3) Where the statement of a person is admitted as evidence in any proceeding pursuant to subsection (1) or (2), the party tendering the statement shall, if required to do so by any other party to the proceeding, call as a witness the person whose statement is so admitted and the person who recorded the statement.

(3A) For a committal proceeding for a relevant offence, subsections (1)(b) and (3) do not apply to the person who made the statement if the person is an affected child.

Note—

For the taking of an affected child's evidence for a committal proceeding for a relevant offence, see part 2, division 4A, subdivision 2.

(4) In the application of subsection (3) to a criminal proceeding—

party means the prosecution or the person charged in the proceeding.

(5) In this section—

affected child see section 21AC.

child, in relation to a person who made a statement under subsection (1), means—

(a) a person who was under 16 years when the statement was made, whether or not the person is under 16 years at the time of the proceeding; or

(b) a person who was 16 or 17 years when the statement was made and who, at the time of the proceeding, is a special witness.

relevant offence see section 21AC.

C *Section 668E(1) of the Criminal Code (Qld) provides:*

The Court on any such appeal against conviction shall allow the appeal if it is of opinion that the verdict of the jury should be set aside on the ground that it is unreasonable, or cannot be supported having regard to the evidence, or that the judgment of the court of trial should be set aside on the ground of the wrong decision of any question of law, or that on any ground whatsoever there was a miscarriage of justice, and in any other case shall dismiss the appeal.

D M v D The Queen (1994) 181 CLR 487 at 493 per Mason CJ, Deane, Dawson and Toohey JJ (applied)

a verdict may be unsafe or unsatisfactory for reasons which lie outside the formula requiring that it not be 'unreasonable' or incapable of being 'supported having regard to the evidence'. A verdict which is unsafe or unsatisfactory for any other reasons must also constitute a miscarriage of justice requiring the verdict to be set aside.

E SKA v The Queen (2011) 243 CLR 400 at [11]–[14] per French CJ, Gummow and Kiefel JJ (applied)

It is agreed between the parties that the relevant function to be performed by the Court of Criminal Appeal in determining an appeal, such as that of the applicant, is as stated in *M v The Queen* by Mason CJ, Deane, Dawson and Toohey JJ:

> Where, notwithstanding that as a matter of law there is evidence to sustain a verdict, a court of criminal appeal is asked to conclude that the verdict is unsafe or unsatisfactory, the question which the court must ask itself is whether it thinks that upon the whole of the evidence it was open to the jury to be satisfied beyond reasonable doubt that the accused was guilty.[1]

This test has been restated to reflect the terms of s 6(1) of the *Criminal Appeal Act*. In *MFA v The Queen*,[2] McHugh, Gummow and Kirby JJ stated that the reference to 'unsafe or unsatisfactory' in *M* is to be taken as 'equivalent to the statutory formula referring to the impugned verdict as "unreasonable" or such as "cannot be supported, having regard to the evidence"'.

The starting point in the application of s 6(1) is that the jury is the body entrusted with the primary responsibility of determining guilt or innocence, and the jury has had the benefit of having seen and heard the witnesses (23).[3] However, the joint judgment in *M* went on to say:

> In most cases a doubt experienced by an appellate court will be a doubt which a jury ought also to have experienced. It is only where a jury's advantage in seeing and hearing the evidence is capable of resolving a doubt experienced by a court of criminal appeal that the court may conclude that no miscarriage of justice occurred.[4]

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1 *M v The Queen* (1994) 181 CLR 487, 493.

2 *MFA v The Queen* (2002) 213 CLR 606, 623–4 [58].

3 *M v The Queen* (1994) 181 CLR 487, 493 per Mason CJ, Deane, Dawson and Toohey JJ.

4 Ibid 494.

Save as to the issue whether the Court of Criminal Appeal erred in not viewing a videotape of the complainant's police interview, to which reference will be made later in these reasons, this qualification is not relevant to the present matter.

In determining an appeal pursuant to s 6(1) of the *Criminal Appeal Act*, by applying the test set down in *M* and restated in *MFA*, the court is to make 'an independent assessment of the evidence, both as to its sufficiency and its quality'.[5] In *M*, Mason CJ, Deane, Dawson and Toohey JJ stated:

> In reaching such a conclusion, the court does not consider as a question of law whether there is evidence to support the verdict. Questions of law are separately dealt with by s 6(1). The question is one of fact which the court must decide by making its own independent assessment of the evidence and determining whether, notwithstanding that there is evidence upon which a jury might convict, 'none the less it would be dangerous in all the circumstances to allow the verdict of guilty to stand'.[6]

F SKA v The Queen (2011) 243 CLR 400 at [22]–[24] per French CJ, Gummow and Kiefel JJ

On appeal, the task of the Court of Criminal Appeal was to make an independent assessment of the whole of the evidence, to determine whether the verdicts of guilty could be supported. There is no doubt that the Court of Criminal Appeal was not bound by the ruling of the trial judge concerning the date of the 2006 offences. However, the Court of Criminal Appeal was required to form an opinion as to the date of the 2006 offences in order to weigh the whole of the evidence.

The reasons for judgment by Simpson J do not disclose that the Court of Criminal Appeal made an independent assessment of the evidence concerning the 2006 offences, and therefore the Court could not

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5 *Morris v The Queen* (1987) 163 CLR 454, 473 per Deane, Toohey and Gaudron JJ.

6 *M v The Queen* (1994) 181 CLR 487, 492–3.

weigh the competing evidence to determine whether the verdicts of guilty could be supported.

It was not sufficient to say that the complainant's account of the incidents was sufficiently particular to enable a jury to accept it. The complainant's evidence as to when they occurred was also part of her account and, potentially at least, a matter by which her other evidence fell to be considered. It may be that the argument of the applicant on the appeal, which focused upon the complainant's nomination of the evening of 23 December as the date of the last two offences and then as one of many 'jury points', served to distract the attention of the Court of Criminal Appeal. Observing that the complainant had not been dogmatic about 23 December may not have sufficiently overcome her identification of the days before Christmas as essential to her recollection. These were matters to be considered by the Court of Criminal Appeal.

To the extent that Simpson J considered whether she was satisfied that it was open to the jury to be satisfied beyond reasonable doubt as to the guilt of the applicant, it appears that this consideration was undertaken without any weighing of the competing evidence; an exercise which the Court of Criminal Appeal was required to undertake to determine whether the verdicts of guilty were unreasonable or could not be supported. Simpson J's reasons do not demonstrate that her Honour weighed the conflicting evidence respecting the 2006 offences and therefore it appears that the Court of Criminal Appeal failed to perform the duty required of it by the Criminal Appeal.

V JUDGMENT

The court rejected all three of the appellant's submission that there were inconsistencies present in E's submission. The submission of the denials of wrongdoing and his wife's evidence that it was not possible that E had got into the matrimonial bed without her knowledge were rejected. In the previous count, the jury could not reach unanimity on account of the third submission. However, the court found that the

reason why the jury was unable to reach unanimity was due to the victim raising allegations involving the third count with her mother a year afterwards. On the other hand, in E's account all three incidents occurred within the same comparatively short time period.[7]

The court found that the explanation that E was scared and embarrassed when responding to the incident as an appropriate reason. They found that it was believable that a child of that age would be subject to such and although they found the video recording evidence for the third count to be unreliable, this was not too strong to diminish her overall credibility in the matter of providing evidence.[8]

The court applied the reasoning that the evidence by E was reasonably sufficient for the prosecution and convict, despite competing considerations.[9]

There was not much law in the discussion because this was already discussed and was accepted in the previous hearing. However the contentious issue of the evidence was discussed greatly. Technically, the appellant was not proven guilty beyond reasonable doubt. However, I believe that the court took the correct approach in this case because the alternative would be creating a precedent that would make it difficult to prove crimes of a similar nature which involve cases of child indecency. The reasoning by the High Court was appropriate given the context of the situation as it displayed strong reasoning of judgments in its justification. This is showcased in:

> On the essential features of her account of the offences E was consistent … The appellant had indecently touched her as she lay in bed next to him. Sometime not long after this first incident, the appellant had sought her out and taken her back into the bedroom, where he had indecently touched her in the same way … E was also consistent in her account that when she got into bed next to the appellant, his wife was asleep on the other side of

7 *BCM v The Queen* [2013] HCA 48, [37]–[39].

8 Ibid [46].

9 Ibid [47].

> the bed. It was open to consider that her recollection of the wife's earplugs was a damning detail.[10]

VI Conclusion

The application of judgment by the High Court was sound and appropriate given the context. This case does not contain much in the way of noteworthiness as it supports previous sentiments held in the cases of *M v The Queen*[11] and *SKA v The Queen*.[12] It shows that the High Court, in cases concerning victims of child indecency providing evidence, provide leniency to their credibility. It seems that in this case, the High Court seems to establish the notion that children of a young age should be distinguished from older people when giving evidence due to their age. This might have limited policy considerations in other cases but it reinforces a principle that will be followed in other child indecency cases.

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[10] Ibid [46].
[11] (1994) 181 CLR 487.
[12] (2011) 243 CLR 400.

COMCARE v PVYW (2013) 250 CLR 246

JOSHUA MULJOHARDJO*

I INTRODUCTION

In this case the respondent is Comcare and the appellant is PVYW. The legal issue concerns whether the Full Federal Court was mistaken in their judgment, that it was enough that PVYW was injured during her accommodation that was induced or encouraged by her employer and that it was not necessary for her to prove that her employer induced or encouraged her actions.

II FACTS

The appellant was an employee of Comcare and was required by her employer to travel to a country town to observe the local budgeting process of the branch of the agency there. She stayed at a motel booked by her employer. During the course of the evening at the motel, she engaged in sexual intercourse with an acquaintance. While they were so engaged, a light fitting above the bed was pulled from its mount and fell on her, causing injuries to her face. As a result, the respondent suffered physical injuries and a subsequent psychological injury. She claimed compensation from Comcare on the footing that the injuries arose 'in the course of' her employment. Under normal circumstances, Comcare is liable to pay compensation to an employee for an injury arising out of, or in the course of their employment. The appellant pursued compensation under s 14 of the *Safety, Rehabilitation and Compensation Act 1988* (Cth) ('*SRC Act*'). However, there is an exception in situations where there was serious and wilful misconduct of that employee. Comcare initially accepted

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to pay for the compensation but later revoked its acceptance of the respondent's claim.

III HOLDING

It was held, by French CJ, Hayne, Crennan and Kiefel JJ, Bell and Gageler JJ dissenting, that the employee was not entitled to compensation. For an injury occurring in an interval in a period of work to be in the course of employment, the circumstance in which the employee was injured must be connected to the inducement or encouragement of the employer. An inducement or encouragement to be at a particular place did not provide the necessary connection to employment merely because an employee was injured while engaged in an activity at that place.

IV BACKGROUND OR DISCUSSION OF PRIOR LAW

A *Hatzimanolis v ANI Corporation Ltd (1992) 173 CLR 473 (applied)*

This case is authority for the proposition that an interval or interlude within an overall period or episode of work occurs within the course of employment if, expressly or impliedly, the employer has induced or encouraged the employee to spend that interval or interlude at a particular place or in a particular way.[1] The course of employment is ordinarily perceived as commencing when the employee starts work in accordance with his or her ordinary or overtime hours of work and as ending when the employee completes his or her ordinary or overtime hours of work.[2] Furthermore, an injury sustained in such an interval will be within the course of employment if it occurred at that place or while the employee was engaged in that activity, unless the employee was guilty of gross misconduct taking him or her outside the course of employment.[3]

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1 *Hatzimanolis v ANI Corporation Ltd* (1992) 173 CLR 473, 484.

2 Ibid 483.

3 Ibid 484.

B *Humphrey Earl Ltd v Speechley (1951) 84 CLR 126 at 133–4 (considered)*

A case in which an employee was injured during his lunch break. His work involved servicing machines at shops at various locations. He had commenced such a task at one shop and stopped for lunch. He desired a particular food which was not available nearby. To obtain it necessitated a journey to somewhere further away. He was injured in a road accident on the return journey. The court considered this case but it found the circumstances to be too different to be applied.[4]

C *Safety, Rehabilitation and Compensation Act 1988 (Cth) s 14(1) (applied)*

> Compensation for injuries
>
> (1) Subject to this Part, Comcare is liable to pay compensation in accordance with this Act in respect of an injury suffered by an employee if the injury results in death, incapacity for work, or impairment.

V JUDGMENT

In the judgment laid out by French CJ, Hayne, Crennan and Kiefel JJ in summary:

> The two circumstances identified by Hatzimanolis were where an injury was suffered by an employee whilst engaged in an activity in which the employer had induced or encouraged the employee to engage; or where an injury was suffered at and by reference to a place where the employer had induced or encouraged the employee to be. An injury sustained in these circumstances may be regarded as sustained in the course of the employee's employment. Properly understood, whilst the inducement or encouragement by the employer may give rise to liability to compensation, it also operates as a limit on liability for injury sustained in an overall period of work.[5]

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4 *Comcare v PVYW* (2013) 250 CLR 246, 267.

5 Ibid [61].

In applying the test in *Hatzimanolis*, the criterion established included the factual finding that an employee suffered injury (but not while engaged in actual work),[6] what the employee was doing when injured (the employee must have been either engaged in an activity or present at a place when the injury occurred)[7] and how the injury was brought about.[8]

1 *Injury and Place (Not Satisfied)*

> An injury occurring to an employee by reference to or associated with a place where the employee is present may involve something occurring to the premises or some defect in the premises … The employer would be responsible for injury because the employer had put the respondent in a position where injury occurred because of something to do with the place. Liability in those circumstances is justifiable. Liability for everything that occurs whilst the employee is present at that place is not.[9]

2 *No 'Unacceptable Extension' to Liability (Not Satisfied)*

> The reasoning in *Hatzimanolis*, when the principle there articulated came to be applied to the facts, does not suggest that any wide view is to be taken of an employer's liability in circumstances where the employer could be seen to have encouraged the employee to be at a particular place.[10]

3 *Association Between Circumstances of Injury and Employment*

> for an injury occurring in an interval in a period of work to be in the course of employment, the circumstance in which an employee is injured must be connected to the inducement or encouragement of the employer. An inducement or encouragement to be at a particular place does not provide the

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6 Ibid [38].
7 Ibid [38].
8 Ibid [38].
9 Ibid [45].
10 Ibid [49].

> necessary connection to employment merely because an employee is injured whilst engaged in an activity at that place.[11]

VI Conclusion

This issue has extensive policy considerations which might flow from the decision such as for those of unfair compensation and it might decrease confidence in the equity of employees in regards to employment. The High Court built up a test from *Hatzimanolis* and developed clear and concise principles in which future cases will follow. The application of the case law was sound and came to a fair judgment. It seems highly likely that this case will be a strong precedent for future cases which involve employee compensation during work intervals as it provides clarity to this particular area of law.

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11 Ibid [60].

COMMONWEALTH v AUSTRALIAN CAPITAL TERRITORY (2013) 250 CLR 441

VICTORIA BARKER*

I INTRODUCTION

Finding a globally accepted definition of the term 'marriage' is impossible with some countries such as Australia limiting 'marriage' to that between a male and female,[1] compared to countries such as Iran permitting Polygamy[2] and some countries such as New Zealand[3] allowing for same sex marriage.

Legislative bodies globally are attempting to weigh up factors such as the morals and attitudes of society, religious and conservative views and the various individual views of members of parliament making the decision to modify the definition by no means a black and white decision.

Australia is not immune to criticism of its definition of marriage. There is a strong social movement towards expanding the definition of marriage to legalise Same Sex Marriage.

According to a survey conducted by Galaxy Research in February 2012:[4]

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1 *Marriage Act 1961* (Cth).

2 *Family Protection Act 1967* (Iran).

3 *Marriage (Definition of Marriage) Amendment Act 2013* (New Zealand).

4 Galaxy Research, *Religion and Same Sex Marriage* (February 2012) Australian Marriage Equality <http://www.australianmarriage

- 62% of Australians believe that same sex marriage should be legalised
- 81% of those surveyed in the age group 18-24 years old support Same Sex Marriage
- 51% of those surveyed in the 50-64 age group support Same Sex Marriage

Two years on and with statistics still verifying support for a change to the definition of marriage, modification has not been made. This however has not been without an attempt from the Australian Capital Territory (ACT). In 2013 the ACT enacted the *Marriage Equality (Same Sex) Act 2013*[5] legalising same sex marriage in the Territory.

The Attorney-General of the Commonwealth subsequently began proceedings against the ACT on the grounds that there was an inconsistency between the *Marriage Equality Act* and the federal *Marriage Act.*[6] As the case dealt with issues surrounding the Constitution, the case went straight to the High Court of Australia.

II Issue 1: Constitutional Issue

Both parties to the case, the Commonwealth and the ACT, submitted that the Federal Legislative Body has the authority to legislate for the marriage of same sex persons.[7] However the court stated that 'parties cannot determine the proper construction of the *Constitution* by agreement'[8] and therefore requiring the court to clearly identify the

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equality.org/wp-content/uploads/2012/03/REPORT-Religion-And-Same-Sex-Marriage-Feb-2012.pdf>.

5 Australian Human Rights Commission, *ACT passes same-sex marriage law* (23 October 2013) Australian Human Rights Commission <https://www.humanrights.gov.au/news/stories/act-passes-same-sex-marriage-law>.

6 *Marriage Act 1961* (Cth).

7 *Commonwealth v Australian Capital Territory* (2013) 250 CLR 441, [2].

8 Ibid [8].

specific powers granted to the Commonwealth in relation to legislating marriage.

Section 51(xxi) of the Australian Constitution states that:

> The Parliament shall, subject to this Constitution, have power to make laws for the peace, order, and good government of the Commonwealth with respect to marriage.[9]

In determining the meaning of the term 'marriage' in context of s 51(xxi), the court found difficulty in determining an appropriate meaning. The question arose whether marriage should be constructed in its traditional meaning, that being the definition at federation or whether a contemporary meaning of the word should be adopted.

A *Decision*

The court determined that marriage in the context of the Constitution was to be defined as a 'consensual union formed between natural persons in accordance with legally prescribed requirements'.[10] The courts expressly stated that this definition of marriage 'includes a marriage between persons of the same sex'.[11] Therefore legislating in regard to same sex marriage is a Federal power and able to be done at the Federal Parliaments discretion.

III Issue 2: Conflict with the Marriage Act

As stated earlier in this paper, both parties agreed that it is a Federal power to legislate same sex marriage before proceedings even began. The real issue of contention in the case was surrounding whether a conflict between the *Marriage Act 1961* (Cth) and the *Marriage Equality (Same Sex) Act 2013* (ACT) existed and whether or not they could be in force concurrently.

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9 *Australian Constitution* s 51 (xxi).

10 (2013) 250 CLR 441, [33].

11 Ibid [38].

As entrenched in the Constitution, 'when a law of a State is inconsistent with a law of the Commonwealth, the latter shall prevail, and the former shall, to the extent of the inconsistency, be invalid'.[12]

A *ACT Argument*

The ACT argued that both acts could be in force concurrently. The reason this could be possible is that the *Marriage Act* defines marriage as 'the union of a man and a woman to the exclusion of all others, voluntarily entered into for life'.[13] Marriage between a man and a woman was by no means addressed in the ACT. The *ACT Act* was aimed at providing marriage equality for same sex couples[14] not marriage between a man and a woman that the Commonwealth statute addressed. The legislation dealt with marriage equality and in no way intended to conflict with the traditional institution of marriage as defined in the *Marriage Act.*

B *Commonwealth Argument*

The Commonwealth argued that the *Marriage Act* represented a full and complete piece of matrimonial legislation. This was reinforced by the 2004 amendment of the *Marriage Act*, which changed the definition of marriage in relation to the act to that between a male and a female, reinforcing Parliaments intent that the only type of marriage legal in Australia is that between a male and a female.

IV Overall Decision of the Case

The court agreed with the Commonwealths argument stating, 'the 2004 amendments to the *Marriage Act* made plain that the federal marriage law is a comprehensive and exhaustive statement of the law

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12 *Australian Constitution* s 109.

13 *Marriage Act 1961* (Cth) s 5. This clause in the legislation was added in 2004 through the *Marriage Amendment Act 2004* (Cth) s 3 sch 1 item 3.

14 (2013) 250 CLR 441, [41].

of marriage'.[15] While this definition of marriage in the *Marriage Act* is evident 'the provisions of the ACT act … remain inoperative'.[16] The *Marriage Equality (Same Sex) Act 2013* was therefore ruled invalid in its entirety.

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15 (2013) 250 CLR 441, [58].

16 Ibid [61].

ELECTRICITY GENERATION CORPORATION v WOODSIDE ENERGY LTD (2014) 306 ALR 25

MADISEN SCOTT*

I INTRODUCTION

Overturning the decision of the Court of Appeal of the Supreme Court of Western Australia,[1] the High Court took a firmer stance than its UK counterparts in the interpretation of 'best endeavour' and 'reasonable endeavour' clauses. Most often these clauses are interpreted in a more lenient manner towards the appellant, however this tough approach by the High Court has upheld the sanctity of contract law in Australia. Although the ruling confirmed the intention of parties in the drafting of contracts should largely be honoured, it allows contracting parties flexibility in difficult commercial situations. In light of recent proposals to introduce broad based contract legislation,[2] the decision exemplifies the fairness and efficiency that the current system operates within.

II KEY FACTS

The Electricity Generation Corporation, trading as Verve Energy Australia (Verve), was the major generator and supplier of electricity in Western Australia. Under a long-term gas supply agreement

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1 *Electricity Generation Corporation t/as Verve Energy v Woodside* [2013] WASCA 36.

2 See Nicola Roxon, 'Improving Australia's law and Justice Framework' (Discussion Paper, Department of the Attorney-General, Parliament of Australia, 2012).

Woodside Energy Ltd (Woodside), and other participants in the North West Shelf Joint Venture, sold gas to Verve. Three core extracts from the gas supply agreement outlined:

- Woodside were obliged to supply Verve with a minimum daily quantity of gas.
- At times when Verve required a supply beyond the minimum daily quantity, Woodside were required to use 'reasonable endeavours' to make available a supplemental daily quantity of gas.
- Included was a qualification that 'In determining whether they are able to supply [additional gas] on a Day, the Sellers may take into account all relevant commercial, economic and operational matters …'.

On 3 June 2008 an explosion occurred at the processing facilities, of the only gas supplier other than Woodside, on Varanus Islands causing a 30–35% reduction in the market. The demand for gas exceeded the supply and the gas supply agreement. As a result, Woodside informed Verve that it would no longer supply the supplemental daily gas for an indefinite period. Woodside invited tenders for supply of an equivalent amount of gas under a short-term agreement for additional payment. Under this new agreement, Verve were supplied with an interruptible quantity at market prices, and entered under protest.

The dispute arose over whether Woodside breached their obligation to use reasonable endeavours to supply additional gas. Verve contested that they entered into the short-term agreement as a result of illegitimate pressure and duress by the respondents. They sought restitution for the additional costs incurred for the excess supply they sought, which Woodside were required to supply under the Gas Supply Agreement. Woodside countered that, given market demand and the situation, they were entitled to take into account the commercial factors in deciding on the supply of additional gas.

At first instance in the Supreme Court of Western Australia,[3] the trial judge considered the terms of the contract. Namely, it was held that the agreement contained no restriction on Woodside entering into supply contracts with third parties and the 'ability to supply' was to be construed in consideration of the 'relevant commercial, economic and operational matters'. The case was dismissed.

On appeal to the Court of Appeal of The Supreme Court[4] the first instance decision was overturned. The court found that 'reasonable endeavours' was expressed in an obligatory notion and thus reflected 'ability' not 'willingness' to supply. Furthermore, Verve incorporated a clause that expressly held Woodside liable if there was a failure to supply additional gas. This reasoning reflects the more lenient approach taken by the courts in other jurisdictions.

III JUDGMENT

The High Court, in a majority judgment by Chief Justice French and Justices Hayne, Crennan and Kiefel, affirmed that a 'tough contract' allowing parties to 'use reasonable endeavours' to protect its commercial position in certain circumstances should not be easily set aside. Furthermore, contracts are to be given a business interpretation and are to take into consideration the context of which the parties entered into the contract.

The court reached a number of conclusions and reaffirmed the position taken by the trial judge at first instance. Woodside were entitled to take into account all 'relevant commercial, economic and operational matters' to qualify their supply of additional quantities of gas to Verve. It is notable to mention the consideration that companies in Woodside's position should not be required to use

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3 *Electricity Generation Corporation t/as Verve Energy v Woodside* [2011] WASC 268.

4 *Electricity Generation Corporation t/as Verve Energy v Woodside* [2013] WASCA 36.

reasonable endeavours which are likely to lead to 'ruin of the company or the utter disregard of shareholders'.[5]

It should be noted that this was not the first agreement with which the two parties had entered; they in fact had a long-term commercial relationship. The court held that '[u]nless a contrary intention is indicated, a court is entitled to approach the task of giving a commercial contract a business like interpretation on the assumption "that the parties … intended to produce a commercial result".'[6]

In the matter at hand, the court re-affirmed a number of principles to be adopted in determining rights and liabilities of parties:

- Meanings of terms in a commercial contract are to be construed as a reasonable businessperson would have understood.
- Consideration is to be given to the language used, surrounding circumstances and the commercial purpose or objectives.
- An understanding of the origin, background, context and market of operation.
- The contract is to be read as not to make commercial nonsense or work commercial inconvenience.

In interpreting the 'reasonable endeavours' it was held that Woodside's obligation was not unconditional or absolute.[7] The nature of the obligation was to be conditioned by what was reasonable in the circumstances, and can contain an internal standard that is expressly referring to the business interests of the party.[8] The three observations made by the court in regards to reasonable endeavours are discussed in the analysis part of the paper.

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5 *Terrell v Mabie Todd & Co Ltd* (1952) 69 RPC 234, 236.

6 *Zhu v Treasurer of New South Wales* (2004) 218 CLR 530.

7 *Electricity Generation Corporation t/as Verve Energy v Woodside* (2014) 306 ALR 25, [41].

8 Ibid [35].

Justice Gageler presented the only dissenting judgment from the bench. He, like the Court of Appeal of the Supreme Court of Western Australia, applied a more lenient interpretation of 'reasonable endeavours' in the applicants favour. He considered that Woodside remained 'able' to supply the gas but were reluctant and unwilling. In his view he stated that if he were to accept Woodside's construction of the clause relating to the supplemental daily gas quantities, the term had no purpose to be included at all.[9] The construction renders the obligation of Woodside 'elusive, if not illusory'.[10] In his opinion the supply of supplemental quantities could cease if Woodside was 'unable' to deliver because of 'commercial, economic and operational matters' and not merely because it saw an opportunity to increase profits. As the only dissenting judge, the majority did not support his view.

The final judgment overruled the decision of the Court of Appeal in Western Australia and reaffirmed the position of the trial judge at first instance. Woodside at no point breached the Gas Supply Agreement, specifically the 'reasonable endeavours' clause. They did not place Verve under economic duress or act unconscionably. The judgment made by the Appellate Court on 20 February 2013 was set aside and dismissed with costs.

IV Analysis

The implications of the decision are most profound in the context over the current contract law reform debate. The proposed reforms seek to provide a 'fairer go' for all businesses. The High Court has reaffirmed the position that intention and contextual circumstances are significant in the interpretation of contracts. In reference to *Re Golden Key Ltd*,[11] unless a contrary intention is indicated the approach must give a businesslike assumption of an intention 'to produce a commercial result'.

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9 Ibid [61].

10 Ibid [64].

11 [2009] EWCA Civ 636, [28]

The majority judgment re-affirmed the principle of an objective approach in determining the rights and liabilities of parties to a contract and requires the court to consider the language used, the surrounding circumstances known to them and the commercial purpose of the contract. This was in line with the previous approaches taken in *Pacific Carriers Ltd v BNP Paribas*[12] and *Toll (FGCT) Pty Ltd v Alphapharm Pty Ltd*.[13] In *Zhu v Treasurer of NSW*,[14] the justices stated a commercial contract must be construed so as to avoid 'making commercial nonsense or working commercial inconvenience'. The object of any commercial enterprise is to make profit; both Verve and Woodside were in the position of doing this. Had Verve intended to have the gas readily available, it would have prevented Woodside from entering into third party agreements or taken precautionary measures.

It is worthy to note that the courts interpretation of the 'reasonable endeavors' clause should shape the way these are incorporated into agreements. Often common in distribution agreements, having prominently been addressed in *Hospital Products v USA Surgical Corporation*,[15] the judgment clarifies that the phrase is to be qualified by internal standards and is fluid in nature. It imposes no obligation on a party and should not be relied upon by parties. In interpreting a 'reasonable endeavors' clause the case presents three principles, which one must observe and consider:

1. An obligation expressed is not an absolute or unconditional obligation.
2. The nature and extent of an obligation imposed in such terms is conditioned by reasonableness, and can include situations that may affect an obligee's business.

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12 (2004) 218 CLR 451.
13 (2004) 219 CLR 165.
14 (2004) 218 CLR 337.
15 (1984) 156 CLR 114.

3. An obligation of reasonable endeavors contains its own internal standard of what is reasonable, often by express reference relevant to the business interests.[16]

These three considerations re-affirm the position taken by the court in *Hospital Products v United States Surgical Corporation*.[17] In the case the phrase 'use best efforts' can be construed to having similar meaning as 'reasonable endeavours'. Although both terms are ambiguous in nature, each time the court was able to imply the intention of the clause in reference to the subject matter and relationship of the parties. In the case at hand, this relationship was one of a long-term commercial nature. The two companies had traded together before, and further the gas supply agreement was one of a long-term nature and thus the words must be construed so as to what a reasonable business person would have interpreted and understood the terms to mean, rather than a strict black letter meaning. Implications of this suggest 'reasonable endeavour' clauses must be carefully drafted and should include express and specific restrictions on their operation. The use of these may give the promising party the option not to fulfil their obligation due to changes in market, economic and business circumstances. Lastly, contingencies and considerations of various scenarios should be contemplated, which may reduce the responsibility to comply with the contract.

It this objective approach to determining the construction of a clause, like 'best endeavours' that is the principle extracted from the case and likely to be applied. Since the judgment, the NSW Supreme Court and Court of Appeal have heard three separate cases and applied the principle stated by the majority in the case.[18] Likewise, the Victorian

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16 *Electricity Generation Corporation t/as Verve Energy v Woodside* (2014) 306 ALR 25, [40]–[43].

17 (1984) 156 CLR 114.

18 See *Lindsay-Owen v Schofields Property Development Pty Ltd* [2014] NSWSC 1177; *Collector Quarries Pty Ltd v JJ & LL Reardon Pty Ltd* [2014] NSWSC 1175; *Barangaroo Delivery Authority v Lend Lease (Millers Point) Pty Ltd* [2014] NSWCA 279.

Supreme Court in *Metier3 Pty Ltd v Enwerd Pty Ltd*[19] stated obligations should be construed in consideration of 'reasonable business and economic and operational matters'.[20] It is these two principles which override the underlying push for a uniform Australian Contract Law. The High Court has affirmed that business contracts will be interpreted objectively pursuant to the parties' intentions in coming to an agreement. The courts are capable of looking past ambiguity in constructing a fair interpretation of an agreement. The need for legislation is undermined by the courts application in the case at hand; the law is capable of moving beyond uncertainty and unfairness to create fair and just results.

V CONCLUSION

In analysing the case and its application since the handing down of the judgment, the writer of this paper believes the decision of the majority was correct. Looking beyond the four walls of the contract and placing heavy emphasis on the intention of the parties is the most fair and objective approach to interpreting a commercial contract. The principles are somewhat resonant with the parole evidence rule already in application in the common law. The draft Law of Contract in Australia seeks to remove this rule because of the imprecise application by the courts. With this judgment I believe the court has clarified the instance in which the conduct of parties can be used to determine the intention of the parties. This is in line with all other jurisdictions, codified or not.

Further, the court has re-iterated the core foundations of a contract lie within the intention of the parties, and the reasonable expectations of the parties. 'Reasonable endeavor' clauses are often included to somewhat downgrade an absolute obligation of a contract. When negotiating contracts these should be drafted carefully, the interpretation of these clauses in the decision suggests if a specific situation is expected to be dealt with in a particular manner, it is best

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19 [2014] VSC 80.

20 *Metier3 Pty Ltd v Enward Pty Ltd* [2014] VSC 80, [45].

to express this explicitly. The ramifications of this judgment have been commented on in the short period since the judgment was reached. Businesses have been given clarification and insight into the depth of which they must express their agreements. The approach taken by the High Court has restored faith in the common law system, and more so the international standards of contractual effectiveness, by updating principles of modern business interaction in the case at hand.

What can be taken from this case is that the High Court is more than capable of re-affirming principles in which inconsistency and lack of clarity becomes prevalent. Legislation is not the only option, and the courts are capable of evolving and developing. The system of common law has not failed before and is by all means a working model; reform is unfounded and not needed. The case of *Electricity Generation Corporation v Woodside Energy Ltd*[21] has reinvigorated the faith in the court system to appeal to community standards and expectations without the need to legislate.

[21] (2014) 306 ALR 25.

MARSH v BAXTER [2014] WASC 187

NADINE ELMOWAFY*

I INTRODUCTION

Marsh v Baxter[1] is a case that brings to question the accountability of Genetically Modified (GM) crop farmers and the duty of care that they owe to their neighbouring farmers. It also highlights the strictness of the National Association of Sustainable agriculture Australia (NASAA) standards[2] on the certification of organic farmers in Western Australia and whether the standards are applied appropriately. This controversial case was one of the first of its kind and is likely to affect what legal protection organic farmers could pursue should their crops be affected or 'contaminated' by neighbouring genetically modified crops.

The case was decided by Justice Kenneth J Martin in the Supreme Court of Western Australia, it was held over 11 days and the judgment handed down on 28 February 2014.

II FACTS

The plaintiffs, Mr Steve Marsh and Mrs Susan Marsh, are organic produce farmers growing organic cereal crops and raising organic meat in their Eagle Rest property in Kojonup. The defendant, Mr Michael Baxter is the owner of the neighbouring property called Sevenoaks, which he uses to grow Genetically Modified (GM) Canola plants among other crops in a rotational cycle.

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1 *Marsh v Baxter* [2014] WASC 187.

2 See National Association for Sustainable Agriculture Australia Ltd, *NASAA Organic Standard* (6 February 2012).

The Marshes received certification for 476 of 477 hectares of property from the National Association of Sustainable agriculture Australia and NASAA Certified Organic Pty Ltd (NCO) in January of 2006,[3] which allowed them to label their products as 'NASSA certified organic' and sell them at a premium price. However in 2008, Mr Baxter used a conventional harvest technique called swathing to cut and stack his conventional (non-genetically modified) Canola plants for harvest, some of those stacked canola crops were presumably blown away to Eagle Rest where they germinated and grew as volunteer canola plants.[4] Mr Marsh discovered 12 conventional canola plants in his property.[5]

Mr Baxter started growing the GM canola crops in 2010 using swathing to harvest his crop, and some were blown away into Eagle Rest from Sevenoaks. In 2011, only eight GM volunteer canola plants were found in the property,[6] and the sheep being raised in Eagle Rest may have consumed some of the GM canola plants while grazing.[7]

Following a few inspections about the contamination in Eagle Rest NASAA decided to revoke the certification for 70% of the Eagle Rest property owned by the Marshes and thus affecting their labelling rights for the produce grown on their property and their ability to charge premium price on the market.

III Causes of Action

The Marshes brought two causes of action against Mr Baxter, one for common law negligence as a breach of a duty of care owed to them by Mr Baxter and another for private nuisance as interfering with their ability to enjoy their land. Mr and Mrs Marsh claimed damages of $85 000 for the loss of profits on what they could have sold their produce and meat for at the premium price, there was no controversy

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3 *Marsh v Baxter* [2014] WASC 187, [9].
4 Ibid [76].
5 Ibid [78].
6 *Marsh v Baxter* [2014] WASC 18, [139].
7 Ibid [118].

on the amount claimed. The Marshes also wanted a perpetual injunction against Mr Baxter to prevent him from harvesting his GM crops within 1 km of Eagle Rest to prevent such issues from arising again.

The first cause of action, common law negligence relies on the fact that there is an established duty of care owed to Mr and Mrs Marsh by Mr Baxter and that he has breached this duty of care. The idea of duty of care was first introduced in *Donoghue v Stevenson*,[8] where the principle is; 'The rule that you love your neighbour becomes in law, you must not injure your neighbour …'.[9] There are three elements to establish a case in negligence; a duty of care owed to the plaintiff, a breach in that duty, and that the plaintiff suffered damage due to the breach.[10] Notably, the Marshes only brought forward a claim of purely economic loss, which has been so far treated cautiously by the courts and assuming the negligence cause of action succeeds in court, both parties agreed that the financial loss suffered by the plaintiffs would amount to $85 000.[11] While outside of the scope of this case note, it is important to note that the introduction of the *Civil Liability Act* (2002)[12] has made it more difficult for plaintiffs if they wish to prove negligence solely on financial loss.

The second cause of action, private nuisance, is the unlawful interference with a person's use or enjoyment of land.[13] At common law one of the remedies available is an injunction, which restricts the defendant from doing something to ensure the grievance does not happen again.[14] In this case, Mr and Mrs Marsh wished to pursue a perpetual injunction against Mr Baxter, the injunction will in turn

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8 *Donoghue v Stevenson* [1932] AC 562.

9 Ibid [580].

10 Frances McGlone and Amanda Stickley, *Australian Torts Law* (LexisNexis Butterworths, 2012) 131.

11 *Marsh v Baxter* [2014] WASC 18, [296].

12 See *Civil Liability Act (2002)* (WA) ss 5B, 5C.

13 McGlone and Stickley, above n 10, 541.

14 Ibid 556.

restrict Mr Baxter from growing his genetically modified crop within 1 km of Eagle rest to prevent future contamination by the GM crop.[15]

IV JUDGMENT

This case was concluded on 28 February 2014, with both actions by the Marshes being dismissed. Justice Kenneth J Martin decided that there were insufficient grounds for the claims of common law negligence and private nuisance to succeed, therefore, the $85 000 and the perpetual injunctions were also dismissed. The reasoning is as follows.

First, common law negligence, Justice K Martin decided that, due to the GM crop growing practice only being introduced in 2010, this is a novel case with little precedence in Australia where there is an absence of established duty of care to avoid foreseeable economic loss.[16] He distinguished from a vaguely similar case *Perre v Apand*,[17] in which the economic loss claim succeeded due to vulnerability of the innocent party. He explained that:

> [He does not] find and degree of vulnerability as arising from the contract the Marshes entered into with NCO/NASAA and under which they have appear to have been wrongly denied their contractual right by NCO to use the label 'NASAA Certified Organic' on their Eagle Rest produce.[18]

He further clarifies that should there have been any vulnerability it was wholly self-initiated by entering in the contract.[19]

There may have been a lesser duty of care owed by Mr Baxter to restrict the movement of the GM crop once stacked. However, Justice K Martin found that Mr Baxter did not breach this duty as he did not have sufficient knowledge of the prior escape event, he gave considerable thought by introducing a 5 metre buffer to his boundary

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15 *Marsh v Baxter* [2014] WASC 18, [745].

16 Ibid [741].

17 See *Perre v Apand* (1999) 198 CLR 180.

18 *Marsh v Baxter* [2014] WASC 18, [741].

19 Ibid.

fence, there was insufficient evidence about unusual wind patterns in November 2010, and finally, the breach does not satisfy the test outlined in s 5B of the *Civil Liability Act*.[20] Therefore, the negligence claim fails.

Second, private nuisance, Justice K Martin decided that there was no unreasonable interference with the Marshes' enjoyment of their land and referenced her Honour McLure P in *Southern Properties*[21] which stated:

> In making that judgment, regard is had to a variety of factors including: the nature and extent of the harm or interference; the social or public interest value in the defendant's activity; the hypersensitivity (if any) of the user or use of the claimant's land; the nature of established uses in the locality (eg, residential, industrial, rural); whether all reasonable precautions were taken to minimise any interference; and the type of damage suffered.[22]

Justice K Martin then outlined eight reasons for the failure of the private nuisance action. The reasons will be briefly listed in no great detail:

(1) There was no physical damage from the swathes to any humans, animals, or land;
(2) Mr Baxter held legitimate reasons for using the swathing process to harvest his crop;
(3) Swathing in itself is not a novel or aberrant method for harvesting a canola crop;
(4) Mr Baxter did not make any uninformed decisions, he relied on expert advice from a local Kojonup agronomist, Mr Chris Robinson;
(5) The airborne GM canola swathes were not reasonably anticipated or expected by Mr Baxter in November 2010;

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20 *Civil Liability Act (2002)* (WA) s 5B.

21 *Southern Properties (WA) Pty Ltd v Executive Director of the Department of Conservation and Land Management* (2012) 42 WAR 287.

22 Ibid [118].

(6) There was a certain measure of first time novelty in the swathe incursion events in November 2010, Mr Baxter has never grown or swathed GM canola crop before;
(7) In the notice of intention to take legal action given to Mr Baxter by Mr Marsh, there was only mention of swathing once, and as a broad context. There was no demand of a different harvest method; and
(8) There was very little research done in terms of separation distances between segregated canola crops.[23]

Finally, the perpetual injunction that the Marshes claimed against Mr Baxter also failed. This is mainly due to the reasons above for the failure of the private nuisance action, but especially for the eighth reason, that there was very little research in terms of the distance that the plaintiffs wanted for the injunction to prevent any future incursion onto the Eagle Rest Land. The plaintiffs fluctuated over identifying the precise dimensions of an appropriate buffer distance, therefore the perpetual injunction claim also failed.[24]

V Closer Look at NASAA Standards

During the judgment, Justice K Martin suggests a closer look at the use of the NASAA standards that govern the contract between Mr and Mrs Marsh and NCO/NASAA, to ascertain whether the decertification was an overreaction or an appropriate use of the standards. Bearing in mind that neither of these groups were parties in the case between the Marshes and Mr Baxter. The section of the NASAA standards that applies to Genetically Modified Organisms (GMO) is standard 3.2[25] in which the standards can be categorised into three categories; those that cannot apply to the Marshes, those that the Marshes did not breach, and those that may apply to the Marshes' situation.

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23 *Marsh v Baxter* [2014] WASC 18, [711]–[721].
24 Ibid [726].
25 See NASAA Ltd, *NASAA Organic Standard* (6 February 2012), 3.2.

First, the NASAA standards that cannot apply to the Marshes' situation are standards 3.2.1 and 3.2.5. These two standards make references to the fact that the organic operator has to have deliberate actions or negligent actions resulting in the contamination, they must have knowledge or be at fault for the cause of the contamination.[26] As Justice K Martin commented, they do not account for the accidental contamination through no fault of the organic operators.[27] This contamination is referred to in the National Standards as 'adventitious contamination', contamination that has come from outside, accidental, or occurring in an unusual place.[28]

Second, the NASAA standards that were not breached by the Marshes, Standards 3.2.2, 3.2.3, 3.2.7, and 3.2.8 make reference to the actual growing of GM crops on the farm not the adventitious contamination of the crop through outside means.[29] The Marshes did not anticipate having GM crop growing on their land and as Justice K Martin stated 'there is and will be no suggestion that Mr or Mrs Marsh ignored or infringed this standard in the circumstances which prevailed at Eagle Rest during 2010'.[30]

NASAA standards 3.2.4 and 3.2.10 were not breached by the Marshes as they state that the organic operators should notify NASAA if they use any ingredient containing GMO's (3.2.4) or if there are any farms growing GM crop within a 10 km radius (3.2.10).[31] Based on the facts of the case, there has been no evidence to prove that the Marshes did anything to breach any of these standards.

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26 Ibid 3.2.1, 3.2.5.

27 *Marsh v Baxter* [2014] WASC 18, [510].

28 Australian Department of Agriculture, *National Standard for Organic and Biodynamic Produce* (1 February 2013), p 6.

29 See NASAA Ltd, *NASAA Organic Standard* (6 February 2012), 3.2.2, 3.2.3, 3.2.7, 3.2.8.

30 *Marsh v Baxter* [2014] WASC 18, [513].

31 See NASAA Ltd, *NASAA Organic Standard* (at 6 February 2012), 3.2.4, 3.2.10.

Finally, the NASAA standards that may apply in this situation are; 3.2.9, 3.2.11, and 3.2.12:

> 3.2.9 Organic certification shall be withdrawn where NASAA considers there is an *unacceptable risk of contamination* from GMOs or their derivatives.
>
> 3.2.11 Contamination of *organic product* by GMOs that results from circumstances beyond the control of the operator *may* alter the organic status of the operation.
>
> 3.2.12 Under the National Standard, NASAA will decertify any *products that are tested* and reveal the presence of GMOs.[32]

NCO revoked the certification given to Mr and Mrs Marsh based on NASAA standard 3.2.9 however, it should have been subject to standards 3.2.11 and 3.2.12 first. NASAA should have first tested the actual produce and animals on Eagle Rest for contamination under 3.2.12 and if there has been any contamination to the 'organic product' as suggested by standard 3.2.11 then the extent of the contamination could be determined. NASAA would then have been able to assess the 'unacceptable risk of contamination' present in Eagle Rest from the airborne GM canola swathes and invoke NASAA standard 3.2.9.

Justice K Martin did make a conclusion on this issue stating:

> All in all, there appears to have been a gross overreaction by NCO to this incident by it proceeding to what presents as very much an unsupportable decertification as to 70% of the area of Eagle Rest (paddocks 7-13) imposed over the period December 2010 to October 2013.[33]

Especially as there was scientific evidence showing that none of the Marshes' crops or sheep could acquire any genetic traits from the GM canola and therefore be contaminated.[34]

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32 Ibid 3.2.9, 3.2.11, 3.2.12.

33 *Marsh v Baxter* [2014] WASC 18, [538].

34 Ibid [667].

VI Conclusion

Genetically modified crops have only been legal to grow in Australia since 2010; therefore, there is a distinct lack of precedence for a case where organic farms are contaminated by genetically modified crops. More issues between Organic and GM farmers will likely arise in the coming years, which makes the case of *Marsh v Baxter* both a controversial and an important case. The decision in this case will not only determine the legal protections accessible to organic farmers, which as seen cannot be of a purely financial loss, but also highlights the issues regarding the strictness NASAA and NCO show when applying their standards concerning genetically modified contamination. In the coming years, there should be more focus towards how to ensure the segregation between organic and GM farms to ensure contamination does not occur and a closer look to the practical application of the NASAA standards should the contamination occur.