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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



# ***‘THEY ARE A TAX FEARING PEOPLE’: DETERRENT EFFECT-PENALTIES, AUDIT AND CORRUPTION IN A DEVELOPING COUNTRY***

NAHIDA FARIDY,\* BRETT FREUDENBERG\*\* AND  
TAPAN SARKER\*\*\*

## **Abstract**

*Critical to a country's tax revenue base is taxpayer compliance, with Allingham and Sandmo's model of tax compliance predicting that if detection is likely and penalties are severe, people will be more compliant. However, the mixed evidence about the deterrent effect has been attributed to factors such as low penalties and corruption. Given the importance of a value added tax ('VAT') for developing nations, this study explores the extent to which there is a deterrent effect to improve compliance with VAT law in such a country. In particular, this article reports the findings from focus groups and a survey of 240 small and medium enterprises ('SMEs') in Bangladesh.*

*The results indicate that there is a greater deterrent effect for SME taxpayers who have a compliant history compared to non-compliant*

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*taxpayers. These results are consistent over a number of measures of deterrence, including the likelihood of audits and penalties. Part of the reason for the reduced deterrence for non-compliant SME taxpayers appears to be due to Tax Officers being 'managed' through bribes. The findings demonstrate that for a deterrent effect through audits and penalties to lead to greater compliance in a developing country, it is essential that the issue of corruption is addressed.*

## I INTRODUCTION

While the specific reasons for adopting a VAT may differ from one country to another, the main argument is that a properly designed VAT raises more revenue than other broad-based taxes. Keen and Lockwood have demonstrated that VAT raised about US\$18 trillion in 2007, representing 20 per cent of the world's tax revenue and affecting approximately 4 billion people.<sup>1</sup> Senior economists of the International Monetary Fund ('IMF') regard VAT as 'probably the most important tax development in the latter part of the twentieth century'.<sup>2</sup> For developing nations, the introduction of a broad-based consumption tax like VAT is seen by supranational organisations, such as the Organisation for Economic Cooperation and Development ('OECD') and the World Bank, as being a critical element in providing a sufficient tax revenue base for government public spending.<sup>3</sup>

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- 1 Michael Keen and Ben Lockwood, 'Is the VAT a Money Machine?' (2006) 59(4) *National Tax Journal* 905.
  - 2 Fiscal Affairs Department, 'Revenue Mobilization in Developing Countries' (Report, International Monetary Fund, 2001).
  - 3 Richard M Bird, 'Taxation and Development: What Have We Learned from Fifty Years of Research?' (Working Paper No 427, Institute of Development Studies, July 2013).

Compliance issues for SMEs are particularly important for developing and transitional economies, as they typically account for more than 95 per cent of all firms outside the primary agriculture sector. They constitute a major source of employment and generate significant domestic and export earnings.<sup>4</sup> For developing economies such as Bangladesh, improving tax compliance for SMEs can contribute to the economic and social development of the country.<sup>5</sup>

Policy makers around the world see VAT as a useful tool to collect at least some taxes from SMEs.<sup>6</sup> However, the VAT collected can be adversely affected by non-compliance and evasion. Developing and underdeveloped countries, along with developed countries, are losing substantial tax revenues due to intentional tax non-compliance or tax evasion.<sup>7</sup> Bangladesh is no exception, as

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4 Sharon Smulders et al, 'Tax Compliance Costs for the Small Business Sector in South Africa — Establishing a Baseline' (2012) 10(2) *eJournal of Tax Research* 184; OECD, *Taxation of SMEs in OECD and G20 Countries* (OECD Publishing, 2015).

5 Lewis I Baurer, 'Tax Administrations and Small and Medium Enterprises (SMEs) in Developing Countries' (Working Paper No 39110, World Bank Group, 2005).

6 Michael Engelschalk, 'Designing a Tax System for Micro and Small Businesses: Guide for Practitioners' (Working Paper No 42435, International Finance Corporation, 2007).

7 In the United Kingdom (UK), VAT revenue losses through evasion is estimated to be in 2013–14 £13.1 billion, which is 11.1% of potential VAT revenue. See HM Revenue and Customs, *Measuring Tax Gaps 2015 Edition: Tax gaps estimates for 2013–14* (2015). In Italy the size of VAT evasion in 1977 was estimated to be as high as 40% of VAT revenue. See Stephen Smith, 'VAT Fraud and Evasion' in Judith Payne (ed), *The IFS Green Budget 2007* (The Institute for Fiscal Studies, 2007) 167. A study by the Global Financial Integrity

Transparency International Bangladesh ('TIB') estimated that an amount of BDT 210 billion (US\$2.8 billion) in taxes was evaded or defalcated in the 2009–10 financial year ('FY'). This represents 2.8 per cent of Bangladesh's national income, which is equivalent to one-third of tax revenues collected during that year. The TIB noted that the National Board of Revenue ('NBR') would have collected 34 per cent more revenue if this evasion had not occurred. The TIB also identified tax evasion as a major reason for the country's poor tax to Gross Domestic Product ('GDP') ratio.

The problem of non-compliance by taxpayers is seen to be more severe in developing nations, where there may be an absence of tax culture, a large informal sector, corruption of tax officials, and a lack of effective enforcement and monitoring of the tax enforcing agencies.<sup>8</sup> For VAT to be effective in assisting developing nations, there needs to be, aside from other factors, effective compliance. However, our understanding of VAT compliance in developing nations, in particular deterrence, is scant. As a developing nation, Bangladesh has had a VAT for over 24 years, and VAT has contributed, on average, some 37 per cent to total tax revenue over the last 15 years.<sup>9</sup> Despite this, many SME<sup>10</sup> taxpayers do not

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demonstrates that, due to tax evasion and corruption, India has lost US\$213 billion in the period between 1948–2008 due to tax evasion and corruption, which is almost 18% of India's 2008 GDP. See KPMG, *Survey on Bribery and Corruption Impact on Economy and Business Environment* (2011) <<https://www.kpmg.com/Global/en/IssuesAndInsights/ArticlesPublications/Documents/bribery-corruption.pdf>>.

8 James Andreoni, Brian Erard and Jonathan Feinstein, 'Tax Compliance' (1998) 36 *Journal of Economic Literature* 818.

9 Ahmed M Saleheen, 'Presumptive Taxation under Bangladesh' (2012) 23(5) *International VAT Monitor* 316; National Board of Revenue, *Annual Report 2011–2012* (2014).

comply with the VAT legislation by not only failing to register for VAT, but also failing to pay the VAT.<sup>11</sup>

Saleheen has conjectured that SME non-compliance could be due to ineffective or under-enforcement of the VAT legislation by the Bangladeshi tax authorities.<sup>12</sup> Indeed, Allingham and Sandmo's model of tax compliance predicts that if detection is likely, and penalties are severe, people will be more compliant.<sup>13</sup> Studies have

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- 10 Using the measures adopted by the National Board of Revenue (the administrating body for VAT in Bangladesh) an SME is an enterprise with an annual turnover equal or greater than 8 million BDT (US\$0.11 million), but with an annual VAT payment less than 50 million BDT (US\$0.67 million). Note 8 million BDT is the VAT registration threshold, and the 50 million BDT and greater is used by the National Board of Revenue to signify large taxpayers.
  - 11 Towfiqul Islam Khan and Mustafizur Rahman, 'Tax Policy and Enterprise Development in South Asia: Bangladesh Case Study' (Report, Centre for Policy Dialogue, 2014) <[http://giniweb.net/gini\\_idrc\\_site1/downloads/Ban-Research\\_Design\\_Document\\_CPD.pdf](http://giniweb.net/gini_idrc_site1/downloads/Ban-Research_Design_Document_CPD.pdf)>.
  - 12 Ahmed M Saleheen, 'Taxation and Good Governance: The Case of Value-Added Tax in Bangladesh' (Doctoral Thesis, Flinders University, 2013) <<http://flex.flinders.edu.au/file/50801cdf-7c7d-4292-834f-2b4a95b453b0/1/Thesis-Saleheen-2013-Abstract.pdf>>.
  - 13 Michael G Allingham and Agnar Sandmo, 'Income Tax Evasion: A Theoretical Analysis' (1972) 1 *Journal of Public Economics* 323; Barak Ariel, 'Deterrence and Moral Persuasion Effects on Corporate Tax Compliance: Findings from a Randomized Controlled Trial' (2012) 50 *Criminology* 27; Dina Pomeranz, 'No Taxation without Information: Deterrence and Self-Enforcement in the Value Added Tax' (2015) 105(8) *The American Economic Review* 2539; Colin C Williams, *Confronting the Shadow Economy: Evaluating Tax Compliance and Behaviour Policies* (Edward Elgar Publishing, 2014).

found a multitude of reasons for non-compliance, including that non-compliance decisions can be indirectly related to the threat of penalties; larger fines are a more effective deterrent than are frequent audits.<sup>14</sup> Some studies further suggest that a penalty increase can have unintended and undesirable effects, resulting in more tax evasion.<sup>15</sup> The mixed evidence about the deterrent effect has been attributed to factors such as penalties for non-compliance being too low, or corruption undermining the enforcement system.<sup>16</sup> Indeed, it appears that corruption does exist in Bangladesh and adds to VAT compliance costs, with bribes (speed payments) accounting for approximately 10 per cent of compliance cost for SMEs.<sup>17</sup>

This article seeks to address the current research gaps surrounding the deterrent responses of government enforcement activities in developing countries. In doing this, the study considers and compares the perceptions of compliant and non-compliant SME taxpayers in Bangladesh. In particular, this article considers the effectiveness of deterrent measures to ensure compliance with VAT laws in Bangladesh. The findings highlight that, for compliant

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14 Nehemiah Friedland, Shlomo Maital and Aryeh Rutenberg, 'A Simulation Study of Income Tax Evasion' (1978) 10(1) *Journal of Public Economics* 107.

15 Andreoni, Erard and Feinstein, above n 8; Carol M Fischer, Martha Wartick and Melvin M Mark, 'Detection Probability and Taxpayer Compliance: A Review of the Literature' (1992) 11(2) *Journal of Accounting Literature* 1; Bruno S Frey, 'Deterrence and Tax Morale in the European Union' (2003) 11(3) *European Review* 385.

16 A M Polinsky and Steven Shavell, 'On Offense History and the Theory of Deterrence' (1998) 18(3) *International Review of Law and Economics* 305; A M Polinsky and Steven Shavell, 'On the Disutility and Discounting of Imprisonment and the Theory of Deterrence' (1999) 8 *Journal of Legal Studies* 1.

17 Khan and Rahman, above n 11.

taxpayers, the deterrent effects of penalties and audits appear to increase compliance, whereas non-compliant taxpayers reported that they are unlikely to reduce their non-compliance with the VAT legislation.

Section two of this article provides an overview of VAT within Bangladesh. Section three briefly reviews the literature regarding the non-compliance theories, including economic deterrence models and social psychology models. This discussion is then followed by an outline of the methods used in this study, comprising of focus groups and a survey. Following this, the findings of the study for both methods are provided. The subsequent section provides a general discussion of the overall findings, before the final section concludes the article and provides suggestions for future research.

## II OVERVIEW OF VAT IN BANGLADESH

Since the introduction of the VAT in Bangladesh in 1991, it has become the largest source of revenue for the Bangladeshi government, ranging from 32 per cent to 39 per cent. However, the tax/GDP ratio is very low in Bangladesh compared with other developing nations. Table 1 illustrates that in Bangladesh, the tax/GDP ratio was less than 10 per cent in 2005–06, and 11 per cent in 2011–12.<sup>18</sup> In comparison, in 2005, the average tax/GDP ratio in the developed world was approximately 35 per cent. In developing countries, it was 15 per cent, and in the poorest of these countries (the low income countries) tax revenue was 12 per cent of the GDP.<sup>19</sup> This low percentage is of concern as Nicholas Kaldor argues

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18 Ministry of Finance, *Bangladesh Economic Review: 2012* (2013).

19 Clemens Fuest and Nadine Riedel, 'Tax Evasion, Tax Avoidance and Tax Expenditures in Developing Countries: A Review of the

that, in order for a country to move away from its ‘developing’ status to a ‘developed’ nation, its collected taxes need to account for 25 per cent to 30 per cent of the GDP.<sup>20</sup>

The IMF believes that this relatively low revenue to GDP ratio is due to inherent weaknesses in the Bangladeshi taxation system, which could be attributed to weaknesses in tax policy as well as revenue administration.<sup>21</sup> Additionally, Keen argues that citizens and businesses are discouraged to comply with tax obligations due to the absence of a well-designed tax system, the large informal business sector and the corrupt tax administration.<sup>22</sup>

**Table 1: Bangladesh’s Tax Revenue as a % of GDP**

	<b>2009-10</b>	<b>2010-11</b>	<b>2011-12</b>	<b>2012-13</b>	<b>2013-14</b>	<b>2014-15 Projections</b>
Total Revenue	10.9	11.7	12.4	13.2	13.6	14.2
Tax Revenue	9.0	10.0	10.4	10.9	11.3	12.2
NBR Tax	8.5	9.6	10.0	10.5	10.7	11.8

Literature’ (Report, Oxford University Centre for Business Taxation, 2009).

20 Bird, above n 3, 3.

21 International Monetary Fund, Bangladesh: country report No. 13/357 (December 2013) <<https://www.imf.org/external/pubs/ft/scr/2013/cr13357.pdf>>; Richard M Bird and Eric M Zolt, ‘Technology and Taxation in Developing Countries: From Hand to Mouse’ (Research Paper No 08-07, UCLA School of Law, September 2008).

22 Michael Keen, ‘VAT Attacks!’ (Working Paper 07/142, International Monetary Fund, June 2007).

Collection						
Of which: <i>VAT and SD</i>	4.9	5.4	5.5	5.5	5.6	6.4
<i>Customs and Excise Duties</i>	1.3	1.4	1.4	1.5	1.4	1.5
<i>Taxes on income and profit</i>	2.3	2.8	3.1	3.5	3.7	3.9

*Source: National Board of Revenue, Annual Report 2011–2012 (2014).*

It has been estimated that in terms of VAT productivity, for each point of the standard VAT rate, Bangladesh generates only 0.22 per cent of GDP in revenue compared to 0.34 per cent of GDP in other low income countries.<sup>23</sup> If Bangladesh could raise its VAT productivity by 0.12 per cent of GDP to the average level of other low income countries, then with everything being equal, VAT could increase government revenues by 1.8 per cent of GDP.<sup>24</sup> It is estimated that the informal economy in Bangladesh accounts for approximately 39 per cent of GDP, which can have a negative impact on the macroeconomic stability.<sup>25</sup>

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23 Fiscal Affairs Department, above n 2.

24 National Board of Revenue, above n 10.

25 Transparency International Bangladesh, Bangladesh Country Report (2012) <<http://www.btiproject.de/fileadmin/Inhalte/reports/2012/pdf/BTI%202012%20Bangladesh.pdf>>; James Heintz, 'Informality, Inclusiveness, and Economic Growth: An Overview of Key Issues' (Working Paper 2012/2, International Development Research Centre, July 2012); Parthasrathi Shome, 'Tax Administration and the Small



This low VAT collection may be due to a lack of effective monitoring or enforcement on the part of authorities such as the NBR, whose responsibility includes tax collection, administration and policy design.<sup>26</sup> In economic terms, any lack of effective monitoring or enforcement on the NBR's part could imply that the expected costs to the NBR of better monitoring and better enforcement of the VAT law exceed the perceived benefits,<sup>27</sup> including those arising from any deterrent effects that enhanced monitoring and enforcement might have on taxpayers. Other reasons for ineffective monitoring could relate to the skill of the audit staff, poor information systems to provide data, and scarce resources. In this context, deterrent effects arise if VAT taxpayers are generally more compliant with the VAT law because they see other (typically, high profile) taxpayers being successfully prosecuted or penalised for non-compliance, and are thereby themselves deterred from non-compliance.<sup>28</sup>

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Taxpayer' (Discussion Paper No PDP/04/2, International Monetary Fund, May 2004).

- 26 Erich Kirchler, *The Economic Psychology of Tax Behaviour*, (Cambridge University Press, 2007).
- 27 Some data also suggests considerable inefficiencies in the administration of the Bangladeshi VAT. For example, there are over 18 000 pending court cases related to VAT and Customs in the Bangladeshi High Court, representing — according to the taxation authorities — about 30 billion taka in potential VAT collections outstanding. See Rahman Mustafiz, 'Bangladesh' in Yoshimi Kitamura (ed), *International Comparisons of Taxation in Developing Countries* (Keio University, 2011) 73. Having said this, any investigation into the efficiency or otherwise of the administration of the Bangladeshi VAT is beyond the scope of this article.
- 28 Polinsky and Shavell (1998), above n 16; Polinsky and Shavell (1999), above n 16; Eric Posner, *Law and Social Norms* (Cambridge University Press, 2000); Jan Palmer, 'Economic Analysis of the Deterrent Effect of Punishment: A Review' (1977) 14 *Journal of*

### A VAT Rate

To appreciate the potential deterrence effect, it is useful to have a broad understanding of Bangladesh's VAT, and its penalty and audit system. Although the standard statutory rate is 15 per cent, the Bangladeshi VAT also has exemptions and zero-rating.<sup>29</sup> However, the reality is that there are other rates in practice (4 per cent, 4.5 per cent, 5 per cent, and 9 per cent) that have emerged due to different methods of calculating<sup>30</sup> the VAT.<sup>31</sup> One of the greatest deviations from the standard practice is the value declaration of Bangladesh VAT system.<sup>32</sup>

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*Research in Crime and Delinquency* 4, 4; Bruce L Benson, Iljoong Kim and David W Rasmussen, 'Estimating Deterrence Effects: A Public Choice Perspective on the Economics of Crime Literature' (1994) 61 *Southern Economic Journal* 1, 161.

29 James M Bickley, *Value Added Tax: Concepts, Policy Issues and OECD Experiences*, (Nova Publishers, 2003).

30 Though in the standard practices of VAT, the amount of VAT is calculated by applying the VAT rate to the difference between sales and purchases, the Bangladesh VAT contains a number of assessment methods applicable to different groups of businesses. Section 5 of the VAT Act 1991 (Bangladesh) ('VAT Act') stipulates methods of valuation for the purpose of determining the amount of VAT charged at different stages of business transaction. At the importation stage, the value on which VAT is charged is the value which is arrived at by adding all duties and charges to the assessable value ascertained/determined: Customs Act 1969 ss 25 or 25a.

31 Abul Maal Abdul Muhith, 'Budget Speech 2013–2014: Four Years of Progress: Bangladesh Marches On' (Speech delivered at the Ministry of Finance in Dhaka, 6 June 2013).

32 In Bangladesh, VAT rules provide for a declaration and subsequent approval from the VAT Authority of the value of the product by a supplier on which VAT will be assessed. The supplier is required to provide information about the input-output co-efficient of the product,

## B *Offences and Penalties*

There are a number of offences and penalties for persons failing to comply with the VAT law.<sup>33</sup> These include failing to register or to submit a VAT return by the specified time, and failing to inform a VAT officer about any change of information in relation to registration.<sup>34</sup> Most occurrences of intentional non-compliance include attempting to evade VAT by supplying goods without recording information in current-account books (*Mushak-18*)<sup>35</sup> or in sales-account books (*Mushak-17*), and evading or attempting to evade VAT by submitting counterfeit or false documents to a VAT Officer.<sup>36</sup>

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that is, the quantity of raw materials, the packaging materials used for each unit of the goods, the percentage of wastage and the components of value addition. The VAT Act empowers the authority to determine the value of the relevant good for imposition of VAT.

33 VAT Act (Bangladesh) ss 37 and 37A.

34 The penalties for breaching these range from 10 000 BDT (US\$133) to a maximum penalty of 25 000 BDT (US\$333). Any taxpayer who, after two written notifications from their local National Board of Revenue branch office, unintentionally fails to give a tax invoice in a timely way, or who fails to pay VAT or supplementary duty on goods or services supplied, is liable to pay a minimum penalty of 10 000 BDT (US\$133) and a maximum penalty of 100 000 BDT (US\$1333) for their failure to comply. In contrast, any taxpayer who intentionally provides a fake invoice or submits a VAT return that is false in important respects is liable to pay, as a minimum penalty, the amount of the tax evaded; and, as a maximum penalty, 2.5 times the amount of VAT that should have been paid.

35 In Bangladesh VAT is known as *Mushak*.

36 Other examples include intentionally failing to retain required documents (invoices and receipts) or destroying relevant documentation, without the permission of the local VAT office; and

### *C Taxation Audits and Appeals*

The Bangladesh VAT has specific provisions for the carrying out of audits in business transactions. To this effect, the NBR issued a number of general orders detailing the audit mechanism and an Audit Manual in 2006. According to this audit manual, each VAT registrant should be audited at least once every three years. However, given that a reassessment of VAT registered business can be done within five years from the date of a certain business transactions, at least one audit should be done once every five years.<sup>37</sup>

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intentionally making a false statement or declaration. Also considered as intentional non-compliance are the following: the intentionally obstruction or prevention of a VAT officer in the course of their duty; intentionally being involved in receiving, taking possession of, or carrying goods in respect of which VAT or supplementary duty has been evaded; and claiming an input tax credit through a false or counterfeit VAT invoice.

- 37 The National Board of Revenue has a Central Audit Directorate headed by a Director General. In addition, each VAT Commissionerate has an Audit Wing headed by a Joint Commissioner. In addition to the existing organizational set-up for conducting audits in VAT, the National Board of Revenue constituted a Central Audit Cell in 2006 to facilitate integrated audits through the exchange of information among the VAT, Income Tax and Customs Divisions. Taxpayer audits are commissioned by the VAT Commissionerate or by any Officer of the Commissionerate with the rank of Joint Commissioner of VAT or above. In the VAT Commissionerate, there are two relevant levels of executive officer above the Joint Commissioner of VAT. These are the Commissioner of VAT himself, and the Additional Commissioner of VAT. Section 26ka of the VAT Act provides: 'A value added tax officer, not below the rank of a Joint Commissioner, may order the auditing of tax and

The VAT law provides for a number of taxpayer rights. According to the *VAT Act 1991* (Bangladesh) ('VAT Act') and Rules, taxpayers enjoy the right of appeal against any decision of a VAT Officer, and taxpayers have the opportunity of being personally heard.<sup>38</sup> Any aggrieved taxpayer intending to appeal against a decision or order relating to a demand of VAT payable on any goods or services or to a fine imposed under the *VAT Act* has to pay 10 per cent of the fine imposed or VAT demanded to the Commissioner Appeal.<sup>39</sup>

#### *D VAT Administration and Enforcement*

Among the enforcement issues in Bangladeshi VAT are the quasi-judicial powers of the VAT Officers, the preventive surveillance, the

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tax related activities of a registered or registrable firm for a specified period and the officer or officers ordered for the purpose shall, after completion of the audit on the basis of orders issued by the Board and the audit manual including the provisions of this Act and the rules made there under, within the specified time, submit a report to the ordering officer'. See Ministry of Finance, Budget Speech 1991–1992 (1991).

- 38 Taxpayers who are aggrieved with any decision or order of a VAT Officer can appeal directly to the Commissioner (Appeal) of VAT and then to the Customs, Excise and VAT Appellate Tribunal. If the taxpayers are not satisfied with the decision of the above two, they can further appeal to the single Judge of the High Court Division of the Supreme Court of Bangladesh and then to the Appellate Division (Full Bench) of the Supreme Court of Bangladesh.
- 39 In the case of an appeal to the Appellate Tribunal against an order given by the Commissioner or by any other value added tax officer of equivalent rank, taxpayers have to pay 25% of VAT demanded or fine imposed. Additionally, in the case of an appeal preferred to the Appellate Tribunal against an order of the Commissioner (Appeal), taxpayers have to pay 15% of the tax demanded or fine imposed.

supervisory clearance of goods, and the use of stamp and banderol.<sup>40</sup> In dealing with tax enforcement, Bangladesh VAT offers a unique approach called quasi-judicial power of adjudication.<sup>41</sup> In Bangladesh, the VAT Officers have the power to seize any goods liable for confiscation. Bangladeshi VAT Officers are more active in seizing rather than in auditing, as there are higher numbers of seizure cases than audits.<sup>42</sup> There is a provision of supervisory clearance in Bangladeshi VAT law which can be made applicable to any goods if the VAT Commissioner believes that a large tax evasion by a particular firm is occurring. With this understanding of Bangladesh's VAT system, the theories about deterrence and non-compliance will be canvassed next.

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40 Section 6(4ka) of the VAT Act has empowered the National Board of Revenue to direct the use of stamp or banderol or special sign or mark of specified size and design for the purpose of realising VAT or SD. Currently stamps and banderols are used in cigarettes, cold drinks and mineral water, toiletries and some other packaging items. It is claimed by National Board of Revenue that uses of stamps and banderols are effective to control VAT evasion and to collect revenue.

41 For offences committed under the VAT law, all VAT Officers (from Revenue Officer up to Commissioner) have quasi-judicial powers of adjudication based on their rank and jurisdiction. The VAT Officers therefore act as both prosecutors and adjudicators.

42 In 2009–10, the number of seizures was 638 involving an amount of revenue of BDT 158 million, while far fewer audits (176) unearthed an evasion/avoidance of BDT 1719 million. This is supported by the study of Saleheen, above n 12. It is not known why exactly there are more seizures but could relate to the ease of a result given that with seizures VAT Officials act as both prosecutors and adjudicators.

### III THEORIES

#### *A Deterrent Effects of VAT*

The deterrence effect occurs when taxpayers are more compliant with VAT because they see other taxpayers being successfully prosecuted or penalised for non-compliance, and are aware of the potential penalties for nonconformity. Deterrence effects, where they exist, are a form of positive externality. Thus deterrence effects of successfully prosecuting or penalising non-compliant taxpayers are a form of positive externality, provided the benefits to the community as a whole exceed the costs to the community of doing so.<sup>43</sup> For example, other taxpayers, who may be more numerous and, together, of more value in terms of potential revenue collected, perceive that they too will be prosecuted or penalised if they do not comply with the VAT law.

According to the deterrence theory, the level of legislative compliance is positively related to the level of enforcement and punishment, including penalties.<sup>44</sup> The theory specifies that the level of enforcement and punishment determines the level of

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43 Robert Pindyck and Daniel Rubinfeld, *Microeconomics* (Pearson International, 7th ed, 2009).

44 Margaret McKerchar, *The Impact of Complexity upon Tax Compliance: A Study of Australian Personal Taxpayers* (Australian Tax Research Foundation, 2003). Of course, the deterrence theory is only part of the compliance puzzle with many other reasons contributing to compliance such as education and beliefs. See Nahida Faridy et al, 'The Hidden Compliance Cost of VAT: An Exploration of Psychological and Corruption Costs of VAT in a Developing Country' (2016) 14(1) *eJournal of Tax Research* 166.

compliance.<sup>45</sup> Penalties and punishments by a legal system communicate to individuals that the legal system takes intentional tax non-compliance as a serious crime. For some taxpayers, the penalties must be demonstrated in concrete sentences that are relevant to their own life situation. The imposition of fines and punishments is a demonstration to society that the legal system is serious in its attempt to prohibit illegal behaviour such as tax evasion. Therefore, even increasing the penalty or fine may improve the deterrent effect. Similarly, the threat of punishment, in the form of a higher penalty rate, is considered a positive strategy for influencing behaviour, as the Australian Taxation Office has undertaken through the issuing of tax rulings and media releases about the enforcement of tax laws.<sup>46</sup>

Conversely, the enforcement and punishment for non-compliance with tax legislation can add to the cost of non-compliance — not only to taxpayers who are caught, but also to others who are non-compliant but not yet caught. The notion of 'cost' can direct monetary cost, but also psychological costs, which has been found to be higher for non-compliant taxpayers.<sup>47</sup> Punishment and the imposition of fines demonstrate to society that the legal system takes contraventions or non-compliant behaviour seriously. Furthermore, the public disclosure of a non-compliant taxpayer's identity and their

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45 Ern Chen Loo, 'Tax Knowledge, Tax Structure and Compliance: A Report on a Quasi-Experiment' (2006) 12(2) *New Zealand Journal of Taxation Law and Policy* 117.

46 Ken Devos, 'Measuring and Ensuring and Analysing Deterrence in Taxpayer Compliance Research' (2007) 10(2) *Journal of Australian Taxation* 182. The Australian Taxation Office's Compliance Model is available at <https://www.ato.gov.au/About-ATO/About-us/In-detail/Key-documents/Compliance-model/>.

47 Faridy et al, above n 44.



punishment can detrimentally affect their reputation, and act as a further deterrent.<sup>48</sup>

Some taxpayers can be more sensitive than others to such threats and punishments. According to deterrence theory, those (generally more numerous) taxpayers who are deterred from non-compliance with tax legislation will be in this category. However, at least some of those non-compliant (often high-profile) taxpayers who are successfully prosecuted and penalised will be less sensitive to the threat and level of punishment.<sup>49</sup>

Deterrence by punishment has been described as a method of retrospective interference, by holding out threats that whenever a wrong is committed the wrongdoer will incur punishment.<sup>50</sup> Deterrence aims to discourage potential offenders by demonstrating the punishment of convicted offenders.<sup>51</sup> The threat of punishment

48 Michael Levi, 'Serious Tax Fraud and Noncompliance: A Review of Evidence on the Differential Impact of Criminal and Noncriminal Proceedings' (2010) 9(3) *Criminology & Public Policy* 3, 493. The media also has the incentive to report non-compliance with taxation legislation, since such stories can generate public attention. See Devos, above n 46.

49 Polinsky and Shavell (1998), above n 16; Polinsky and Shavell (1999), above n 16. Of course, outside of the deterrence theory, there may be other reasons why taxpayers comply including their sense of civic duty and moral obligation. See Nahida Faridy et al, 'Complexity, Compliance Costs and Non-Compliance with VAT by Small and Medium Enterprises (SMEs) in Bangladesh: Is there a Relationship' (2014) 29(2) *Australian Tax Forum* 281.

50 Courtney Stanhope Kenny, *Outlines of Criminal Law* (Cambridge University Press, 13th ed, 1929).

51 Nigel Walker, *Crime and Punishment in Britain* (Edinburgh University Press, 1965).

(fines, penalties and imprisonment) may improve taxpayers' behaviour and habits of obeying the tax law and stopping criminal activities. The New Zealand case of *R v Radich* is useful to illustrate the purpose of punishment:

One of the main purposes of punishment ... is to protect the public from the commission of such crimes by making it clear to the offender and to other persons with similar impulses that, if they yield to them, they will meet with severe punishment. In all civilised countries, in all ages, that has been the main purpose of punishment and still continues so.<sup>52</sup>

However, the empirical evidence relating to the effectiveness of a deterrence effect is mixed, at least from the developed economies, with the observed effects being weaker than expected, and at best inconclusive or non-existent.<sup>53</sup> Some of these weak results may be because the penalties for non-compliance within the law are too low.<sup>54</sup> In addition, corruption can undermine penalties, with some taxpayers in South Africa believing that their tax officials can be managed relatively easily with the use of side-payments or bribes.<sup>55</sup> Similarly, in Bangladesh, where there may be corruption among the

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52 [1954] NZLR 86, 201.

53 Ken Devos, 'An Investigation In to Australian Personal Tax Evaders — Their Attitudes Towards Compliance And The Penalties For Non-Compliance' (2009) 19(1) *Revenue Law Journal* 1; Frey, above n 15; M M Ali, H W Cecil and J A Knoble, 'The Effects of Tax Rates and Enforcement Policies on Taxpayer Compliance: A Study of Self-Employed Taxpayers' (2001) 29(2) *Atlantic Economic Journal* 186; Andreoni, Erard and Feinstein, above n 8; Fischer, Wartick and Mark, above n 15.

54 Polinsky and Shavell (1998), above n 16; Polinsky and Shavell (1999), above n 16.

55 International Finance Corporation, 'Tax Perception and Compliance Cost Surveys: A Tool for Tax Reform' (Report, International Monetary Fund, 2001).

tax authorities and the policy makers, this potentially could reduce the effectiveness of the deterrent effect.<sup>56</sup>

### *B Corruption in Taxation*

Perceptions of fairness and corruption have also been identified in the tax compliance literature as a crucial factor.<sup>57</sup> Feld and Frey noted that taxpayers show more willingness to comply with tax law when governments are seen to be fair, not corrupt, and to treat taxpayers respectfully.<sup>58</sup> This willingness to comply with the tax authorities also relates to the degree of satisfaction with public services.<sup>59</sup> Kirchler conveyed the idea that mutual respect and trust between tax authorities and taxpayers has an important role in voluntary compliance. Trust also appears to be related to perceptions of corruption.<sup>60</sup> In 2012, a survey of the European Commission revealed that 57 per cent of Europeans believed that corruption is a major problem in Europe, and that bribery and the abuse of power

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56 Nashid Rizwana Monir, *Political Economy of Corruption: The Case of Tax Evasion in Bangladesh* (Doctoral Thesis, Monash University, 2012).

57 Benno Torgler, 'Tax Morale, Trust and Corruption: Empirical Evidence from Transition Countries' (Working Paper No 2004-05, Centre for Research in Economics, Management and the Arts (CREMA), 2004); Michael Wenzel, 'Tax Compliance and the Psychology of Justice' in Valerie Braithwaite (ed), *Taxing Democracy: Understanding Tax Avoidance and Evasion* (Ashgate, 2003) 41.

58 Lars P Feld and Bruno S Frey, 'Trust Breeds Trust: How Taxpayers are Treated?' (2002) 3 *Economics of Governance* 87.

59 James Alm et al, 'Taxpayer Information Assistance Services and Tax Compliance Behavior' (2001) 31 *Journal of Economic Psychology* 577.

60 Kirchler, above n 26.

for personal gains were widespread among politicians.<sup>61</sup> Corruption and tax evasion (intentional non-compliance) are two major problems globally, as these two factors obstruct socio-economic progress in developing countries, and erode the welfare programmes of developed countries.<sup>62</sup> These two economic delinquencies sometimes occur together, and sometimes substitute for one another, depending on the situation and the economic condition of a country. Corruption and taxpayer non-compliance are significantly interrelated and reinforce each other in causing negative effects on government finances, growth and wealth distribution.<sup>63</sup> The prior literature of developing countries demonstrates that more than half of the taxes that could, or should, be collected remain untraced by government treasuries due to corruption and tax evasion.<sup>64</sup>

Taxation and corruption have been widely discussed in the public finance literature. In a number of studies, it has been empirically established that the countries with a high level of corruption tend to

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61 TNS Opinion and Socia, 'Corruption Report: Eurobarometer No 374' (Report, European Commission, February 2012) <[http://ec.europa.eu/public\\_opinion/archives/ebs/ebs\\_374\\_en.pdf](http://ec.europa.eu/public_opinion/archives/ebs/ebs_374_en.pdf)>.

62 O J Olatunde, 'Tax Evasion, Tax Avoidance, and Corruption: An Interface with Source of Revenue for Development in Nigeria' (2014) 2 *Journal of Critical and Applied Economics* 1.

63 Anastasia Litina and Theodore Palivos, 'Explicating Corruption and Tax Evasion: Reflections on Greek Tragedy' (Working Paper No 2011\_07, University of Macedonia, May 2011).

64 P R Krugman et al, *Transforming the Philippine Economy* (National Economic and Development Authority, 1992); Richard M Bird, *Tax Policy and Economic Development* (Johns Hopkins University Press, 1992); James Alm, Roy Bahl and Matthew Murray, 'Tax Base Erosion in Developing Countries' (1991) 39(4) *Economic Development and Cultural Change* 849.

have a lower collection of tax revenue as a percentage of GDP.<sup>65</sup> As Le points out, corruption and tax evasion reduce voluntary compliance with tax laws and regulations, demoralising honest taxpayers, and create an atmosphere of distrust. Corruption by tax officials has been established as a vital reason for non-compliance in most developing countries.<sup>66</sup> The TIB report of 2011 stated that the NBR in Bangladesh lost US\$3 billion in one year and failed to generate optimum revenue, due to tax officials' involvement in corrupt practices, a high rate of indirect tax, and people's unwillingness to pay taxes due to apparently complex procedures.<sup>67</sup>

Flatters and Macleod have identified three agents in developing countries which can be involved in corruption: the Minister of Finance (or government or president) who sets the revenue target, the collector who collects the revenue for the Ministry of Finance, and the taxpayer who pays the tax to the collector.<sup>68</sup>

The first agent might take part in corruption by the formulation of complex tax laws and policies which result in a degree of uncertainty as to how the tax law should apply, especially if the tax collector has discretion with its application. The last two agents

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65 Vito Tanzi and Hamid Davoodi, 'Corruption, Growth and Public Finances' (Working Paper No 00/182, International Monetary Fund, 2000).

66 Tuan Minh Le, 'Combating Corruption in Revenue Administration: An Overview' in J E Campos and Sanjay Pradhan (eds), *The Many Faces of Corruption: Tracking Vulnerabilities at the Sector Level* (The World Bank, 2007) 335; Victor Thuronyi, *Comparative Tax Law* (Kluwer Law International, 2003).

67 Ahmed M Saleheen, 'Reigning Tax Discretion: A Case Study of VAT in Bangladesh' (2013) 16(2) *Asia-Pacific Journal of Taxation* 77.

68 Frank Flatters and W B Macleod, 'Administrative Corruption and Taxation' (1995) 2 *International Tax and Public Finance* 397.

might be directly involved in corruption and tax evasion. In the case of most developing countries, tax officials can be lowly paid, the monitoring system inefficient, and the taxation system complex. The tax system can be manually operated and the tax collectors might overlook various types of intentional non-compliance activities through bribes from taxpayers. Obid, who has examined the effect of corrupt tax administration on tax compliance, points out that poorly paid and low morality tax officials might tend to maximise personal benefit by colluding with the taxpayers in utilising the complexities of the tax system and the inadequate resources of the tax administration.<sup>69</sup> Obid further argues that corruption negatively affects the equity and fairness of the tax system, as well as the efficiency of the tax administration. Despite the importance of this topic, very little empirical research has been conducted to date on corruption and taxpayers' non-compliance in Bangladesh. Monir identified the influential driving forces for income tax non-compliance as being the absence of a tax culture among income earners, the inadequacy of taxpayer services, the complexities and unfairness with the income tax estimation, and the weak enforcement by, and negative image of, the income tax department.<sup>70</sup> The empirical findings of that study also revealed that corruption is facilitated by inappropriate relationships between self-interested policy makers and rent-seeking income tax officials, and between self-utility maximiser taxpayers and their intermediaries and income tax agents.<sup>71</sup> As Monir's study was limited to income tax evasion in the socio-economic and administrative context of

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69 Siti Normala Sheikh Obid, 'The Influence of Penalties on Taxpayers' Compliance: A Comparison of the Theoretical Models' (2004) 12(1) *IJUM Journal of Economics & Management* 1.

70 Monir, above n 56.

71 Ibid.

Bangladesh, generalising the findings to VAT non-compliance by SMEs is problematic.

Over the last 40 years, two widely accepted findings have emerged from the considerable body of literature which has developed in the area of taxpayer compliance.<sup>72</sup> Firstly, taxpayer non-compliance is a continual and growing global problem that is not adequately addressed in many countries. Secondly, despite a great deal of research originating from a wide variety of disciplines, there is not a unified consensus about why people do, or do not, pay their taxes or otherwise comply with their tax obligations. Most of the literature about taxpayer non-compliance has been concerned mainly with direct taxes and has focused on developed countries. The analysis of indirect tax non-compliance is largely ignored.<sup>73</sup> Indeed, VAT is seen as a neglected area in the compliance behaviour and tax evasion research.<sup>74</sup> A reason for the absence of VAT from evasion studies may be due to the common belief that VAT has a self-policing mechanism: buyers of intermediate goods have opposing interests to the sellers, thus reducing the scope for VAT evasion.<sup>75</sup> However, in practice, VAT in several countries has not achieved its objective of raising the projected revenue, as VAT, like any other

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72 James Alm, 'Measuring, Explaining and Controlling Tax Evasion: Lessons from Theory, Experiments, and Field Studies' (2012) 1(1) *International Tax and Public Finance* 54; Margaret McKerchar and Chris Evans, 'Sustaining Growth in Developing Economies through Improved Taxpayer Compliance: Challenges for Policy Makers and Revenue Authorities' (2009) 7(2) *eJournal of Tax Research* 171.

73 Alm, above n 72; Agnar Sandmo, 'The Theory of Tax Evasion: A Retrospective View' (2005) 58(4) *National Tax Journal* 643.

74 Alm, above n 72.

75 Michael Keen and Stephen Smith, 'VAT Fraud and Evasion: What Do We Know and What Can Be Done?' (2007) 59 *National Tax Journal* 861.

tax, is open to fraud and evasion.<sup>76</sup> For these reasons, Hemming and Kay questioned the 'self-enforcing' power of VAT, as both seller and buyer can benefit from intentional non-compliance where tax administrations have poor control and auditing.<sup>77</sup>

Although there is some research into compliance with consumption taxes in developed economies (such as the UK, OECD Countries, and European Union member countries), there is a lack of research into VAT compliance in developing countries in general, and particularly in Bangladesh. This article seeks to address this.

#### IV METHODOLOGY

The overarching research problem which underlies this study, is to explore the extent to which deterrent measures are effective in ensuring SME compliance within VAT law in Bangladesh. A mixed methods approach was adopted utilising quantitative and qualitative methods. This type of mixed methods approach is most likely to maximise, as far as is practically possible, the internal and external validity of the results.<sup>78</sup> While much of the earlier empirical literature on tax non-compliance utilised quantitative research methods, more recent studies have used a combination of quantitative and qualitative methods.<sup>79</sup>

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76 Keen, above n 22.

77 R Hemming and J A Kay, 'Contracting Out of the State Earnings Related Pension Scheme' (1981) 2 *Fiscal Studies* 20; Luca Barbone, Richard Bird and Jaime Vázquez-Caro, *The Costs of VAT: A Review of the Literature* (Report No 106/2012, Center for Economic and Social Research, 2012).

78 Schuyler W Huck, William H Cormier and William G Bounds, *Reading Statistics and Research* (Harper & Row, 1974).

79 Binh Tran-Nam and John Glover, 'Estimating the Transitional Compliance Costs of the GST in Australia: A Case Study Approach'



Permission was obtained from the NBR to obtain lists of SMEs taxpayers that filed monthly VAT returns in the 2011–12 FY. Participants were divided into three groups:

1. SMEs taxpayers who have no non-compliance history and registered with VAT for at least three years (Referred to as Compliant VAT payers, and abbreviated to ‘CT’);<sup>80</sup>
2. SMEs taxpayers who have completed and decided VAT non-compliance cases against them and have already paid the fines and penalties imposed on them (Referred to as Non-Compliant VAT payers, and abbreviated to ‘NCT’);<sup>81</sup> and

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(2002) 17(4) *Australian Tax Forum* 499; John Glover and Binh Tran-Nam, ‘The GST Recurrent Compliance Costs/Benefits of Small Business in Australia: A Case Study Approach’ (2005) 1(2) *Journal of Australasian Tax Teachers Association* 237; McKerchar, above n 44; Loo, above n 45; Wollela A Yesegat, *Value added tax in Ethiopia: A Study of Operating Costs and Compliance* (Doctoral Thesis, University of New South Wales, 2009).

80 Compliant taxpayers (CT) were those who had paid VAT to the National Board of Revenue and who had no dispute in respect of their VAT payments; or taxpayers who had had a dispute with the National Board of Revenue but had subsequently been vindicated by the National Board of Revenue, the Tribunals, or the Courts.

81 Non-compliant taxpayers (NCT) were those who had either not paid the correct amount of VAT to the National Board of Revenue (as assessed by National Board of Revenue’s VAT Inspectors) and who had had a dispute in respect of their VAT payment but who ultimately lost their appeals through the National Board of Revenue, the Tribunals, or the Courts. For ethical reasons, taxpayers who were still engaged in ongoing dispute with the National Board of Revenue in respect of their VAT payment were excluded from the study.

3. NBR's VAT Officials from field level to policy level and who have been working with the NBR at least for eight years (Referred to as VAT Officials, and abbreviated to 'VO').

The study relevant to this article was conducted in two stages. Stage 1 involved focus group discussions ('FGD') with VAT payers of the SME sector (both CTs and NCTs) and VAT Officials. After completing the focus group discussions, a survey was designed through three stages: First, drafting of the survey; pilot testing and revision of the initial draft. Finally, the content of the survey was submitted to independent readers for checking before commencing the actual survey. Stage 2 involved the mailing of a survey, seeking qualitative and quantitative data, from both complying and non-complying SME taxpayers. Participation was voluntary and no financial incentives were given for their time. As this study used human subjects, it was necessary to ensure that ethics approval was received before commencement of each stage.

#### *A Focus Group Discussions*

The focus groups were conducted in Dhaka, the capital city of Bangladesh, because of the respondents' location. A total of 45 participants participated in the FGD, consisting of 15 from CTs (11 were business owners and 4 were Director VAT of the enterprises), 15 from the NCTs (12 were business owners and 3 were VAT consultants from the selected enterprises) and 15 from VAT Officials (9 were Joint Commissioners of VAT and 6 were Second Secretaries of VAT from the NBR). As very few participants were fluent in English, the discussions were conducted mainly in Bangla, the common language among SMEs. The discussions were recorded for transcription, and any identification of names or references were removed from the transcription. By coding the participant and not using the participants' names, this confirmed the confidentiality and

anonymity of the recorded data. The findings of the focus groups are presented later in this article.

### *B Survey Development*

In Stage 2, a survey was mailed to compliant and non-compliant SME taxpayers, with a view of gathering both quantitative and qualitative information on factors affecting VAT compliance. The questionnaire was designed using mainly closed-ended questions in order to gather numerical data, in the form of information which could be verified against documentation (such as, the value of fees paid to professional advisers); in categorical form (such as, tax rates applicable to different product categories); or in integer format (such as, taxpayers' ratings of their perceptions on a 1-6 Likert scale).

After the pilot test and refinement of the survey instrument, a total of 500 questionnaires were distributed to SME VAT payers from June 2013 to September 2013. The SME VAT payers were selected based on purposive sampling from NBR's taxpayers list. Out of this total, 200 questionnaires were distributed to NCTs group, and the remaining 300 questionnaires were distributed to CTs. Two reminders were sent to the taxpayers to improve the response rate. There were 240 usable responses — 152 from CTs and 88 from NCTs. The overall response rate was 48 per cent, representing 51 per cent response rate from CT and 44 per cent response rate from NCT.

Since VAT extends to the whole of Bangladesh, mail survey data was collected from the target population resident in the business regions of the city corporation area, district town, and Upazilla area. Most of the respondents of the mail survey were well qualified in terms of academic qualifications, 35 per cent holding a Masters degree and 38 per cent holding a Bachelor degree. Further, 50 per cent of the respondents were from manufacturing business units, and

approximately 45 per cent conducted their businesses as sole proprietorships. Regarding the manner of keeping accounting records, 43.1 per cent from the compliant group and 34.1 per cent from the non-compliant group indicated that their systems were fully manual. The rest noted that either their accounting systems were fully or partially computerised, or their external accountants or tax advisors kept their accounting records.

## V FINDINGS

To explore the issue of VAT compliance and deterrence effects, the findings from the focus groups (Stage 1), and the survey (Stage 2) are presented below.

### *A Focus Groups*

#### *Reason for complying*

In the focus groups, for compliant taxpayers the most common response about VAT compliance was that participants saw civic duty as a motivating factor for people to comply with the VAT law. In contrast, the most common influence for complying with the VAT by the non-compliant taxpayers was that VAT was seen as a mandatory obligation for businesses and to avoid conflict with VAT Officials. Three enterprise owners asserted that most business persons want to run their business according to the law and to avoid any interference and obstruction from VAT Officials. This was more prominent in cases where a large percentage of their wealth was invested in the business, so it may be very costly if they are subjected to any penalties:

I don't want any conflict with my local VAT offices and also I want to avoid any sort of legal trouble with the NBR which may be very costly for me. So I try to pay my VAT timely.  
(NCT 13)

I firstly understand my duty when any kind of tax is mentioned. Paying VAT and abiding by the VAT law cannot be enjoyable for people but if I can calculate my VAT correctly, paying the rightful amount of the taxes is a good job actually. I feel secure if I maintain a good relationship with the VAT offices. I think some SMEs taxpayers comply with the VAT law to maintain a good relationship with VAT offices and to get co-operation from them. (NCT 9)

To ascertain if there were any differences between taxpayers and that of the tax administration, the view of the VAT Officials was sought. Largely, the views from the VAT Officials were consistent with Aaron and Slemrod, as they asserted better enforcement and monitoring by the revenue authority to be the most influential factor to improve VAT compliance:<sup>82</sup>

Civic duty or contributions to the state are not the main factors. The most important things are strong monitoring and enforcement. They are tax fearing people; they are not tax loving people. (VO 3)

In my 15 years of service life with the VAT department, I have never seen a taxpayer want to deposit the right share of VAT. Most of the times they want to avoid our requests to pay VAT. Finally, when they are given threat by the VAT Officials about audit, surprise visit or 26 dhara (Section 26)<sup>83</sup> of the VAT Law,

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82 Henry Aaron and Joel Slemrod, 'Introduction' in Henry Aaron and Joel Slemrod (eds), *The Crisis in Tax Administration* (Brookings Institution Press, 2004) 1.

83 VAT Law 1991 (Bangladesh) s 26 provides:  
 'Any value added tax officer not below the rank of an Assistant Commissioner or any value added tax officer authorized by him in this behalf (a) shall have the right to enter a place of production, supply, rendering of service or trading or other related houses or premises belonging to a registered or registrable person; (b) may

they got careful and pay VAT. But in most cases, they pay a little more than before, not the right amount. (VO 5)

Audit, penalties and sanctions play a vital role in changing their attitude towards paying tax. It also serves as a deterrent for them. So better enforcement and monitoring through more auditing, penalties and sanctions from our part can encourage taxpayers for being compliant. (VO1)

Allingham and Sandmo stated that an increase in the probability of detection would lead to larger incomes being declared.<sup>84</sup> Consistent with this literature, the likelihood of audits, penalties and sanctions appear to affect compliance rates for some taxpayers, especially CTs:

I think, NBR's effective steps regarding better enforcement of VAT law, strong monitoring and vigilance of local VAT offices and finally the likelihood of audits, penalties and sanctions are very important to make us more compliant. (CT 10)

When I saw the possibility of visits of VAT Officials to my business premises and got information that my business can be audited, I become more careful to any dealings with VAT. (CT 14)

However, the focus groups suggest that this may not be the case for NCTs:

I don't think the enforcement and monitoring of NBR is sufficient to prevent the taxpayers from non-compliance. The

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inspect production process; and goods in stock, service and inputs and examine related accounts of a registered or registrable person; and (c) may at any time, examine all trading documents including books, files and commercial documents related to value added tax of any registered or registrable person, direct to submit or detain them or to do any other thing necessary for this purpose.'

84 Allingham and Sandmo, above n 13.

frequency of audit is very low in Bangladesh, then why the taxpayers' will be afraid of audit? (NCT 2)

This implies that the frequency and adequacy of the audits in Bangladesh may be deficient. Indeed, in the NBR, statistics less than 1 per cent (0.07 per cent) of VAT registered businesses were audited in the 2011–2012 FY.<sup>85</sup> Consequently, the relevant question might be whether NCTs would be more deterred if they perceived the risk of *actual* detection and punishment to be higher.

### *Reasons for non-complying*

The most common reason that emerged for non-compliance by SMEs in Bangladesh was corruption:

If I saw less corruption of the VAT officials, I would comply more with the VAT Law and pay more VAT. (NCT 12)

Some of the tax officials are so rich and corrupted that is beyond our imagination. You will never believe, a revenue officer gave me the proposal to give him money personally each month and I need not to take the VAT registration as he will manage the VAT office. (NCT 3)

We actually don't have any options except to give them bribe. I think, if I not give him some money this time, next time he will not do my work and will not co-operate with me. So we compromise with them, pay less VAT than the actual amount. (CT 5)

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85 National Board of Revenue, above n 10. Only 410 audits (0.07%) were done in 2011–12 FY against a total of 534 991 VAT registered units. Of these 410 businesses which were audited, 257 were manufacturing industries, and 167 were others including service rendering units.

The VAT Officials acknowledged that corruption does exist, although some of the taxpayers informed that young VAT Officials are less corrupt:

Our taxpayers always love to talk about corruption by the revenue department. They will never agree that they gave 1 BDT to the officials and take the opportunity of more than 100 BDT. Actually they inspired the revenue officials to be corrupted so that they can evade taxes. (VO 13)

I don't think all the VAT Officials are corrupted. Some of them may be, but not all of them. Comparatively the young officers are helpful and cordial to me. I received remarkable support every time I needed. I can't say I am not listened to and I am not heard. (CT 3)

### *Deterrence Effects*

Focus groups were asked for their views about the possible relationship between the deterrent effect and non-compliance. From the discussion, the most common themes emerging from this question, in order, were connection with NBR and political parties, lengthy judiciary processes, and ineffective audits.

The first theme, which participants recognised in relation to the deterrent effect, was the association of business owners with the NBR and political parties. In Bangladesh, politics is dominated by 'big money' (mostly unaccounted for), 'goons' and people with little background and training in formal politics.<sup>86</sup> It has been reported that the party which has the greatest business support can influence

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86 Mohammad Mohabbat Khan, 'State of Governance in Bangladesh' (2003) 92(370) *The Round Table: The Commonwealth Journal of International Affairs* 391, 394.



the general elections by the distribution of illegal money among the poor voters.<sup>87</sup> Buying political influence and buying votes are common manifestations of political corruption in many countries including Bangladesh.<sup>88</sup> Given that money is a requirement for being active in politics and participating in elections, businesses are invited to join the mainstream of politics. This gives rise to the notion of ‘Businessman Politicians’, which is also the case in Bangladesh.<sup>89</sup> Tasnim demonstrates that the percentage of business professions among the members of parliament has increased from 24 per cent in 1971 to 61 per cent in 1991, and was still 60 per cent in 2001.<sup>90</sup> This concentrated representation can lead to benefits being provided to the rich. Similarly, some civil service employees view public service as an opportunity for self-enrichment, particularly with side payments to public sector officials who are poorly paid.<sup>91</sup> Moreover, civil servants may engage in corrupt activities in an effort to meet personal obligations to members of their immediate and extended family. In Bangladesh, the extended family places significant pressure on the civil servants, which may lead them to engage in corrupt and nepotistic practices. Bureaucrats are believed to

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87 Tim Meisburger, *Booth Capture — Observing Municipal Elections in Bangladesh* (6 May 2015) The Asia Foundation <<http://asiafoundation.org/2015/05/06/booth-capture-observing-municipal-elections-in-bangladesh/>>.

88 M Mushtaque Ahmed, ‘Overview of VAT’ (2003) 9(11/12) *Asia-Pacific Tax Bulletin* 364.

89 Yves Mény, “‘Fin de siècle’ Corruption: Change, Crisis and Shifting Value’ (1996) 149 *International Social Science Journal* 309.

90 Farhat Tasnim, *Civil Society in Bangladesh: Vibrant but not Vigilant* (PhD Dissertation, Political Science University of Tsukuba, 2007).

91 Khan, above n 86.

exploit their public positions to generate benefits for themselves, their families, and their ethnic or social cleavage.<sup>92</sup>

There can also be interaction with corrupt officials and entrepreneurs, which promotes the strengthening of organised crime.<sup>93</sup> For instance, a business person who evades VAT is at the mercy of a VAT inspector and becomes an easy target for demands for bribes in exchange for promises of protection. Official corruption, particularly through bribery, reduces the likelihood of punishment and consequently, the effectiveness of punishment as a deterrent.<sup>94</sup> Comments from participants highlight this interaction:

How can you say a deterrent effect exists in Bangladesh? Political connection and corruption by civil servants allow inefficient producers to remain in business. This business group motivates government to pursue perverse tax policies and provide opportunities to civil servants and politicians to enrich themselves through extorting bribes. (NCT 12)

Some businessmen maintain political affiliation to keep a monopoly in the business sector. They take extra benefit during the annual budget. The payment of bribes to the right Ministers and Officials can help them to mitigate their unsolved issues very quickly. (NCT 9)

Civil service employees view public service as an opportunity for self-enrichment. Civil service positions should not be used

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92 Rawlings A Udama, 'Understanding Corruption in Nigeria and its Implications to National Security and Sustainable Development' (2013) 10(1) *IOSR Journal of Humanities And Social Science* 60.

93 Mark Levin and Georgy Satarov, 'Corruption and Institutions in Russia' (2000) 16 *European Journal of Political Economy* 113, 116.

94 Charles Moskos, *How to Clean up Foreign Militaries: Subsidize and Control their Pay and Pension* (29 December 1997) US News & World Report <<http://www.usnews.com/>>.

as a reward for businesses' illegal support, political support or negotiated for bribes. Incompetent, unqualified and unprofessional politicians and civil servants are significantly responsible for insubstantial deterrent effect. (CT 10)

The Global Competitiveness Report ('GCR') 2014–15, which surveyed 77 Bangladeshi business executives, found that the key factors hampering the country's business competitiveness was a politically ineffective parliament, political corruption, burdensome government procedures, and improper government and business relationships. The report argued that for this to change, accountability and ethical standards for politicians are needed.

During the focus group discussions, some taxpayer participants indicated that in the early stages of business registration, expenses are considerably higher in Bangladesh. They described how creating a business requires permission from approximately 50 officials from several departments. Such expenses included bribes to the government officials. When government regulation imposes significant costs and time on a business, the entrepreneur may try to minimise these costs and time by paying bribes to the right politicians and members of the enforcement community. The bribe is expected either to exclude the business from the laws and regulations or to have the individual's enterprise taxed at a lower rate by special orders from the NBR. Political and bureaucratic corruption can be seen as primarily rent-seeking behaviour, which is directly related to the level and extent of government activity in the economy:<sup>95</sup>

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95 John Mbaku, 'Corruption Clean Ups in Africa: Lessons from Public Choice Theory' (2008) 43(4) *Journal of Asian and African Studies* 427.

I think, to extract extra income a corrupt bureaucrat always helps private entrepreneurs. With the help of corrupted bureaucracy and affiliation with political parties, some businesses are able to capture and maintain monopoly position in the economy. (CT 1)

The habitual bias of the NBR Officials towards some businessmen makes us insecure. Not having found enough co-operation and legal protection from NBR, we are obliged to seek special arrangement by buying unlawful services from NBR officials. (NCT 9)

However, government officials were not solely to blame. Some participants stated that pressure exerted by politicians of the ruling parties is sometimes unavoidable for civil servants:

I think we should not only blame the government officials. Use of a public officer for one's (businessmen politicians) private interest is a common practice in Bangladesh now. This conflict of interest exists when a member of the Parliament or a member of his family or a friend or a partner or a contributor to his/her election expenses does have a business. (CT 5)

Why do we talk only about the civil servants? Political inference everywhere in civil service creates a lack of confidence in public officials at different levels. In the absence of guarantees for posting and promotions, the officials become more susceptible to the temptations of bribe taking. They take the motto that as long as they have opportunities to earn extra money, they will earn. Who can say, what will happen tomorrow? (NCT 2)

From these comments and discussions, it is evident that the deterrent effect appears to be adversely affected by corrupt politicians and civil servants. For example, if a civil servant accepts money from a business person to give some favour, it is unlikely they will be aggressive or take lawful action against that business. However, some of the VAT Officials stated that the deterrent effect was

apparent during the military backed caretaker government in 2007–08:

During the caretaker government there was tremendous pressure from the higher authority to the tax officials to collect as much revenue as they can and to taxpayers' to deposit more income tax and VAT without looking at the actual rules and regulations. At that time media also played a vital role. In Chittagong Customs House and some other land customs station, army people set up their office to look after the revenue matters. Some of the big shot businessmen were caught and was sent to jail for tax evasion. The general taxpayers were very afraid at that period. I think there was strong deterrent effect during that military-backed army government. (VO 9)

A number of focus group taxpayers also confessed that they paid more income tax and VAT during 2007 and 2008 due to tremendous pressure from the NBR. Watching news reports of highly wealthy business owners being victimised by the army-backed government reinforced this:

We have seen in TV and newspapers that some of the civil officials are openly assaulted by the army officers. As they (army person) can be so rude with the civil servant, then they can go to any extent with the general taxpayers. Naturally, I was afraid and deposited more VAT than before though I had loss in my business at that time. (NCT 8)

There is a set of law everywhere and in every sector in Bangladesh. But what is absent is its enforcement. During the caretaker government, enforcement was strong and monitoring was very intensive and close. Even, the government officials were closely monitored at that time. So we all tried to comply with the VAT law. But things went to back to square one with the end of that regime. (CT 5)

One NBR Official acknowledged that it was not only the taxpayers, as tax officers were also under extreme pressure at that time.

Saleheen has acknowledged the revenue collection scenario under the caretaker government and some of their initiatives. An example of this is the Citizen Charter of the NBR, which is improving good governance and VAT collection in Bangladesh.<sup>96</sup> The discussions and comments made by the respondents during the focus groups indicated that the deterrent effect could be more visible and effective if there was better and more honest enforcement by the revenue administration.

The second theme that emerged relating to the deterrent effect was the perception by focus group members of corruption and the lengthy judiciary system. In Bangladesh, successful implementation of the taxation policy depends primarily on the NBR, the judiciary and the press.<sup>97</sup> It would be hoped that those agencies are appropriately constrained by the law, proactive and free of corruption. However, in Bangladesh, the political system, the judiciary and the revenue department appear to be embroiled in high levels of corruption. The 2014 TIB report found that 76 per cent of the respondents thought corruption in the public sector was the major problem, while 40 per cent thought personal relationships were more important in getting public service. The report also revealed that 93 per cent of Bangladeshi interviewees thought that the police were the most prone to bribery, followed by the judiciary (63 per cent) and land services (44 per cent). On the other hand, the 2011 TIB report noted that citizens perceive political parties (62 per cent) and the parliament (40 per cent) as some of the most corrupt institutions in Bangladesh. Given this, it is difficult for the taxation system, which is backed by these agencies, to be effective in

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96 Ahmed M Saleheen, 'The Use of Discretions in Taxation: the Case of VAT in Bangladesh' (2013) 11(1) eJournal of Tax Research 97.

97 Ahmed, above n 88.

Bangladesh. The comments about the judiciary shed some light on this situation:

I think most judiciary systems, revenue officers and police forces in our country are not properly controlled by the Law and that most civil servants (including some Judges and revenue officers) are themselves corrupt. So we can't expect deterrent effect in Bangladesh. (NCT 9)

Our company lawyer sometimes gives luxury gifts to the persons related to legal service. I am not unhappy for that as this helps us to save a lot of money by delaying the court decision. (CT 6)

These findings are consistent with the literature, which illustrates that most of the citizens in Africa are not afraid of the enforcing agencies as the politicians, civil servants and the legal system are mostly corrupted.<sup>98</sup> Brennan and Buchanan argue that any existing rules and regulations of a country will be ineffective if citizens perceive that politician and bureaucrats are corrupt.<sup>99</sup> Therefore, the entrepreneurs or the taxpayers who bribe politicians and civil servants are never afraid of the enforcement agencies and there will be minimal deterrent effect among the taxpayers. One of the respondents commented:

Corruption infiltrates courts also. Our lawyers can use bribes as an effective tool for the defence of their clients. (NCT 13)

Moreover, court decisions are often not implemented in a timely manner. For tax matters, the low effectiveness of courts relating to tax matters results in long case processing delays, which can have a

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98 John M Mbaku, *Bureaucratic and Political Corruption in Africa: The Public Choice Perspective* (Krieger Publication Co, 2000).

99 Geoffrey Brennan and James M Buchanan, *The Reason of Rules: Constitutional Political Economy* (Cambridge University Press, 1st ed, 1985).

paralysing effect on economic activity. This is made worse by the shortage of skilled and knowledgeable personnel at the NBR to meet the requirements of the court cases.<sup>100</sup> Therefore, the judiciary has become largely unapproachable for VAT Officials, which results in an apparent loss of tax revenue and reduced confidence in the tax system as a whole.

The participants also considered a lack of effective audits as an important theme relating to the deterrent effect. As in other developing countries that have adopted VAT, audits are yet to evolve as an effective instrument in the organisational culture of Bangladeshi VAT. Bangladesh has not been able to achieve a satisfactory level of audit performance compared to the number of businesses registered for VAT, turnover taxes and cottage industries. The number of audits currently is below 1 per cent in comparison to the number of larger taxpayers, such as manufacturers.<sup>101</sup> Whereas audits have become the major tool for tackling non-compliance in most developed countries, in Bangladesh this has largely not occurred. In the words of a compliant respondent:

Before starting business, the word audit strikes a fear in my mind. But my business has not been audited by VAT department for last 4 years. I am continuing a very good relation with the local VAT office. I hope they will inform me before starting any audit, so that I can get enough time to arrange everything. (CT 3)

According to the respondents from the taxpayers' group, auditing has yet to take professional shape in Bangladesh. Everyone agreed that audits should be one of the most important issues for the NBR. However, ironically, a posting in the audit division of the NBR or the Audit Directorate is considered as a 'punishment posting' for

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100 Monir, above n 56.

101 National Board of Revenue, above n 10.



staff in Bangladesh.<sup>102</sup> In addition, comparatively inefficient inspectors and superintendents are posted to this division, due to the lack of status of the job. Taxpayers are informed that the audit division has a low social image and that the officers are not as efficient and knowledgeable as they should be. As a result, taxpayers do not take VAT auditing as an effective deterrent tool:

My enterprise was audited last year. The problem was from the beginning of the audit: the team started their attitude that they came to catch a thief. At the beginning I was very worried. Even I needed to visit a psychiatrist. But sorry to say, when I understood that two of the members of that team had minimum knowledge about VAT law, I became relaxed. My VAT consultant helped them to write the report. I realised from then, we should not be afraid of a VAT audit. (NCT 6)

VAT Officials confirm this:

It is fact that there has always been some meritorious detection of irregularities, but many of the objections were ill-conceived, without adequate understanding of rules and regulations of VAT. So for most of the cases we can't establish our claims. So taxpayers are not very much concerned about VAT audits. (VO 9)

Saleheen, in his thesis about 'VAT and Good Governance in Bangladesh', quoted one taxpayer: 'unless you are in hands of a few officers who are very skilled, honest, many of whom are arrogant and discourteous as well, audit is a matter of involving some additional cost'.<sup>103</sup> Therefore, an audit would appear as more effective when the auditor is skilled and honest.

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102 Ahmed M Saleheen and Noore Siddiquee, 'Tax Innovation or Excise Duty in Disguise? Deviations and Distortions in Value-Added Tax in Bangladesh' (2013) 36(6) *International Journal of Public Administration* 381.

103 Saleheen, above n 12, 233.

The VAT Officials stated that the taxpayers who have political connections or who are both politicians and businessmen are very reluctant to discuss VAT auditing. Their political influence may have made them confident about the consequences of VAT auditing, although the Officials did not deny the strength of auditing:

Auditing is an effective tool of deterrent, when the findings from audit are really genuine. Even the influential and politically connected business owners became fully in our control when we identified their VAT evasion through audit.  
(VO 5)

The relationship between the auditor and the auditee, especially the level of trust between the two parties, is very important to make the auditing process effective.<sup>104</sup> In response to the question of how effective the audit was, some of the participants from SME taxpayers perceived that audit as not being effective at all:

Most of the time, the auditors raised very silly objections. Sometimes maybe the objections are genuine but when we can understand our fault, we generally try our best to manage them by offering bribes. I think, we are successful in about 75% cases. Otherwise we go to court to object. I think audit is not an effective tool to make me compliant. (CT 2)

An aggrieved taxpayer has the forum to file an appeal. Then why will I be afraid of VAT Audit? I have very good relation with our local VAT offices and NBR. So I believe, I will get sufficient help and lawful suggestions from them. I know, if I have any fault, they will give me enough time to rectify myself.  
(NCT 3)

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104 Saleheen, above n 9.

Overall, it appears through the focus groups that any potential deterrent effect of VAT audits and penalties is being undermined in Bangladesh by corruption and inadequacies at many levels.

### *B Findings: Survey*

To explore empirically the initial findings of the focus groups, the survey sought to measure the effectiveness of the deterrence effect for complying and non-complying taxpayers.

#### *Reasons for complying*

One of the key findings of this study relates to the perceptions of fines and penalties with compliant behaviour. Allingham and Sandmo predict that if detection is likely and penalties are severe, people will be more compliant.<sup>105</sup> However, this positive relationship between penalties and sanctions with compliance appears not to hold with the non-compliant VAT payers in Bangladesh. Only 32 per cent of non-compliant VAT payers strongly agreed or agreed that the likelihood of penalties and sanctions would encourage them to comply with the VAT law (Table 2). In comparison, 73 per cent of compliant VAT payers considered the likelihood of penalties and sanctions would increase their compliance behaviour. This may be due to the fact that NCTs tend to be risk-takers in making compliant decisions. Alternatively, it may be because non-compliant VAT payers do not think that there is a great risk of detection by the NBR, as less than 28 per cent thought the likelihood of audits would encourage compliance.

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105 Allingham and Sandmo, above n 13.

**Table 2: Reasons for Compliance with VAT Law in Bangladesh**

<b>Reasons for Compliance</b>	<b>Not Sure (%)</b>	<b>Strongly Disagree (%)</b>	<b>Disagree (%)</b>	<b>Neutral (%)</b>	<b>Agree (%)</b>	<b>Strongly Agree (%)</b>
Paying the correct amount of VAT is our civic duty						
CT	0.65	0	0	1.97	59.21	38.15
NCT	3.41	0	60.23	12.50	23.86	0
The likelihood of audits encourages me to comply with the VAT law						
CT	5.92	1.32	5.27	17.10	46.71	23.68
NCT	6.82	25.00	30.65	9.09	22.73	5.68
The likelihood of penalties and sanctions encourage me to comply with the VAT law						
CT	1.97	1.32	7.24	15.79	51.32	22.36
NCT	6.82	21.59	26.14	13.64	27.27	4.54

The ANOVA<sup>106</sup> results (Table 3) demonstrate that three statements yielded significant results between the two groups in terms of reasons for compliance: civic duty, likelihood of audit and the likelihood of fines and penalties. It appears for CTs that the major reasons for their compliant behaviour relate to their sense of civic duty and fear of audits and penalties. These three reasons affect CTs more than NCTs.

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106 The ANOVA is an important test because it enables us to see the comparison of two different types of treatment. The F-ratio tells the researcher how big of a difference there is between the conditions. ANOVA tests assume: the population sample must be normal; and the observations must be independent in each sample.

**Table 3: Reasons for compliance: ANOVA Table (one tailed and between groups)**

Reasons of compliance	Sum of Squares	df	Mean Square	F	Sig
Paying the correct amount of VAT is your civic duty	13.812	1	13.812	9.046	0.003**
The likelihood of audits encourages me to comply with the VAT law	12.463	1	12.463	10.746	0.001**
The likelihood of penalties and sanctions encourage me to comply with the VAT law	13.14	1	13.14	4.964	0.027*

$R = 0.568$ ,  $R \text{ Square} = 0.322$ ,  $\text{Adjusted } R \text{ Squared} = 0.198$ .

$\text{Std. Error of the estimate} = 0.429$

\* $p < 0.05$ ; \*\* $p < 0.005$

#### *Possible reasons for non-compliance*

More than 70 per cent of the respondents considered that non-compliance increases when there are higher fines and penalty rates (Table 4). It should be recalled that the penalty rate for intentional non-compliance is up to 250 per cent in Bangladesh. By having higher penalties and fines, SMEs may be encouraged to stay within the cash economy and not register for VAT. Moreover, when the NCTs had to pay higher penalties for their evasion, they may have considered the imposition of such penalties as nearly harassment. Literature suggests that when the fines and penalties are too high, the tax system can be perceived as being unjust and unfair —

ultimately leading taxpayers to avoid their tax payment.<sup>107</sup> The findings also indicate that NCTs tended to consider the VAT system to be unfair, as approximately 46 per cent of NCTs agreed or strongly agreed, whereas only 16 per cent of CTs did so.

It appears that NCTs have the perception that by becoming VAT registered, businesses are more likely to come to the attention of the NBR; compared to if they stayed outside of the VAT system altogether and operated in the 'cash economy'. Kirchler states that if a taxpayer finds the burden of taxes as unfair and that a non-compliant taxpayer is in a better position than a compliant taxpayer, then taxpayers may be discouraged to comply.<sup>108</sup>

**Table 4: Reasons for non-compliance with VAT Law**

<b>SMEs do not comply with the VAT Law because</b>	<b>Not Sure (%)</b>	<b>Strongly Disagree (%)</b>	<b>Disagree (%)</b>	<b>Neutral (%)</b>	<b>Agree (%)</b>	<b>Strongly Agree (%)</b>
<b>The fine and penalty rates are very high</b>						
CT	0	3.30	20.40	5.90	52.60	17.80
NCT	1.10	3.40	10.20	9.10	58.00	18.20
<b>The VAT system is unfair</b>						
CT	2.6	9.2	59.2	13.2	9.9	5.9
NCT	3.4	9.1	27.3	14.8	26.1	19.3
<b>VAT Officials are corrupt</b>						

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107 Devos, above n 53.

108 Kirchler, above n 26.

CT	1.32	8.55	28.29	21.05	30.26	10.52
NCT	6.84	1.15	15.91	9.09	28.41	38.69
Discretionary and judicial power of NBR						
CT						
NCT	11.36	7.95	9.09	12.50	28.41	30.68
Audit and inspections of NBR for VAT registered businesses						
CT						
NCT	4.55	1.13	4.55	4.55	37.50	47.72

The discretionary and judicial powers of the VAT Authority appear to be important factors for non-compliance, as 69 per cent of CTs and 59 per cent of NCTs agreed or strongly agreed that the discretionary and judicial power of VAT Authority discourages them to comply with the VAT law. Saleheen demonstrates that the presence of excessive discretionary powers within Bangladeshi VAT law creates a lack of trust between taxpayers and tax officials. Excessive discretionary power may encourage corruption, especially in the case of price declarations and the determination of tariff values or truncated base.<sup>109</sup>

**Table 5: Reasons for non-compliance: ANOVA Table (One tailed and Between Groups)**

Reasons of Non-compliance	Sum of Squares	df	Mean Square	F	Sig*
The fines and penalty rates are	0.226	1	0.226	0.192	0.661

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109 Saleheen, above n 67.

very high					
VAT system is unfair	12.846	1	12.846	8.465	0.004**
VAT officials are corrupt	25.618	1	25.618	10.162	0.002**
The discretionary and judicial power of VAT Authority discourages me to pay VAT	0.015	1	0.015	0.008	0.927
Audit and inspections of NBR for VAT registered businesses	22.22	1	22.22	11.069	0.001**

$R = 0.649$ ,  $R\text{ Square} = 0.421$ ,  $\text{Adjusted } R\text{ Squared} = 0.268$ .

$\text{Std. Error of the estimate} = 0.429$

\* $p < 0.05$ ; \*\* $p < 0.005$

The ANOVA results demonstrate (Table 5) that among the selected reasons for non-compliance, only three statements yielded significant differences between compliant and non-compliant taxpayers. The areas of significant differences included the unfair VAT system, the corruption of VAT Officials, and the possibility of audits and inspections for VAT registered businesses. Among these reasons, NCTs emphasised the possibility of audits and inspections for VAT registered businesses (85 per cent), and the corruption of the VAT Officials (67 per cent). Consequently, the big issues for non-compliance for NCTs appear to include audits, inspections and corruption. However, for both sample groups (CTs and NCTs), the higher the fines and penalty rates, coupled with the discretionary and judicial power of VAT Officials, can contribute to non-compliance.



*Deterrence and VAT Compliance*

Table 6 reports the findings of taxpayers' perceptions about the deterrent effect on taxpayer compliance. There were differing opinions about the deterrent effects of significant promotion of the NBR prosecutions regarding compliance decisions. For example, 72 per cent of the CTs strongly agreed or agreed that significant promotion of NBR prosecutions of non-compliant taxpayers would increase compliance among other SME taxpayers, while only 36 per cent of NCTs thought so. Similarly, 43 per cent of NCTs did not agree that greater enforcement by the NBR would increase compliance, whereas only 5 per cent of CTs disagreed with this. This would indicate that there is a greater deterrent effect for CTs rather than for NCTs. This is re-enforced by the findings in Table 2, which indicate the likelihood of audits and penalties having greater impact on CTs compared to NCTs. It should be noted that there was still a large percentage (38 per cent) of NCTs that strongly agreed or agreed that greater enforcement by the VAT Authority would lead to the payment of the correct amount of VAT. This suggests that enforcement by the NBR could improve the compliance of some NCTs, even if not all. The findings demonstrate how deterrence attributes can have different effects on compliant and non-compliant SME VAT payers.

**Table 6: Deterrent Effect**

Statement about Deterrent Effect (CT=152, NCT=88)	Not Sure (%)	Strongly Disagree (%)	Disagree (%)	Neutral (%)	Agree (%)	Strongly Agree (%)
Taxpayers would pay the correct amount of VAT if there was greater enforcement by VAT Authority						
CT	6.58	5.92	9.87	9.21	46.71	21.71
NCT	6.82	22.73	22.73	9.09	26.13	12.50
CT	4.61	0.66	4.61	17.76	42.76	29.61
NCT	6.82	25.00	18.18	13.64	27.27	9.09

The present enforcement by NBR may be another reason for the lower deterrent effects by NCTs. For example, in 2012 a mere 15 873 (out of 460 092) businesses received a show-cause letter from the VAT Commissionerates for not submitting the monthly VAT returns — of them, only 1659 businesses were penalised for these non-compliance activities.<sup>110</sup> It may be that taxpayers are well acquainted with the NBR's administrative inefficiency and they feel it is extremely unlikely that their non-compliance will be detected and penalised. Indeed, it may be the ineffectiveness of the audits and the potential corruption that reduce the deterrent effects of audits.

### *Corruption and Compliance*

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110 National Board of Revenue, above n 10.



CT	0	7.00	6.6	7.2	66.4	17.1
NCT	11.4	3.4	23.9	12.5	33.0	15.9

It appears that the reduction of corruption would have the biggest positive influence for CTs, although it would still have some positive impact for NCTs. Particularly, less corruption by VAT Officials could have the largest influence for both CT (85 per cent) and NCT (69 per cent), followed by government officials. It is interesting that more than 20 per cent of the NCTs are in the position of 'not sure' or 'neutral' about the statements relating to corruption, whereas only 10 per cent of the CTs are in this position. This may be because a larger portion of NCTs did not want to comment about the corruption of the VAT Officials or the politicians, as they have taken part in the corruption process to gain favour. Only 11 per cent of CTs and 20 per cent of NCTs disagreed or strongly disagreed that less corruption by politicians, civil servants (government officials and VAT officials) and big businesses would increase voluntary compliance among the taxpayers. The ANOVA results (Table 8) do not show significant differences between groups in terms of less corruption by politicians and big businesses. The findings that the corrupt practice of politicians, government officials, VAT Officials, and big businesses encourage VAT non-compliance are consistent with prior literature based on income tax corruption in Bangladesh.<sup>111</sup>

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111 Monir, above n 56.

**Table 8: Role of Corruption in Voluntary Compliance:  
ANOVA Table (Between Groups)**

<b>Voluntary Compliance</b>	Sum of Squares	df	Mean Square	F	Sig
Less corruption by Govt Officials	16.116	1	16.116	16.261	.000* *
Less corruption by VAT Officials	6.253	1	6.253	5.731	.017*
Less corruption by big businesses	3.881	1	3.881	3.246	.073
Less corruption by Bangladeshi politicians	3.652	1	3.652	2.557	.111

$R = 0.710$ ,  $R \text{ Square} = 0.504$ ,  $\text{Adjusted } R \text{ Squared} = 0.277$ .

$\text{Std. Error of the estimate} = 0.426$

\* $p < 0.05$ ; \*\* $p < 0.005$

The comments from the focus groups were that VAT Officials believed significant deterrent effects from NBR prosecutions of non-compliant taxpayers would increase voluntary compliance among taxpayers. However, the survey found that for non-compliant taxpayers, such prosecutions appear to have little impact on them. For example, 36 per cent of the NCTs disagreed or strongly disagreed that significant promotion of NBR prosecutions of non-compliant taxpayers would increase compliance among other SME taxpayers. However, the deterrent effect appears to influence CTs, as 72 per cent of compliant VAT payers thought significant promotion of NBR prosecutions would be effective to increase compliance. Legislators often try to increase the deterrent effect by successful prosecution against non-compliant taxpayers. However, Bangladeshi non-compliant taxpayers do not think heavier fines and penalties or prosecution actually improve compliance. This may be because NCTs tend to be risk-takers in making compliance decisions, and so

penalties and fines imposed by the VAT authority are seen as risks worth taking. Alternatively, it may be because NCTs do not take the deterrent effect seriously, as tax administration is seen as weak, inefficient, and corrupt in Bangladesh. The findings suggest that perceived corruption by VAT Officers, politicians and other government officials reduces the effectiveness of audits, fines and penalties, and decreases the level of voluntary compliance. This is a critical issue to be addressed, as it appears that corruption can undermine, to a significant extent, the benefit of the deterrent effect in gaining taxpayer compliance. This highlights the importance of ensuring a whole of processes when it comes to implementing a tax system, as laws are only as effective as those who are implementing them.

## V RECOMMENDATIONS

Through the research findings a number of recommendations are posit to enhance VAT compliance by SMEs in Bangladesh.

### *A Reduce Corruption*

This study has highlighted how corruption is undermining various aspects of the VAT system, including the audit process. Indeed, one of the most interesting results of this research is that non-compliant taxpayers appear not to be too concerned about fines and penalties, or audit procedures, apparently because of the possibility of bribing NBR officials. In order to enhance revenue collection and voluntary compliance, policy makers need to take steps to reduce corruption at all levels. One area of concern relates to the discretionary powers of the VAT Officials. Measures could include introducing a hot line for taxpayers to report corrupt VAT Officials, and disciplinary proceedings by an independent body. It is important that disciplinary proceedings are made transparent to the public in order to improve public perception of the integrity of the NBR and its staff. However,

it must be noted that corruption at all levels, such as big business, other government officials, and politicians also needs to be addressed.

To lessen the temptation for corruption, one possible reform could be to improve the wages and conditions for NBR Officers. Increasing the wages of tax officials, however, will not reduce corruption unless and until an extensive and effective monitoring of corrupt VAT Officials is implemented.<sup>112</sup> Accordingly, any increase in wages would need to be accompanied by the prosecution of corrupt VAT officials. Special service rules and regulations for NBR officials also need to be reinforced to ensure the provision of punishment for any corruption by public officials.

### *B Effective Enforcement*

Local VAT offices require effective enforcement and the NBR need to ensure that all businesses that require registering for VAT, are in fact registered. This will assist in establishing a level playing field for compliant SMEs. This includes improving the speed of the VAT registration process and stopping the culture of unauthorised payments during registration. The NBR must ensure the proper enforcement of rules and regulations in relation to non-compliant taxpayers in order to stop them taking advantage of weaknesses in the VAT system. Increased media reporting about the prosecution of non-compliant taxpayers could help increase the deterrent effect. The government should also consider introducing a general anti-

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112 Odd-Helge Fjeldstad, 'Local Revenue Mobilization in Urban Settings in Africa' in K Millett, D Olowu and R Cameron (eds), *Local Governance and Poverty Reduction in Africa* (Joint Africa Institute (2006) 105, 105-126.

avoidance rule for VAT, rather than making annual 'band aid' style changes to try to address loopholes.

### *C Improve Communication/Media*

The NBR should consider treating compliant and non-compliant taxpayers differently. Compliant taxpayers should be given more assistance from NBR and local VAT officers. This could include the NBR being more understanding about inadvertent breaches, improving the audit process and increasing the frequency of constructive communications with taxpayers.

One of the most interesting results from the research is that non-compliant taxpayers do not appear to be too concerned about fines, penalties or audit procedures. VAT officials should be stricter with NCTs through regular audits and the imposition of fines and penalties to increase pressure upon them to be compliant. However, this is only likely to be effective if the audit process is free from corruption, since any corruption of VAT officials undermines the audit and penalty system.

### *D Restructure Fines and Penalties*

As the penalty rate for intentional non-compliance is very high (250 per cent) in Bangladesh and the probability of detection is very low, taxpayers could see evasion as a worthwhile gamble. Furthermore, the penalty for not registering VAT is not very high in the existing VAT law. As a result, businesses that do not register or comply with the VAT Law may not take the possibility of detection seriously. It is recommended that the NBR should focus on restructuring the fines and penalties for failing to register for VAT. Moreover, the



NBR could consider reducing penalties and fines for those taxpayers with a reasonable track record for compliance.<sup>113</sup> For example, the NBR could take into account the track record of taxpayers in the audit process: for example, if unintentional errors or mistakes arise, lower penalties could apply. Of course, this does provide for some discretion, so it is important that there are some checks and balances surrounding this to ensure corruption does not occur.

## VI LIMITATIONS AND FUTURE RESEARCH

As with any research, the limitations of this analysis must be acknowledged. First, the findings in relation to the focus groups are limited by the sample and demographic characteristics of the participants. The two main sample biases were that a larger percentage of SMEs came from city areas as opposed to country areas, and that these SMEs had typically attained higher education levels than the national average. These deficiencies could reduce the generalisation of some of the findings. A second weakness of this research could be a Type II error in the classification of the taxpayers as ‘compliant’ and ‘non-compliant’. That is, it is possible that some compliant taxpayers were in fact non-compliant but had not yet been identified as such by the NBR. Indeed, some of the comments made by compliant taxpayers would suggest that they have undertaken some activities which bring into question their compliance record. Also, given the sensitive nature of this topic matter (non-compliance), the self-reporting measures used may not be accurate. Nevertheless, it is suggested that this research provides

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113 Such a strategy is built into the Australian income tax system with its tax shortfall penalties which is in part based on the taxpayer’s prior compliance behaviour. See <<https://www.ato.gov.au/General/Dispute-or-object-to-an-ATO-decision/Request-remission-of-interest-or-penalties/Remission-of-penalties/>>.

an important contribution to knowledge in terms of VAT compliance by SMEs in a developing nation, Bangladesh.

Future research could estimate the enforcement and monitoring costs of VAT and test whether the findings of this research are corroborated. Research could also consider in more detail the 'gaming' that may be occurring when non-compliant taxpayers consider their activities in terms of likelihood of audits and the penalty regime. This research could add to the notion of corruption and how this influences the gaming decisions of taxpayers. Given the apparent importance of corruption to the effective audit process, research could consider exploring exactly what are the circumstances which are more likely to lead to corruption and which measures are more effective to reduce it. Given that it was noted in the focus groups that younger VAT Officials appeared to be less corrupt, future research could explore whether the age of the VAT Official does influence corruption, and if yes, the reasons why.

## VII CONCLUSION

The VAT is generally acknowledged for its significant revenue-raising potential for financing government services and for the efficiency with which it can be imposed.<sup>114</sup> Indeed, VAT has become one of the most important revenue-mobilising instruments in advanced industrialised countries, as well as in developing countries.<sup>115</sup> Since a robust and functioning VAT system is seen as

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114 David Williams, 'Value Added Tax' in Victor Thuronyi (ed), *Tax Law Design and Drafting*, Vol 1 (Washington, D.C., International Monetary Fund, 1996) 184, 184–8.

115 Bird, above n 3; Richard Eccleston, *Taxing Reforms: The Politics of the Consumption Tax in Japan, the United States, Canada and Australia* (Edward Elgar Publishing, 2007).

important for a developing economy, the findings of this research are likely to be important not only for Bangladesh, but also for similar developing economies.

When a VAT system does not operate well, this represents a substantial opportunity cost to the Government, since tax revenue otherwise collected could be spent on vital infrastructure development. Moreover, to make the VAT system an effective tool for revenue-raising in a self-assessment environment, there needs to be trust and confidence in taxpayers, motivating them to pay the right share of VAT. The findings of this research provided clear indications to the NBR and other enforcement agencies to improve the efficiency, fairness and integrity of the whole taxation system. It is likely that these directions are relevant to tax administration in other developing countries and perhaps to other types of taxpayers (large taxpayers of VAT, personal income taxpayers and corporate income taxpayers in Bangladesh).

Without an effective audit and penalty regime free of corruption, it is unlikely that the deterrence effect will be fully realised. Particularly, the existence of corruption means that taxpayers, especially non-compliant taxpayers, are unlikely to be ‘tax fearing people’ and instead see that tax officials can be ‘managed’ through bribes. For a VAT to assist developing nations in raising sufficient revenue, it is critical that the presence of corruption at various levels is addressed. While the framework of legislation, audits and penalties of a VAT is important, how it is implemented and enforced is also critical. Without this, developing nations will struggle to raise sufficient tax revenues for their public expenditure programs to assist with their progress. Otherwise, the ‘fear’ of audits and penalties will not be effective in improving tax compliance and thereby the revenue collected.

# ***GAAR, WHAT IS IT GOOD FOR? CONTEMPLATIONS, CONSIDERATIONS AND CONTENTIONS SURROUNDING AUSTRALIA'S GENERAL ANTI-AVOIDANCE RULES***

DONOVAN CASTELYN\*

## **Abstract**

*The global proliferation of aggressive tax planning strategies poses significant threats to the tax revenue bases of all countries. Nationally, various integrity measures have been introduced into the Australian taxation laws to address the risk associated with these activities. Broadly, these measures apply to both direct and indirect taxing regimes and function generally to prevent the taxpayer from obtaining a tax benefit through the manipulation or misuse of primary tax provisions. This article undertakes a comparative analysis of three of these general anti-avoidance provisions, namely pt IVA of the Income Tax Assessment Act 1936, Div 165 of A New Tax System (Goods and Services Tax) Act 1999 and Sections 267–271 in ch 7 of the Duties Act 2008 (WA) and evaluates the utility of these measures in light of the tax policy criteria of equity, efficiency and simplicity. This article concludes that whilst at present these measures may serve as an adequate deterrent for tax avoidance, changes in the global and domestic economic and political climate necessitate improvement.*

## I ANTI-AVOIDANCE MEASURES: A GLOBAL PERSPECTIVE

### *A The Need for Avoidance Measures*

Internationally, numerous countries have witnessed the proliferation of aggressive tax planning schemes which pose significant threats to their tax revenue base.<sup>1</sup> In an attempt to preserve vulnerable tax bases, various integrity measures have been developed to address the risk associated with these activities. These responses range from specific or general anti-avoidance rules to new penalty regimes for taxpayers and scheme promoters.<sup>2</sup>

The linchpin of any response to addressing aggressive tax planning is the availability of timely, targeted and comprehensive information.<sup>3</sup> The accessibility of information at an early stage greatly aids the tax authority in their ability to improve risk assessment, efficiently allocate resources and effectively regulate administration, therefore improving overall compliance.<sup>4</sup>

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<sup>1</sup> Organisation for Economic Co-operation and Development ('OECD'), 'Tackling Aggressive Tax Planning through Improved Transparency and Disclosure' (Report, OECD, 2011) [12].

<sup>2</sup> OECD, above n 1. See *Income Tax Assessment Act 1936* (Cth) ('ITAA36') ss 177A–177H.

<sup>3</sup> OECD, above n 1. See also David Richardson, 'Submission No 62 to Senate Economics References Committee', Parliament of Australia, *Inquiry into Corporate Tax Avoidance*, 26 February 2015.

<sup>4</sup> Ibid.

Concurrently, it allows the fiscal policy function to make timely and informed decisions on appropriate legislative responses.<sup>5</sup>

Before undertaking an analysis of the utility associated with measures that address the challenges created by tax avoidance, it is both instructive and necessary to have an understanding of the Australian tax landscape, to appreciate the key features that are relevant from a tax perspective.

The structure of this paper is as follows. The next part will briefly canvass the Australian tax landscape, identifying regimes which are particularly susceptible to aggressive tax planning. Following this, the paper will expound on the ambit of the general anti-avoidance rules and distinguish them from their targeted counterparts. This part will also examine the role of the anti-avoidance regimes in the provision of taxation advice to clients. Finally, this paper will undertake a comparison of three GAAR provisions, namely; pt IVA of the *Income Tax Assessment Act 1936* ('ITAA36'), div 165 of *A New Tax System (Goods and Services Tax) Act 1999* ('GST Act') and ss 267–271 in ch 7 of the *Duties Act 2008* (WA) ('Duties Act') in terms of the canons of equity, efficiency and simplicity.

## II ANTI-AVOIDANCE MEASURES: AN AUSTRALIAN PERSPECTIVE

### *A The Australian Tax Landscape*

Like most developed countries, Australia imposes a broad array of taxes on labour, capital and consumption.<sup>6</sup> The Australian taxation

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<sup>5</sup> Ibid.

<sup>6</sup> Stephen Barkoczy, *Foundations of Taxation Law* (CCH Australia Limited, 7<sup>th</sup> ed, 2015) 77.

system is, however, further complicated by the fact that the Australian federation includes six States and two mainland Territories which all have their own Parliaments that impose their own taxes.<sup>7</sup> In addition, Australia has over 500 local government authorities which levy their own council rates.<sup>8</sup> In 2008, the Commonwealth Treasury identified at least 125 different taxes levied in Australia.<sup>9</sup> Notably, the regiment includes: 99 Commonwealth taxes; Income Tax, Capital Gains Tax ('CGT'), Goods and Services Tax ('GST') etc, 25 State taxes; Duties, Payroll and Land Tax etc, and one by local government; 'municipal rates'.

Unsurprisingly, numerous inconsistencies and ambiguities exist between the various regimes.<sup>10</sup> The Australian tax landscape is thusly susceptible to non-compliance, misuse and to a greater extent, abuse.<sup>11</sup>

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<sup>7</sup> Commonwealth, *Architecture of Australia's Tax and Transfer System*, Australia's Future Tax System Review (2008).

<sup>8</sup> Ibid.

<sup>9</sup> Tax Institute of Australia, *Framework of Taxation in Australia* (15 March 2014) <[https://www.taxinstitute.com.au/files/dmfile/Institutional\\_Framework\\_of\\_Taxation\\_in\\_Australia.pdf](https://www.taxinstitute.com.au/files/dmfile/Institutional_Framework_of_Taxation_in_Australia.pdf)>.

<sup>10</sup> In an attempt to combat the independent and often inconsistent operation of various taxes at both Commonwealth and State level, significant reform approaches have been actioned to unify the regimes and provide clarity and consistency to their operation. The success of these reforms is debatable. See Taxation Review Committee, Parliament of Australia, *Inquiry into the Operation of the Commonwealth Taxation System (Asprey Report)* (1975); Commonwealth, *Reform of Australian Tax System: Draft White Paper* (1985).

<sup>11</sup> See, eg, Australian Taxation Office ('ATO'), *Targeting Tax Crime — A Whole-of-Government Approach* (2015).

Against this background, the somewhat nebulous concepts of ‘tax avoidance’, ‘tax evasion’ and permissible ‘tax planning’ arose. It is both instructive and helpful to understand, at a high level, the scope of these terms:

### *Tax avoidance*

Tax avoidance involves entering into legal arrangements that are designed to exploit unintended defects in the legislation. Often denoted as promoting the ‘black letter’ of the law whilst offending the ‘spirit’ of the legislation.<sup>12</sup>

### *Tax evasion*

Tax evasion is concerned with the illegal underpayment of tax. It is generally synonymous with covert non-disclosure of liability or fraudulent claims of deductions.<sup>13</sup>

### *Tax planning*

Tax planning involves legal arrangements that are entered into in order to exploit legitimate opportunities available under the various tax law regimes in an attempt to minimise liability.<sup>14</sup>

This paper will focus on the legislative and judicial attempts aimed at combatting tax avoidance. Where necessary, the paper will

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<sup>12</sup> Barkoczy, above n 6.

<sup>13</sup> For further commentary see John McLaren, ‘The Distinction Between Tax Avoidance and Tax Evasion has Become Blurred in Australia: Why has it Happened?’ (2008) *Journal of the Australasian Tax Teachers Association* 3(2), 141–63.

<sup>14</sup> Ibid.



distinguish the concepts of tax evasion and permissible tax planning, which are sometimes confused.

### *B General and Specific Anti-avoidance Rules*

Conceivably, the most effective way of combatting tax avoidance is to ensure the law is devoid of loopholes that allow it to be exploited or manipulated.<sup>15</sup> Realistically, it is not always possible to design an impenetrable tax provision, as many tax avoidance arrangements are unforeseen at the time legislation is drafted or introduced.<sup>16</sup> As a consequence, the legislature combats tax avoidance by enacting general and specific anti-avoidance provisions.<sup>17</sup> As Federal Court Justice, the Hon Tony Pagone stated:

General [and specific] anti-avoidance provisions occupy a very special role in tax laws because their role is to underpin the effectiveness of the primary operative provisions when those primary provisions fail to achieve their purpose.<sup>18</sup>

In essence, these provisions operate to defeat any tax benefit that might otherwise be obtained through the misuse of primary

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<sup>15</sup> Barkoczy, above n 6, [723]; OECD, above n 1; ATO, above n 11.

<sup>16</sup> For further commentary see John Hockey, 'Strengthening Our Taxation System' (Media Release, 040-2015, 11 May 2015) <<http://jbh.ministers.treasury.gov.au/media-release/040-2015/>>.

<sup>17</sup> For example, on 11 December 2015 the *Tax Laws Amendment (Combating Multinational Tax Avoidance) Act* 2015 was enacted. Among others, the new laws allow the Commissioner to double the maximum administrative penalties that can be applied to significant global entities that enter into tax avoidance and profit shifting schemes.

<sup>18</sup> Tony Pagone, 'Part IVA: The General Anti-Avoidance Provisions in Australian Taxation Law' (2003) 27 *Melbourne University Law Review* 770, 771.

provisions. In doing so, these provisions may also result in the imposition of penalties on persons involved in such arrangements.<sup>19</sup>

The distinct merit of the general anti-avoidance rules ('GAARs') over their specific counterparts is that the GAARs are broadly designed and adaptable to a number of arrangements.<sup>20</sup> The flexibility engendered by the construction of the GAARs allows for domain over a broad range of transactions, not specifically contemplated at the time of enacting the provisions.<sup>21</sup>

In contrast, specific anti-avoidance rules ('SAARs') are usually reactive responses to particular arrangements that have been able to circumvent the law.<sup>22</sup> These provisions are therefore enacted for the specific purpose of quashing the mischief engendered by a particular scheme as opposed to dealing with broad-ranging tax avoidance arrangements.<sup>23</sup> Whilst it is necessarily instructive to distinguish

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<sup>19</sup> See Robert Whait, Gerald Whittenburg and Ira Horowitz, 'The World According to GAAR' (2012) *Australian Tax Forum* 27(4); Barkoczy, above n 6. These provisions may also afford the Commissioner the opportunity to restructure transactions and impose hypothetical tax.

<sup>20</sup> Ibid.

<sup>21</sup> Ibid.

<sup>22</sup> There are many specific anti-avoidance rules peppered throughout the income tax legislation. Some of these consist of only a single section ie, *ITAA36* s 100, which was designed to combat schemes involving reimbursement agreements. Others consist of entire regimes made up of numerous provisions ie, pt 2-42 of the *Income Tax Assessment Act 1997* (Cth) ('ITAA97'), which was designed to combat schemes involving the alienation of 'personal services income'.

<sup>23</sup> See also Bill Thompson, 'Part IVA: Shifting the Goal Posts — Will You Have to Take the Highest Taxed Alternative?' (2012) *Tax Specialists* 219.

SAARs from GAARs, this paper will focus its attention on GAARs contained within the Australian tax landscape.

*C Part IVA: Australia's Seminal General Anti-Avoidance Provisions*

Federally, Australia's income tax general anti-avoidance provisions ('GAAPs') are located in pt IVA of the *ITAA36* ('pt IVA').<sup>24</sup> In order to appreciate the context in which pt IVA operates, it is useful to briefly examine its predecessor, *ITAA36* s 260 ('s 260').<sup>25</sup>

Despite being drafted in broad terms, the Commissioner encountered significant difficulties in applying s 260. The most notable inadequacies and limitations of s 260 were exposed in a string of

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<sup>24</sup> Modelled on the operation of pt IVA, the state based anti-avoidance regime is located in ss 267–271, ch 7 of the *Duties Act 2008* (WA) ('*Duties Act*'); see also Explanatory Memorandum, A New Tax System (Goods and Services Tax) Bill 1998 (Cth), para 6.313.

<sup>25</sup> Section 260 provided as follows:

- (1) Every contract, agreement, or arrangement made or entered into, orally or in writing, whether before or after the commencement of this Act, shall so far as it has or purports to have the purpose or effect of in any way, directly or indirectly
  - (a) altering the incidence of any income tax;
  - (b) relieving any person from liability to pay any income tax or make any return;
  - (c) defeating, evading, or avoiding any duty or liability imposed on any person by this Act; or
  - (d) preventing the operation of this Act in any respect;
 be absolutely void, as against the Commissioner, or in regard to any proceeding under this Act, but without prejudice to such validity as it may have in any other respect or for any other purpose.

landmark cases handed down in the Privy Council and High Court from the 1950s to the 1970s.<sup>26</sup>

Limitations exposed on the construction of s 260 included:

*Annihilation limitation*

Section 260 rendered an arrangement entirely void as against the Commissioner. There was no avenue to restructure the arrangement and tax an alternative transaction. Therefore, tax was only applied to the residual funds after the arrangement was eliminated.<sup>27</sup>

*Prediction limitation*

Section 260 only applied to arrangements that were explicable by reference to tax avoidance and not to ordinary business or commercial dealings.<sup>28</sup>

*Choice limitation*

Section 260 could not be used to deny a taxpayer a choice allowed in the legislation. Hence, in a number of significant cases, taxpayers

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<sup>26</sup> See, eg, *Bell v Federal Commissioner of Taxation* (1953) 87 CLR 548, 573 (note that in *Bell*, the Commissioner succeeded — see paras 14–17); *Newton v Federal Commissioner of Taxation* (1958) 98 CLR 1, 8; *Mullens v Federal Commissioner of Taxation* (1976) 135 CLR 290, 302; *WP Keighery Pty Ltd v Federal Commissioner of Taxation* (1957) 100 CLR 66, 92.

<sup>27</sup> See *Bell v Federal Commissioner of Taxation* (1953) 87 CLR 548, 573.

<sup>28</sup> See *Newton v Federal Commissioner of Taxation* (1958) 98 CLR 1, 8.

were receiving disproportionate tax benefits from entering into certain arrangements allowable under the legislation.<sup>29</sup>

Subsequently, the Income Tax Laws Amendment Bill (No 2) 1981 ('ITLAB81') which came into operation on 24 June 1981 introduced the now renowned pt IVA into the *ITAA36*, in order to overcome the limitations of s 260.

From the Explanatory Memorandum ('EM') that accompanied the ITLAB81, it is clear that the intent of pt IVA was to apply to tax avoidance schemes that were, 'blatant, artificial or contrived'.<sup>30</sup> In this respect, the EM stated:

The proposed new Part IVA, which this Bill will insert into the Principal Act, is designed to overcome these difficulties and provide — with paramount force in the income tax law — an effective general measure against those tax avoidance arrangements that — inexact though the words be in legal terms — are blatant, artificial or contrived. In other words, the new provisions are designed to apply where, on an objective view of the particular arrangement and its surrounding circumstances, it would be concluded that the arrangement was entered into for the sole or dominant purpose of obtaining a tax deduction or having an amount left out of assessable income.<sup>31</sup>

However, pt IVA was not designed to apply to ordinary business or family dealings. This intent was affirmed by the then Treasurer, the Hon. John Howard in his second reading speech, where he stated:

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<sup>29</sup> See famously *Cridland v Federal Commissioner of Taxation* 77 ATC 4538; *WP Keighery Pty Ltd v Federal Commissioner of Taxation* (1957) 100 CLR 66, 92

<sup>30</sup> Explanatory Memorandum, Income Tax Laws Amendment Bill (No 2) 1981, 3.

<sup>31</sup> *Ibid.*

The proposed provisions ... seek to give effect to a policy that such measures ought to strike down blatant, artificial and contrived arrangements, but not cast unnecessary inhibitions on normal commercial transactions by which taxpayers legitimately take advantage of opportunities available for the arrangement of their affairs. For example, a husband or wife who choose to run a business as partners will need have no fear of having their arrangements affected by Part IVA. There will be no question, either, of the new provisions impeding a parent who wishes to pass to a spouse or to children the use and enjoyment of some income-producing assets.<sup>32</sup>

Part IVA thus approaches tax avoidance from a different perspective to s 260. Unlike s 260, which was not concerned with the motives of the taxpayer or any other person who entered into the arrangement but rather with the arrangement itself, pt IVA places great emphasis on the purpose of the person entering into a 'scheme'; determined according to a set of objective criteria.<sup>33</sup>

However, pt IVA is not without its shortcomings. Effective from 16 November 2012, pt IVA was substantially amended in an attempt to respond to the issues apparent in the application of pt IVA by the courts.<sup>34</sup>

The amendments majorly targeted deficiencies perceived in *ITAA36* s 177C, and the way the provision interacted with other elements of pt IVA, particularly *ITAA36* s 177D.<sup>35</sup>

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<sup>32</sup> Commonwealth, *Parliamentary Debates*, House of Representatives, 27 May 1981 (John Howard, Treasurer).

<sup>33</sup> *ITAA36* s 177D; See also *Spotless Services Ltd v Federal Commissioner of Taxation* (1993) 25 ATR 344.

<sup>34</sup> See Tax Laws Amendment (Countering Tax Avoidance and Multinational Profit Shifting) Bill 2013.

<sup>35</sup> *Ibid* 16.

### III DUTY TO ADVISE: A PRACTITIONER'S PERSPECTIVE

#### *A Duties and Liabilities of Tax Advisers*

There is an inherent duty for tax advisers to advise on the ramifications of any tax planning arrangement, including exposure, scrutiny and penalties that may permeate as a result of entering into such an arrangement.<sup>36</sup> Failure to do so may expose the tax adviser to an action for damages for professional negligence.<sup>37</sup>

A professional person with specialist tax knowledge will be subject to a higher standard of care that reflects the level of knowledge and experience a reasonable person in their circumstance would possess.<sup>38</sup> However, general professional advisers such as solicitors and accountants are also arguably under a duty to advise their clients

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<sup>36</sup> See div 30, *Tax Agent Services Act 2009* (Cth) ('TASA'). Under div 30, tax agents are required to comply with all Australian taxation laws whilst serving the best interests of their clients. In doing so, agents are required to take all reasonable steps to correctly apply the taxation laws in relation to providing client advice and act in a manner that does not knowingly obstruct the proper administration of the taxation laws.

<sup>37</sup> See *Sacca v Adam* 83 ATC 4326; *Jindi (Nominees) v Dutney* 93 ATC 4598.

<sup>38</sup> The decision in *Arnett v Federal Commissioner of Taxation* (1998) 39 ATR 1095 illustrates this proposition. In that case, the entity's agent had requested an amended assessment on the basis that a lump sum payment on termination of employment was a bona fide redundancy payment and exempt from tax. The AAT found that the tax agent should have been expected to know or at least find out about possible treatment of the lump sum payment.

on the tax implications of any proposed transactions or, if they lack tax expertise, to refer their client to a tax specialist.<sup>39</sup>

A tax adviser will generally discharge their duty of care if the advice is soundly based and the client is made fully aware of the consequences before acting on the advice or entering into the transaction.<sup>40</sup> However, if an adviser is guilty of negligence, the client also needs to prove that the negligence caused the loss.<sup>41</sup>

Against this background, the paper will now evaluate specific judicial guidance provided by Australian and international courts in the context of tax advice and the anti-avoidance provisions.

### B Judicial Guidance

The courts in Australia and overseas have provided guidance, or at least parameters, to professional advisers in respect of the provision of tax advice to clients.

The starting position for many is the Privy Council decision in *IRC v Duke of Westminster*,<sup>42</sup> where Lord Tomlin held that:

[E]very man is entitled if he can to order his affairs so as that the tax attracting under the appropriate Acts is less than it otherwise would be.<sup>43</sup>

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<sup>39</sup> *Hurlingham Estates v Wilde* (1997) 1 Lloyd's Rep 525; *Balkin v Peck* 98 ATC 4842; *Bayer v Balkin* 95 ATC 4609.

<sup>40</sup> *Zelino v Budai* 2001 ATC 4479.

<sup>41</sup> *Tip Top Dry Cleaners v Mackintosh* 98 ATC 4036.

<sup>42</sup> [1936] AC 1.

<sup>43</sup> *Ibid* [19]. Aptly titled 'The Duke of Westminster Principle'.



However, the High Court in *Federal Commissioner of Taxation v Spotless Services Ltd* ('Spotless')<sup>44</sup> rejected the application of the Duke of Westminster principle in the context of the Australian tax regime. In reference to the remarks of Lord Tomlin, the court stated that:

Lord Tomlin spoke in the course of rejecting a submission that in assessing surtax under the *Income Tax Act 1918* (UK) the Revenue might disregard legal form in favour of 'the substance of the matter'. His remarks have no significance for the present appeal.<sup>45</sup>

In Australia, it is now clear from the decision in *Symond v Gadens Lawyers Sydney Pty Ltd* ('Symond')<sup>46</sup> that professional advisors are under an obligation to advise their client of: 1) Other alternatives that may achieve the objective/s of a particular arrangement in a more tax-efficient way; 2) The existence of any anti-avoidance provisions which may be applicable; and 3) The possibility that the arrangement will attract scrutiny from the Australian Taxation Office.<sup>47</sup>

The decision in *Symond* serves two purposes, firstly, the decision reflects the common law position under div 30 of the *Tax Agent Services Act 2009* (Cth);<sup>48</sup> and secondly, the decision affirms that consideration of the anti-avoidance provisions is critical to the delivery of sound, reasonable and compliant advice.

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<sup>44</sup> (1996) 186 CLR 404.

<sup>45</sup> Ibid [414].

<sup>46</sup> [2013] NSWSC 955.

<sup>47</sup> Ibid [63], [216], [438].

<sup>48</sup> Division 30 of the TASA relates to the tax practitioners Code of Professional Conduct ('Code'). For further commentary, see generally, the Tax Practitioners Board, *Explanatory Paper*, TBP 01/2010.

#### IV FRAMEWORK FOR ANALYSIS

##### *A Canons of Taxation*

Having canvassed the landscape of the Australian taxation regime and identified the efficacy of the anti-avoidance provisions in relation to taxation advice, the paper will now consider what might be an appropriate framework for evaluating the three GAARs identified previously, namely: pt IVA of the *ITAA36*, div 165 of the *GST Act* and ss 267–271 in ch 7 of the *Duties Act*.

There is substantial literature commenting on the fundamental principles of tax policy.<sup>49</sup> It has, however, generally been accepted that a well-designed tax policy will meet its intended objective while balancing the core criteria of equity, efficiency and simplicity.<sup>50</sup> Accordingly, each of these criterion are explained below:

##### *Equity*

Equity encompasses two major components: horizontal equity and vertical equity.<sup>51</sup> Horizontal equity suggests that taxpayers in similar circumstances should bear a similar tax burden.<sup>52</sup> Vertical equity is a normative concept, which suggests that taxpayers in more

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<sup>49</sup> One of the more recognisable texts to comment on this matter was authored by Adam Smith (1723–1790) in 1776. See Adam Smith, *An Inquiry Into the Nature and Causes of the Wealth of Nations* (PF Collier & Son, 10<sup>th</sup> ed, 1909).

<sup>50</sup> Commonwealth of Australia, *Re:Think: Tax Discussion Paper* (March 2015) <[http://bettertax.gov.au/files/2015/03/TWP\\_combined-online.pdf](http://bettertax.gov.au/files/2015/03/TWP_combined-online.pdf)>.

<sup>51</sup> OECD, *Addressing the Tax Challenges of the Digital Economy* (OECD Publishing, 2014).

<sup>52</sup> Charles M Allan, *The Theory of Taxation* (Penguin Books, 1971) 36.

favourable economic circumstances should bear a larger part of the tax burden as a proportion of their income.<sup>53</sup>

### *Efficiency*

An essential aspect of efficiency is neutrality.<sup>54</sup> Against this background, taxes should aim to minimise distortions to economic activities and not impede genuine commercial transactions.<sup>55</sup> Therefore, compliance costs for taxpayers and administrative costs for the tax authorities should be minimised as far as possible.<sup>56</sup>

### *Simplicity*

The concept of simplicity may readily be viewed in the context of compliance and administration.<sup>57</sup> Accordingly, the tax rules should be clear and simple to understand so that taxpayers can anticipate the tax consequences in advance of a transaction, including knowing when, where and how the tax is to be accounted.<sup>58</sup> Administratively, enforcing the tax should incur as little cost as possible with respect

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<sup>53</sup> Ibid.

<sup>54</sup> The OECD defines ‘neutrality’ as, ‘ensuring that optimal allocation of the means of production is achieved’ whilst simultaneously limiting economic distortion; see OECD (2014), *Addressing the Tax Challenges of the Digital Economy*, OECD/G20 Base Erosion and Profit Shifting Project, OECD Publishing, 31.

<sup>55</sup> Nicole Wilson-Rogers and Dale Pinto, ‘Tax Reform: A Matter of Principle? An Integrated Framework for the Review of Australian Taxes’ (2009) 7(1) *eJournal of Tax Research* 78.

<sup>56</sup> Ibid.

<sup>57</sup> Ibid 79.

<sup>58</sup> Ibid.

to tax policy planning, resolving taxation disputes and administering the law.<sup>59</sup>

The above tax policy principles represent a useful theoretical framework within which the different integrity measures may be considered. Accordingly, this framework will be adopted for the analysis undertaken in the next section of the paper.

## V GAAR COMPARATIVE ANALYSIS

### *A Legislative Elements*

Part IVA of the *ITAA36*, div 165 of the *GST Act* and ss 267–271 in ch 7 of the *Duties Act* (collectively termed, ‘the provisions’) share three distinct legislative elements. In each provision there must be objective evidence of:

1. The existence of a ‘scheme’;<sup>60</sup>
2. The sole or dominant purpose of entering into or carrying out the scheme was to obtain a tax benefit;<sup>61</sup> and
3. The tax benefit itself.<sup>62</sup>

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<sup>59</sup> Ibid.

<sup>60</sup> *ITAA36* s 177A; *GST Act* s 165.5(1); *Duties Act* s 267(1); see also *Federal Commissioner of Taxation v Hart* 2004 ATC 4599 at 4602 (‘*Hart*’); *Peabody v Commissioner of Taxation* (1994) 123 ALR 451 at [458]–[459] (‘*Peabody*’).

<sup>61</sup> *ITAA36* s 177D; *GST Act* s 165-5(1)(c)(i); *Duties Act* s 268(2)(a). The *Duties Act* broadens the definition of ‘tax benefit’ further by incorporating the terms ‘trust’ or ‘contract’. The definition is further expanded by extending the definition to all steps and transactions which carry a scheme into effect.

<sup>62</sup> *ITAA36* ss 177C, 177CA; *GST Act* s 165-5(1)(c)(i); *Duties Act* s 268(2)(a).

It is both necessary and instructive for comparison to understand the ambit of each of the elements announced above.

### *Scheme*

Each of the provisions define a scheme in almost identical terms. The word is given a wide meaning and defined as any agreement, arrangement, understanding, promise or undertaking, whether express or implied and whether or not enforceable, or intended to be enforceable, by legal proceedings.<sup>63</sup> It is additionally defined as any scheme, plan, proposal, action, course of action or course of conduct.<sup>64</sup> Given such a broad definition, a scheme is likely to be readily identified without much dispute.<sup>65</sup>

### *Sole or dominant purpose*

The purpose test is the fulcrum around which the provisions are based. The broad question is construed almost identically among the provisions and asks whether a person who entered into or carried out the scheme did so for the purpose of enabling a taxpayer to obtain a tax benefit.<sup>66</sup>

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<sup>63</sup> *ITAA36* s 177A; *GST Act* s 165-5(1); *Duties Act* s 267(1).

<sup>64</sup> *Ibid.*

<sup>65</sup> *Spotless* 95 ATC 4775, [4805]. See also Nicole Wilson-Rogers, 'Coming out of the Dark? The Uncertainties that Remain in Respect of Part IVA: How Does Recent Tax Office Guidance Help?' (2006) 4(1) *eJournal of Tax Research* 25, 30.

<sup>66</sup> *ITAA36* s 177D; *GST Act* s 165-15(1); *Duties Act* s 269(2).

The question is answered by considering similarly enlisted factors in each of the provisions.<sup>67</sup> The factors predominantly concern themselves with how the scheme was implemented and the overall effect of the scheme.<sup>68</sup> No one factor is determinative of a scheme, nor do they need to hold equal weighting.<sup>69</sup> However, all relevant factors must be taken into consideration.

### *Tax Benefit*

For either of the provisions to operate, a taxpayer must have obtained, or would but for the provisions have obtained, a ‘tax benefit’ in connection with the scheme.<sup>70</sup>

A tax benefit does not include benefits arising from making a choice allowed by the tax legislation such as the choice to use diminishing value depreciation rates rather than prime cost or the choice to take advantage of the CGT rollover provisions. However, the provisions do apply if a scheme was constructed to create circumstances such that the choice could be made.<sup>71</sup>

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<sup>67</sup> Above n 66. Like pt IVA, s 165-15 contains a number of factors that must be taken into account in considering an entity’s purpose in entering into or carrying out the scheme. Unlike pt IVA, div 165 includes the concept of the ‘principal effect’ of the scheme. For further literature on this distinction see Chris Sievers, ‘Division 165 — What Does the Future Hold?’ (Speech delivered at the Corporate Tax Association’s 2012 GST Corporate Intensive, Melbourne, 15 October 2012) <<https://chrissievers.com/article-division-165-what-does-the-future-hold/>>.

<sup>68</sup> See *Hart* 2004 ATC 4599.

<sup>69</sup> *Ibid.*

<sup>70</sup> *ITAA36* s 177C; *GST Act* s 165-10(1); *Duties Act* s 267(2).

<sup>71</sup> See *Macquarie v Federal Commissioner of Taxation* [2013] FCAFC 119.

Relevantly, this part of the provisions asks what would have happened, or might reasonably be expected to happen, if the tax scheme did not happen ('the counterfactual').<sup>72</sup>

### B *Comparison*

Each provision broadly operates in much the same way, ie, requiring a scheme and a tax benefit and establishing the sole or dominant purpose of the scheme by reference to a list of prescribed factors. There are, however, important differences between pt IVA *ITAA36*, div 165 *GST Act* ('div 165') and ss 276–271 of the *Duties Act* ('ss 276–271'), which may mean that div 165 and ss 276–271 are broader in application than pt IVA.

Notably, both div 165 and ss 276–271 apply to part of a scheme.<sup>73</sup> Consequently, this may assist the Commissioner in defining a

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<sup>72</sup> *ITAA36* s 177C; *GST Act* s 165-10(1); *Duties Act* s 267(2).

<sup>73</sup> *GST Act* s 165-10; *Duties Act* s 267(1). The interpretation of pt IVA of the *ITAA36* by the Courts has indicated that a scheme cannot be a part of a scheme. In *Peabody* (1994) 94 ATC 4663, the High Court prevented the Commissioner from defining a scheme very narrowly, stating at 4670:

Part IVA does not provide that a scheme includes part of a scheme and it is possible, despite the very wide definition of a scheme, to conceive of a set of circumstances which constitutes only part of a scheme and not a scheme in itself. That will occur where the circumstances are incapable of standing on their own without being robbed of all practical meaning ....

However, as was noted by Hill J in *Federal Commissioner of Taxation v Consolidated Press Holdings Pty Ltd* [2001] HCA 32, 'it does not matter if the scheme identified by the Commissioner is itself but a part of a larger scheme, so long as it brings about a tax benefit and thus is susceptible to cancellation under s 177F *ITAA36*.'

scheme narrowly and aid the Commissioner establishing a dominant tax avoidance purpose or principal tax avoidance effect.<sup>74</sup> In this way, the taxpayer may be unable to demonstrate that a scheme had a commercial purpose other than the avoidance of taxation.<sup>75</sup>

Furthermore, the factors to which reference is made in determining the dominant purpose of a scheme differ between pt IVA, div 165 and ss 267–71. Notably, both div 165 and ss 267–271 have additional consideration with respect to the circumstances surrounding the scheme.<sup>76</sup>

While it is expected that the courts will take a similar approach in interpreting Division 165 and ss 267–271 to that adopted in relation to pt IVA — ie, not requiring the Commissioner to refer to each factor but permitting a holistic assessment of purpose by reference to listed factors<sup>77</sup> — the inclusion of ‘circumstances surrounding the

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The relevant question is really whether the part of the scheme could itself constitute a scheme to which pt IVA applies. To this end, s 177D(1) coupled with the wide definition of ‘scheme’ contained within 177A catches a scheme where ‘... [any] person ... entered into or carried out the scheme or any part of the scheme’ for the relevant purpose; similarly in *Peabody*, the High Court took the view that a step or steps in a wider scheme could comprise a separate narrower scheme where those steps standing alone constituted a scheme.

<sup>74</sup> Julie Cassidy, ‘Are Court Decisions Changing our Old Taxes? Is Tax Avoidance Destroying Old Taxes? The Hart Decision — A Case in Point?’ (Paper presented at the Australasian Tax Teachers Association Conference, Melbourne University Law School, 30 January 2006).

<sup>75</sup> Ibid.

<sup>76</sup> *GST Act* s 165-15(1); *Duties Act* s 270(3).

<sup>77</sup> *Federal Commissioner of Taxation v Consolidated Press Holdings Ltd* [2001] HCA 32.



scheme,<sup>78</sup> may give both div 165 and ss 267–271 wider application than pt IVA as it can be argued that the Commissioner now has regard to subjective considerations.<sup>79</sup>

Additionally, both the *GST Act* and the *Duties Act* afford the taxpayer the opportunity to seek determinations from the Commissioner with respect to whether the GAAPs apply.<sup>80</sup>

In light of the above comparison and general operation of the provisions, this paper will now analyse how these provisions compare against the theoretical framework described previously.

### *C Equity*

In terms of equity considerations, the provisions generally uphold the principles of both horizontal and vertical equity; applicable only as measures of last resort in circumstances where a tax benefit has arisen or is likely to arise from engagement in a scheme.<sup>81</sup>

This argument is mounted on the premise that the provisions are broadly designed to target select taxpayers engaged in mischievous tax avoidance activities — ie, taxpayers in similar circumstances comparative to one another and distinct from the wider taxpayer community not engaged in tax avoidance schemes.

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<sup>78</sup> *GST Act* s 165-15(1)(k); *Duties Act* s 269(8)(a).

<sup>79</sup> *Contra Hart* 2004 ATC 4599.

<sup>80</sup> *Duties Act* s 262; *GST Act* div 165.

<sup>81</sup> See PS LA 2000/10; PS LA 2005/24.

Conversely, it can also be argued that the provisions are inequitable as the scope of their operation is cast too wide and may offend genuine commercial activity.<sup>82</sup>

Inevitably, aligning with the notion of equity will ultimately conflict with the principles of both simplicity and efficiency.<sup>83</sup>

By promoting equity there may arise a disincentive for taxpayers to engage in general commerce, thus possibly hampering economic growth and development. Similarly, when contrast with simplicity, the promotion of equity i.e. construing the provisions broadly — often results in uncertainty about the operation of the provisions, when liability arises and how best to structure a taxpayer's affairs. The consequence of which is increased litigation, administration and compliance costs.<sup>84</sup>

#### D *Efficiency*

The operation of the provisions may be seen as promoting the principle of efficiency. The use of the GAAR panel with respect to pt IVA and the determination procedure for certain transactions which may attract GAAP consequences contained within the GST and *Duties Acts*, are likely to cause little to no distortion to taxpayers' economic activities. Furthermore, these options provide clarity to the wider taxpaying community about the operation of the

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<sup>82</sup> See Rachel Anne Tooma, *A Case for a Uniform Statutory General Anti-avoidance Rule in Australian Taxation Legislation*, (PhD Thesis, University of New South Wales, 2007); *Contra* Grant Wardell-Johnson, 'The "New" Part IVA' (2014) *Tax Specialist* 118.

<sup>83</sup> Wilson-Rogers and Pinto, above n 55.

<sup>84</sup> See Explanatory Memorandum, Tax Laws Amendment (Countering Tax Avoidance and Multinational Profit Shifting) Bill 2013.

GAARs and the Commissioner's approach towards assessing certain transactions.<sup>85</sup>

## VI SIMPLICITY

It may be argued that the construction of the provisions is entirely too broad and thus lends itself to uncertainty. This contention is refuted by the support of the GAAR panel with respect to pt IVA and the determination procedure available to taxpayers contained within the *GST Act* and *Duties Act*.

Notwithstanding appropriate procedure for the exercise of the provisions, there is still considerable uncertainty surrounding the operation and application of the provisions, resulting in increased litigation and legislative reform.<sup>86</sup>

It has been suggested that the taxpayer may benefit from increased certainty if a uniform GAAR were to be adopted across all Australian taxation legislation, particularly where there is a uniform practice procedure for the administration of the statutory GAAR.<sup>87</sup>

Whilst a novel idea, the implementation of such reform may be too onerous to undertake and ultimately suffer the same fate as the proposed rewrite of the *ITAA36*. As a result, the principle of

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<sup>85</sup> PS LA 2005/24. As to the GAAR panel, see generally ATO, *General Anti-avoidance Rules Panel* (15 September 2015) <<https://www.ato.gov.au/General/ATO-advice-and-guidance/In-detail/Private-rulings/General-Anti-Avoidance-Rules-Panel/>>.

<sup>86</sup> See Sue Williamson and Ada Lam, 'Duty Anti-Avoidance Provisions' (Paper presented at the 11th Annual States' Taxation Conference, 28–9 July 2011) 1.

<sup>87</sup> See Tooma, above n 82.

efficiency would be grossly offended as administration costs are likely to increase dramatically.<sup>88</sup>

## VI CONCLUSION

Following the logic of Ken Schurgott,<sup>89</sup> the structure and effectiveness of the provisions needs to be considered in light of the many ways in which the GAARs affect tax liability, taxpayer behaviour and the taxing authority. Subsequent reform should ensure that the provisions are drafted in such a manner to ensure:

- The provisions promote simplicity and equity by only applying to those taxpayers that are intended to be affected;
- The provisions promote simplicity and efficiency by striking the right balance between deterring tax avoidance behaviour and not adversely impacting on genuine commercial transactions; and
- The provisions promote equity and efficiency by maintaining the appropriate balance between enabling the tax authority to counter integrity concerns, and allowing taxpayers the right to challenge the Commissioner's assessment.

At present, the provisions serve as effective deterrence and enforcement for the mitigation of tax avoidance. However, as the economic and political climate evolves, so too must the relevant

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<sup>88</sup> Ibid.

<sup>89</sup> Former President of the Advisory Panel to the Board of Taxation. See email from Ken Schurgott to Tom Reid, 19 December 2012.

integrity measures.<sup>90</sup> The comparative analysis performed above serves as a reference to this framework.

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<sup>90</sup> See Graeme Cooper, 'A Glimpse at Australia's GAAR Bill' (2013) 69(8) *Tax Notes International*, 759–63.

# ***THE EXCLUSION OF SUBCLASS 457 VISA WORKERS FROM THE PROTECTION OF THE FAIR ENTITLEMENTS GUARANTEE: HUMAN RIGHTS ISSUES***

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KYLE BOWYER<sup>\*\*</sup>

## **Abstract**

*Subclass 457 visa workers contribute to the Australian economy by addressing labour skill shortages, sharing their skills and experience with local counterparts, making tax contributions, and purchasing goods and services in the local economy. These workers also benefit, often experiencing better working and pay conditions than what they may encounter in their home countries. There are some legislative requirements that foreign, temporary workers be treated equally to their local colleagues, supported also by Australia's commitment to the observation of human rights principles such as non-discrimination. However, it is submitted that the inability of these workers to access government protection of*

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*their work entitlements in cases of employer insolvency, on the basis that they are not citizens, is a violation of human rights.*

## I INTRODUCTION

In the last three decades, overseas, temporary, skilled workers have become an important part of the workforce of many developed countries. These workers provide the flexibility, mobility and expertise needed to address skill shortages arising through a range of factors, including a lack of local employees with essential technical skills or qualities that employers consider important, a lack of local mobility to remote areas, and recruitment difficulties under current market conditions.<sup>1</sup> Systemic or economic factors such as an under-investment in skills development or rapid growth in particular industries (eg, mining and construction) may also give rise to skill shortages.<sup>2</sup> To facilitate access to overseas, skilled worker markets and to attract expertise into the Australian workforce, the Subclass 457 Visa ('457 visa') was introduced in 1996 by the Howard Government to provide flexible, skilled labour in areas where there was a shortage of local skilled workers.<sup>3</sup>

The 457 visa was seen as a significant step towards modernising the labour market and allowing the Australian economy to compete with other developed and developing countries. As at 31 March 2016

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1 Sue Richardson, 'What is a Skill Shortage?' (Research Report, National Centre for Vocational Education Research, 26 February 2007) 7.

2 Ibid 8.

3 Department of Parliamentary Services, 'Temporary (Long Stay) Business Visas: Subclass 45' (Research Note No 15, Parliamentary Library, Parliament of Australia, 2007) 1.

there were 97 770 primary 457 visa holders in Australia.<sup>4</sup> Their skills have been utilised by various industries and these workers contribute to the Australian economy in terms of expertise and tax contributions.<sup>5</sup> In fact, 457 visa workers pay at least 8.5 per cent and up to 33 per cent more tax than Australian workers due to their ineligibility for certain tax offsets.<sup>6</sup>

However, the 457 visa can spark uneasiness towards foreign skilled workers due to the perception that the visa holders divert jobs from local workers. Furthermore, some have criticised the 457 visa procedures that may allow sponsors to hire foreign workers without first genuinely attempting to source local, Australian workers. There are other concerns that many 457 visa workers lack English language skills and place a strain on local state facilities such as schools, health and other community and welfare services.

There are also issues that 457 visa workers personally face including lack of acceptance by local workers, cultural differences, language difficulties and discrimination. Of particular concern is the potential for exploitation of 457 visa workers by employers due to the visa holders' vulnerability triggered by their temporary visa status, lack

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4 Department of Immigration and Border Protection, *Subclass 457 Quarterly Report: Quarter Ending at 31 March 2016* (2016), 1 <<https://www.border.gov.au/ReportsandPublications/Documents/statistics/457-quarterly-report-2016-03-31.pdf>>.

5 See Peter Mares' submission in John Azarias et al, 'Robust New Foundations: A Streamlined, Transparent and Responsive System for the 457 Programme — An Independent Review into Integrity in the Subclass 457 Programme' (September 2014) 83.

6 Susanne Bahn, 'Workers on 457 Visas: Evidence from the Western Australian Resources Sector' (2013) 39(2) *Australian Bulletin of Labour* 34, 47–51.



of familial support, language competencies and lack of awareness of their rights under the Australian legal system.

Whilst there are measures and protections in place to protect many of the rights and entitlements of foreign workers, an issue that is not immediately apparent, but which potentially can severely and negatively impact upon 457 visa workers, is their exclusion from the protection of the Fair Entitlements Guarantee ('FEG') in cases of employer insolvency.

The aim of this paper is to examine the exclusion of 457 visa workers from the protection of the FEG and to determine whether such exclusion is a breach of Australia's commitment to recognise and uphold human rights. To do so, the paper begins with a general background on the 457 visa and an examination of 457 visa worker contributions to the Australian economy. Some of the challenges that 457 visa workers face, such as exploitation, will then be canvassed and their exclusion from the protection of the FEG will be examined, including an assessment of whether the exclusion of 457 visa workers from the FEG constitutes a breach of Australia's obligations under human rights conventions.

## II BACKGROUND TO THE 457 VISA

Hiring foreign workers in Australia has been practiced since the nineteenth century, when Pacific Islanders laboured in the Queensland sugar industry. In the 1830s, Chinese labourers worked in the New South Wales mining, construction, manufacturing and trade industries for a fixed number of years.<sup>7</sup> In modern times,

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7 Laurie Berg, *Migrant Rights at Work: Law's Precariousness at the Intersection of Immigration and Labour* (Taylor and Francis, 2015) 54.

during the 1990s and beyond, the Australian economy blossomed, creating a demand for skilled labour that was not being satisfied by the local market due to a shortage of local, Australian skilled workers.

The occurrence of skill shortages in Australia is perhaps no surprise given the country's geographical characteristics and relatively small, dispersed population. The need for foreign workers to address skill shortages is recognised in the *Migration Act 1958* (Cth) ('*Migration Act*'). This Act specifically details the goal of providing a framework for a temporary sponsored work visa program to address genuine skills shortages, whilst also balancing the interests of Australian citizen workers and ensuring that non-citizens are treated fairly.<sup>8</sup>

To provide businesses with the much-needed skilled labour, the Roach Report in 1995 recommended a more streamlined approach to the use of foreign skilled workers.<sup>9</sup> In 1996, the Howard Government introduced a new, temporary business 457 visa. Since then, temporary immigration has overtaken permanent migration to Australia.<sup>10</sup> The attractiveness of the Australian 457 visa program is bolstered by the fact that the 457 visa scheme allows visa holders to bring their families with them to Australia, and also enables their

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8 *Migration Act 1958* (Cth) s 140AA.

9 Joint Standing Committee on Migration, Parliament of Australia, *Business Entry: Future Direction — Report to the Committee of Inquiry into the Temporary Entry of Business People and Highly Skilled Specialists* (1995) 84.

10 Selvaraj Velayutham, 'Precarious Experiences of Indians in Australia on 457 Temporary Work Visas' (2013) 24(3) *The Economic and Labour Relations Review* 340.

spouses to have work entitlements.<sup>11</sup> Further, the workers may apply for permanent residency after meeting certain requirements.

Under the 457 visa program, employers who are unable to find sufficiently skilled workers from the local market are entitled to sponsor foreign skilled workers to work in Australia. However, employers must provide the opportunity of employment and training to local workers prior to sponsoring foreign workers.<sup>12</sup> The 457 visa is uncapped, meaning employers are entitled to sponsor an unlimited number of overseas skilled workers to meet local demands.<sup>13</sup>

In order to satisfy the requirement of locating skilled workers from the domestic labour market, a potential sponsor has to advertise the position locally. Additionally, the sponsor should declare if any redundancies have been made within the last four months.<sup>14</sup> This requirement was created by an amendment to the *Migration Act* which introduced labour market testing.<sup>15</sup> The amendment requires sponsors to undertake testing of the Australian labour market to demonstrate whether or not a suitably qualified and experienced Australian citizen or Australian permanent resident is readily available to fill the position.<sup>16</sup>

Over time, visa application and granting rules and procedures were simplified to provide a quicker process for employers to sponsor the required skilled workers. This was completed in order to achieve the

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11 *Migration Act 1958* (Cth) s 83.

12 *Ibid* s 140AA(c).

13 Department of Immigration and Border Protection, Temporary Work (Skilled) (Subclass 457) Visa (2016), 3 <<https://www.border.gov.au/Forms/Documents/1154.pdf>>.

14 *Migration Act 1958* (Cth) s 140GBA(4A).

15 *Ibid* s 140GBA(7).

16 *Ibid* s 140GBA(3).

objectives of the 457 visa program, and to give the Australian economy a competitive advantage over other developed countries that had introduced similar visa programs to attract skilled labour.<sup>17</sup>

Although there are various eligibility, procedural and reporting requirements, once the 457 visa worker is employed they are to be treated, with respect to their employment conditions and relationship with their employers, in the same manner as their local Australian counterparts.<sup>18</sup> It is important to emphasise that a sponsor must not employ a sponsored worker under any terms or conditions that are less favourable than the employer's Australian workers who are performing the same job.<sup>19</sup>

The appeal of the 457 visa is clearly demonstrated by the increased number of 457 visas issued in 2004–05, where a total of 49 855 visas were granted, constituting a 24 per cent increase compared to the previous year.<sup>20</sup> The number of primary 457 visa holders in Australia as at 31 March 2015 was 106 750.<sup>21</sup>

### III THE POSITIVE IMPACTS OF THE 457 VISA

Evidence shows that migrant workers contribute to the capacity and functionality of the labour market by undertaking jobs that are

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17 Berg, above n 7, 66.

18 Department of Immigration and Border Protection, Temporary Work (Skilled) (Subclass 457) Visa, above n 13.

19 Ibid.

20 Ibid.

21 Department of Immigration and Border Protection, Subclass 457 Quarterly Report, above n 4.

undesirable to local workers in the host country.<sup>22</sup> A study performed by Bahn et al suggested that by 2050 the impact of migrant workers could result in the projected Global Domestic Product ('GDP') growth rate being 2.4 times higher than if no additional migrants were to enter Australia.<sup>23</sup> A study conducted by McDonald and Temple predicted that, by 2025, the number of migrants entering Australia will increase the size of Australia's economy.<sup>24</sup> This study further forecasted that the GDP will grow by 263 per cent in Australia if the number of skilled migrants increases to 300 000 by 2050.<sup>25</sup>

With regard to the shortage of skilled workers, a 1995 Australian Parliamentary Committee Report stated that:

A country of Australia's size cannot expect to be completely self-sufficient at the leading edge of all skills in the area of key business personnel. When world trade in service is based on different countries developing specialised skills in different areas, it is not realistic for Australia to attempt to develop specialised skills in all areas. Thus there will be of necessity a

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22 Susanne Bahn, Llandis Barratt-Pugh and Ghialy Choy Lee Yap, 'The Employment of Skilled Migrants on Temporary 457 Visas in Australia: Emerging Issues' (2012) 22(4) *Labour & Industry* 379.

23 Ibid 388.

24 Peter McDonald and Jeromey Temple, 'Immigration, Labour Supply and Per Capita Gross Domestic Product: Australia 2010–2050' (Research Report, Australian Demographic & Social Research Institute, May 2010) <<https://www.border.gov.au/ReportsandPublications/Documents/research/labour-supply-gdp-2010-2050.pdf>>.

25 Ibid 32.

need for Australia to import certain skills, in much the same way as Australia is developing skills to export.<sup>26</sup>

This has been reinforced by the Australian Mines and Metals Association's submission to the Senate Standing Committee Inquiry, stating that:

The program provides a 'circuit breaker' when appropriate labour cannot be sourced locally, allowing important job creating projects and investments to proceed that would be unviable or significantly delayed without access to such labour (or in the case of the major users of the system, allowing minimum levels of patient care expected by the community).<sup>27</sup>

The Minister for Immigration and Citizenship, Senator Chris Bowen, acknowledged the contribution of 457 visa workers to the Australian economy, stating that 'skilled migrants deliver major benefits to the Australian economy in terms of contributing to economic growth and offsetting the impacts of an ageing population'.<sup>28</sup>

Other benefits that skilled migrant workers bring to Australia include skill exchange, which involves sponsored workers being able to share their knowledge, skills and experience with local

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26 Committee of Inquiry into the Temporary Entry of Business People and Highly Skilled Specialists, Parliament of Australia, *Business Temporary Entry: Future Directions* (1995) 84 ('Roach Report').

27 Australian Mines & Metals Association (AMMA), *Submission to the Senate Standing Committee on Legal and Constitutional Affairs: Inquiry into the Framework and Operation of Subclass 457 Visas* (April 2013) Parliament of Australia, 5 <<http://www.aph.gov.au/DocumentStore.ashx?id=71e782cd-8ebd-44c4-90bd-cb37ccd9ac46>>.

28 Energy News Premium.Net, Govt to Slash Visa Red Tape (12 March 2012) <<http://www.energynewspremium.net/StoryView.asp?storyID=3201562&section=Policy&sectionsource=s245&aspdsc=yes>>.

workers.<sup>29</sup> In addition, 457 visa workers make a direct contribution to the Australian economy through the taxes they pay and domestic spending.<sup>30</sup>

Of course the benefits flow both ways; sponsored workers are, generally, able to prosper financially, socially and professionally from their engagements.<sup>31</sup> Financially, they are often very well remunerated in comparison to their countries of origin, and sometimes even in comparison to local workers. John Elliott, a freelance writer fascinated with data, has argued that on average some sponsored workers are earning 34 per cent more than Australian local workers.<sup>32</sup> However, it should be noted that foreign workers pay up to 33 per cent more tax than their domestic colleagues.<sup>33</sup>

Despite the contributions made by 457 visa workers to the Australian economy and the benefits they receive, the relationship is not without issues. There are actual or perceived disadvantages to local workers or industries and, on the other side, the treatment of foreign workers by local workers and employers may not always be

29 Senate Legal and Constitutional Affairs Committee, Senate, Framework and Operation of Subclass 457 Visas, Enterprise Migration Agreements and Regional Migration Agreements (2013) 11.

30 Infoatperthrelocation, 'Job hunting Tips for New Migrants in Australia' on All the Latest News from Perth (8 July 2009) <<http://perthrelocationlatestnews.wordpress.com/2009/07/08/job-hunting-tips-for-new-migrants-inaustralia/>>.

31 Ibid.

32 John Elliott, At-a-Glance: 457 Visa Holders in Australia (27 February 2015) <<http://www.sbs.com.au/news/article/2013/06/27/glance-457-visa-holders-australia>>.

33 Bahn, above n 6, 47–51.

fair. Berg argues that temporary migrant workers, such as 457 visa workers, operate in a legal and social framework that could lead to their exploitation by employers.<sup>34</sup> This is compounded by the fact that there is little public awareness of actual and potential exploitation, and of the social, economic, legal or other factors that create a propensity for 457 visa workers to be taken advantage of. Further, the impact of exploitative practices and the vulnerability of migrant workers due to the temporary nature and conditions of the 457 visa, from the perspective of the workers themselves, has not often been considered.<sup>35</sup>

#### IV THE NEGATIVE IMPACTS OF THE 457 VISA

The fact that the 457 visas have generated support and criticism at the same time might explain the number of specific inquiries conducted by the Australian Parliament into the 457 visa. There are two competing aims associated with the 457 visa. The first is to respond to the shortage of skilled workers by allowing businesses to sponsor migrant workers under fair conditions. The second is to ensure that local workers are not disadvantaged or prevented from obtaining job opportunities.<sup>36</sup> If the alleged shortage of skilled workers is not genuine, there may be concerns that local workers are being denied job opportunities, if these opportunities are given to foreign workers. However, a genuine shortage may be caused by a number of factors and not merely because of a physical shortage of local workers. It may be due, *inter alia*, to local workers being unwilling to work in particular conditions, recruitment issues,

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34 Berg, above n 7, 51.

35 Velayutham, above n 10, 341.

36 Barbara Deegan, 'Visa Subclass 457: Integrity Review' (Research Report, October 2008) <<https://www.border.gov.au/WorkinginAustralia/Documents/457-integrity-review.pdf>>.



workforce development problems, or local workers not possessing certain attributes that employers are looking for.<sup>37</sup>

### *A Protecting Local Jobs*

One of the concerns that has been articulated in relation to the 457 visa is that sponsored workers have taken local jobs, especially where there is no genuine labour shortage in relation to a position.<sup>38</sup> This proposition has been expressed by the Australian Nursing Foundation in its submission to the Senate Standing Committee Inquiry conducted on the framework and operation of the 457 visa.<sup>39</sup> Their concern was that the number of overseas nurses sponsored under the 457 visa program has been increasing whilst new Australian graduates are not able to find employment.<sup>40</sup>

However, according to Bahn, there is reluctance by Australian workers in the Western Australian resource sector to undertake fly-in fly-out or regional work, and therefore workers on 457 visas are often not competing with domestic workers for the same job. Instead they are filling genuine shortages.<sup>41</sup> Bahn also points out that, without 457 visa workers' willingness to work where domestic

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37 Richardson, above n 1.

38 Senate Legal and Constitutional Affairs Committee, above n 29, 18.

39 Australian Nursing Federation, Submission 27: Framework and Operation of Subclass 457 Visas (3 May 2013) Senate Legal and Constitutional Affairs Committee <[http://www.aph.gov.au/Parliamentary\\_Business/Committees/Senate/Legal\\_and\\_Constitutional\\_Affairs/Completed\\_inquiries/2010-13/457visas/submissions](http://www.aph.gov.au/Parliamentary_Business/Committees/Senate/Legal_and_Constitutional_Affairs/Completed_inquiries/2010-13/457visas/submissions)>.

40 Ibid.

41 Bahn, above n 6, 36 citing Department of Immigration and Citizenship, 'Subclass 457 State/Territory Summary Report — January 2013' (2013) <<http://www.immi.gov.au/media/statistics/pdf/457-state-territory-summary-report-jan13.pdf>>.

workers would not, resource projects were at risk of failing to commence, or encountering delays and cost blowouts.<sup>42</sup>

It is worth noting that skill shortages are not always reflective of the actual market workforce supply. A concern surrounding the current 457 visa arrangement is that it is the employer who decides whether or not there is a skills shortage.<sup>43</sup> Employers may have an incentive to exaggerate the labour skill shortage, because they do not want to invest in training their unskilled workers for the required skill shortage positions if that training would cost more than sponsoring 457 visa workers.<sup>44</sup>

There are also concerns with the labour market test that imposes a legal obligation on employers to try to recruit from the Australian market before accessing overseas, skilled workers.<sup>45</sup> Under the current arrangement, businesses are not obliged to show that they have attempted to recruit from the local market prior to sponsoring overseas skilled workers.<sup>46</sup>

Furthermore, some believe that the list of occupations for which 457 visas can be granted does not genuinely reflect need. The Consolidated Sponsored Occupations List ('CSOL') is a list, authorised by the *Migration Regulations 1994* (Cth), specifying occupations for which employers are able to sponsor foreign workers if there are shortages in the local market. The list was

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42 Ibid.

43 Joanna Howe, 'Is the Net Cast too Wide? An Assessment of Whether the Regulatory Design of the 457 Visa Meets Australian's Skill Needs' (2013) 41(3) *Federal Law Review* 443, 445.

44 Ibid.

45 Senate Legal and Constitutional Affairs Committee, above n 29, 19.

46 Ibid.

established in July 2012 and replaced three occupation lists that were previously used to sponsor 457 visa workers.<sup>47</sup> However, there are concerns that the CSOL mechanisms that are provided are ineffective. On this point, Dr Joanna Howe, Associate Professor Alexander Reilly and Professor Andrew Stewart have observed in their submission to the Senate Standing Committee Inquiry that:

[The 457 program currently relies] upon a broadly-based occupational list to identify the occupations for which employers can sponsor temporary migrant workers. Crucially, this list is not compiled with reference to skill shortages in the domestic economy. The CSOL currently has 742 occupations on it from A[NZ]SCO skill levels 1–4. So long as an occupation is on this list, an employer can make a 457 nomination and the occupation is deemed to be in shortage. Present on this list is a number of occupations where there is clearly no domestic labour shortfall.<sup>48</sup>

Further, Howe points out that the CSOL is flawed in its design and operation because it is too broad, and is based on skill levels rather than actual domestic shortages. Other criticisms are that the list is employer-driven, it contains skills that could easily be trained in the domestic market and it does not protect the employment status of 457 visa workers.<sup>49</sup>

Concerns have been expressed about accountability and transparency in relation to the list:

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47 Howe, above n 43, 459.

48 Dr Joanna Howe, Associate Professor Alexander Reilly and Professor Andrew Stewart, *Submission 11: Framework and Operation of Subclass 457 Visas* (26 April 2013) Senate Legal and Constitutional Affairs Committee 5 <[http://www.aph.gov.au/Parliamentary\\_Business/Committees/Senate/Legal\\_and\\_Constitutional\\_Affairs/Completed\\_inquiries/2010-13/457visas/submissions](http://www.aph.gov.au/Parliamentary_Business/Committees/Senate/Legal_and_Constitutional_Affairs/Completed_inquiries/2010-13/457visas/submissions)>.

49 Howe, above n 43, 460.

[There is] limited transparency and accountability in the compilation of the list. It is unclear when annual reviews of this list take place. It is unclear as to how and why occupations are added to this list. Very little justification, if any, is given for the occupations that are on this list.<sup>50</sup>

In addition, there are other concerns that have been articulated about the English language proficiency of foreign workers.<sup>51</sup> Besides the above concerns, the community has also expressed their unease with the fact that skilled foreignworkers and their families place a strain on government services and infrastructure, such as schools, roads and hospitals.<sup>52</sup> Conversely, it should be noted that 457 visa workers pay at least 8.5 per cent and up to 33 per cent more income tax than their local counterparts,<sup>53</sup> and spend money in their communities in the same way that local workers do. Furthermore, in many cases 457 visa workers are excluded from benefits that are otherwise free to citizens, such as free public school education for their children.<sup>54</sup>

The Independent Review, commissioned by the Abbott Government in 2014, entitled 'Robust New Foundations', recommended, inter alia, for a revision of the CSOL, the abolishment of labour market

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50 Howe, Reilly and Stewart, above n 48.

51 Department of Immigration and Citizenship, 'Strengthening the Integrity of the Subclass 457 Program' (Discussion Paper, Ministerial Advisory Council on Skilled Migration, December 2012) 16.

52 Bahn, Barratt-Pugh and Choy Lee Yap, above n 22, 392.

53 Bahn, above n 6, 50.

54 See, for example, Education HQ, Pressure on WA govt Over 457 School Charge (23 August 2013) <<http://au.educationhq.com/news/23975/pressure-on-wa-govt-over-457-school-charge/>> which discusses the charging of 457 visa holders for public education for their children as being a violation of the Convention on the Rights of the Child since it is free for children of Australian citizens and permanent residents.

testing, changes to English language requirements, and improved monitoring of the list and its application.<sup>55</sup>

### B *Protecting 457 Visa Workers*

#### *Exploitation*

Piper observed that migrant workers are one of the most marginalised groups, particularly in policy terms.<sup>56</sup> There are obstacles preventing them from being an effective social movement.<sup>57</sup>

This marginalisation could lead to exploitation, which is one of the issues associated with 457 visa workers. Toh and Quinlan state that the '[457 visa] workers' ignorance of legal entitlements, indebtedness, reliance on employer sponsorship to remain in the country and aspirations for permanent residence place them in an acutely vulnerable position'.<sup>58</sup>

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55 John Azarias et al, 'Robust New Foundations: A Streamlined, Transparent and Responsive System for the 457 Programme — An Independent Review into Integrity in the Subclass 457 Programme' (September 2014) 14–19.

56 Nicola Piper, 'The "Migration-Development Nexus" Revisited from a Rights Perspective' (2008) 7(3) *Journal of Human Rights* 282.

57 Ibid.

58 S Toh and M Quinlan, 'Safeguarding the Global Contingent Workforce? Guestworkers in Australia' (2009) 30(5) *International Journal of Manpower* 453, 467.

The International Labour Organisation articulated that the temporary stay element of the foreign workers alone causes vulnerability.<sup>59</sup> This issue has been examined by both the Deegan review,<sup>60</sup> and the Senate Standing Committee Inquiry.<sup>61</sup> Furthermore, such vulnerability is exacerbated by the fact that 457 visa workers are less likely to make complaints if they have been treated unfairly, for fear of reprisals or termination.<sup>62</sup> In particular, in some cases, they are worried that their employer might cancel their visa if they raise concerns that they have been subjected to unfair treatment.<sup>63</sup> On this issue, Tham and Campbell assert that 457 visas create a serious risk of precarious employment that results in a state of dependency on the employer. This dependency is created because continuing to work for a sponsor allows 457 visa workers to stay legally in Australia. Secondly, it may restrict foreign workers' freedom to seek employment opportunities from anyone other than their sponsor employers.<sup>64</sup> This issue has been highlighted by the Deegan Inquiry which stated:

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59 International Labour Office, 'Towards a Fair Deal for Migrant Workers in the Global Economy' (Paper presented at the International Labour Conference, Geneva, 1–17 June 2004) 89–90.

60 Department of Immigration and Citizenship, above n 51.

61 Senate Legal and Constitutional Affairs Committee, above n 29, 39.

62 Howe, Reilly and Stewart, above n 48.

63 Australian Council of Trade Unions, Submission 40: Framework and Operation of Subclass 457 Visas, (3 May 2015) Senate Legal and Constitutional Affairs Committee <[http://www.aph.gov.au/Parliamentary\\_Business/Committees/Senate/Legal\\_and\\_Constitutional\\_Affairs/Completed\\_inquiries/2010-13/457visas/submissions](http://www.aph.gov.au/Parliamentary_Business/Committees/Senate/Legal_and_Constitutional_Affairs/Completed_inquiries/2010-13/457visas/submissions)>.

64 Joo-Cheong Tham and Iain Campbell, 'Equal Treatment for Temporary Migrant Workers and Challenge of their Precariousness' (Paper presented at ILERA (IIRA) World Congress, Philadelphia, July 2012).

Despite the views of some employers and employer organisations, Subclass 457 visa holders are different from other employees in Australian workplaces. They are the only group of employees whose ability to remain in Australia is largely dependent upon their employment, and to a large extent, their employer. It is for these reasons that visa holders of this type are vulnerable and are open to exploitation.<sup>65</sup>

It follows that there is often little equal bargaining power between sponsors and 457 visa workers, and a power imbalance in the employer-employee relationship when compared to that of local workers.

Velayutham, in a three year qualitative study on the experiences of temporary skilled migrants from India, suggests that there are three different sub-groups of workers, resulting in the creation of different levels of exploitation depending on their ability to respond to difficulties.<sup>66</sup> White-collar professionals and blue-collar workers in unionised industries fare better than workers in non-unionised, subcontracting, or small businesses, who are most vulnerable to exploitation and least able to respond to it.<sup>67</sup>

Around 30 per cent of sponsor employers assessed by the Fair Work Ombudsman ('FWO') in 2014–15 were found to not be meeting obligations, with 223 of 702 entities assessed being referred to the Department of Immigration and Border Protection.<sup>68</sup> To give an example of how 457 visa holders have been exploited, construction company Kentwood Industries was fined \$430 000 by the Federal

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65 Department of Immigration and Citizenship, above n 50, 69.

66 Velayutham, above n 10, 341.

67 Ibid.

68 Fair Work Ombudsman, 'Annual Report 2014–2015' (28 September 2015) 40 <<https://www.fairwork.gov.au/ArticleDocuments/710/fair-work-ombudsman-annual-report-2014-15.pdf.aspx>>.

Court in Perth for paying \$3 per hour for 457 visa sponsored tradesmen.<sup>69</sup> The workers lived in overcrowded accommodation, with three men sharing a bedroom in a house rented by the company. The Federal Court heard that workers were forced to sleep on the floor and to work up to 11 hours a day, for six to seven days a week, without days off. They also were not paid penalty rates or annual leave entitlements.<sup>70</sup>

In addition, the 457 visa workers' vulnerability may increase if they are planning to apply for permanent residency, as they would then be even less likely to jeopardise their relationship with their employers by making complaints against them. Commenting on this matter, Dr Joanna Howe, Professor Alexander Reilly and Professor Andrew Stewart stated in their submission to the Senate Standing Committee Inquiry that:

[The] vulnerability of subclass 457 visa holders is exacerbated by their profile as migrants. The vulnerability of temporary migrant workers in general is well documented. Migrant workers lack the capacity of citizens to participate in the political system that determines their work rights, they lack security of residence, and they often face language and cultural barriers which makes it less likely they will know their rights as workers, and more difficult for them to assert them against a local employer.<sup>71</sup>

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69 *Fair Work Ombudsman v Kentwood Industries Pty Ltd (No 3)* [2011] FCA 579.

70 Ibid; Courtney Trenwith, 'Hundreds of Workers Robbed of Unpaid Wages Last Financial Year' (8 November 2011) *WA Today* <<http://www.watoday.com.au/wa-news/hundreds-of-workers-robbed-of-unpaid-wages-last-financial-year-20111107-1n3k1.html>>.

71 Howe, Reilly and Stewart, above n 48.



Despite this, there are measures that may assist in reducing differential treatment of foreign workers. Since 2010, pursuant to the *Fair Work Act 2009* (Cth) (*'Fair Work Act'*), all workers in Australia are entitled to the same employment conditions.<sup>72</sup> The Temporary Skilled Migration Income Threshold (*'TSMIT'*) is an income floor, currently set at \$53 900 per annum, which is the minimum salary to be paid to a skilled 457 visa worker. The TSMIT not only protects local workers but also provides some level of comfort that foreign workers will be able to support themselves given that they are ineligible for income support, taxation benefits and other protections.<sup>73</sup>

The FWO has also acknowledged foreign workers' vulnerability.<sup>74</sup> Amongst those factors considered by the FWO to lead to vulnerability of workers in general, those that are relevant to 457 visa workers include people who are recent immigrants, people with literacy difficulties and people from non-English speaking backgrounds.<sup>75</sup> Currently, the FWO monitors compliance with sponsor obligations and it has pursued a number of cases against 457 visa sponsors for breaches of workplace law.<sup>76</sup>

In 2010, to help foreign workers, including 457 visa holders overcome language and legal barriers, the FWO formulated various measures to improve awareness of legal rights. This included information, in various languages, designed to inform foreign

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72 *Fair Work Act 2009* (Cth) pt 2–2.

73 Azarias et al, above n 55, 54.

74 Berg, above n 7, 80. Fair Work Ombudsman, *Guidance Note 1: Litigation Policy of the Office of the Fair Work Ombudsman* (4th ed, 3 December 2013).

75 Fair Work Ombudsman, *Guidance Note 1: Litigation Policy of the Office of the Fair Work Ombudsman* (4th ed, 3 December 2013).

76 Azarias et al, above n 55, 94.

workers of their rights and the legal services and protections that are available to them.<sup>77</sup> Furthermore, the FWO's Overseas Workers Team was created to monitor compliance and assist with complaints.

The *Migration Amendment (Temporary Sponsored Visa) Act 2013* (Cth) granted the FWO new powers that allows its inspectors to monitor the treatment of 457 visa workers, and to ensure employer compliance with the visa's conditions.<sup>78</sup> This includes ensuring that foreign workers are not being paid less than the market rate and that they are doing work that matches their job titles as described in their visa approval.<sup>79</sup> In the period between 1 July 2013 to 31 December 2014, concerns were identified in about 18 per cent of the 3076 then current 457 visa holders' cases that were monitored by the FWO.<sup>80</sup>

Furthermore, the Department of Immigration and Border Protection and the FWO are leading Taskforce Cadena which commenced on 1 July 2015. The taskforce also involves the Australian Federal Police, the Australian Securities and Investment Commission, the Australian Taxation Office and other relevant agencies to protect foreign workers from exploitation.<sup>81</sup>

The Fair Work Commission itself operates to assist all employees working in Australia with workplace issues and has done so for a number of 457 visa holders, especially in relation to unfair

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77 Berg, above n 7, 80.

78 *Migration Act 1958* (Cth) s 140UA.

79 Fair Work Ombudsman, Subclass 457 Visa Monitoring (2016) <<https://www.fairwork.gov.au/find-help-for/visa-holders-and-migrants#working-holiday-visa>>.

80 Senate Standing Committee on Education and Employment, Parliament of Australia, *A National Disgrace: The Exploitation of Temporary Work Visa Holders* (2016) 270 [9.8].

81 Ibid.

dismissal, unlawful dismissal or underpayment, and referring relevant matters to the Department of Immigration for action.<sup>82</sup>

In May 2016 the Liberal Government announced that it will strengthen protection for vulnerable workers by increasing penalties, bolstering the FWO, establishing a Migrant Workers Taskforce within the FWO, improving the FWO's evidence-gathering powers, and amending the *Fair Work Act*.<sup>83</sup>

However, the legal remedies such as civil, FWO or Fair Work claims available to 457 visa workers for employment breaches or allegations of exploitation are often not viable options. Apart from the general deterrent in making claims for fear of losing their visa status, other deterrents include lack of English proficiency, lack of awareness of rights and avenues of protection, cost of claims (depending on the nature of the claim, especially for low-paid workers such as cleaners), and, more importantly perhaps, the time involved in pursuing claims. In cases where 457 visa workers are able to bear the costs involved in civil cases, they are still constrained by time issues. This is because 457 workers are given 90 days after losing their employment to find another sponsor, who may be less inclined to employ someone who has made a claim of any sort against their previous employer, before facing deportation from Australia.

Importantly, there is an area of vulnerability in relation to 457 visa workers that is still not specifically addressed by the measures and protections discussed above. A major issue that 457 visa holders

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82 Azarias et al, above n 55, 95.

83 Liberal Party of Australia, *The Coalition's Policy to Protect Vulnerable Workers* (2016) <<https://www.liberal.org.au/coalitions-policy-protect-vulnerable-workers>>.

may face, and that their local equivalents do not, is the lack of protection of their entitlements when a sponsor employer becomes insolvent. In this instance, the Fair Entitlements Guarantee that protects Australian citizens and permanent resident workers' entitlements excludes from its protection the 457 visa workers' entitlements.<sup>84</sup>

### *Fair Entitlements Guarantee*

The FEG was enacted in 2012 to replace the General Employee Entitlements and Redundancy Scheme ('GEERS'), after more than 10 years in operation, to provide protection of employee entitlements in instances of insolvency. The intention behind the introduction of the FEG was to enhance the protection of employees' entitlements by ensuring entitlements would be protected in the event of insolvency. The FEG is administered by the Department of Employment and provides advance Commonwealth payments to employees who have lost their jobs due to insolvency. Subsequently, the Commonwealth is given priority for recovering paid entitlements from the assets of the insolvent firms concerned.<sup>85</sup>

The FEG protects the following entitlements:

1. Up to 13 weeks unpaid wages;
2. Unpaid annual leave;
3. Unpaid long service leave;
4. Up to 5 weeks unpaid payment in lieu of notice; and
5. Up to 4 weeks unpaid redundancy entitlement per year.

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84 It must be noted that it is not only 457 visa holders who are not qualified for the protection of the FEG, foreign students and visa holders who are allowed to work in Australia are also exempt from the protection of FEG.

85 *Fair Entitlements Guarantee Act 2012* (Cth) s 29.

Even though the concerns that have been raised about the FEG's effectiveness are not within the scope of this paper, they could be described briefly as revolving around outstanding and unresolved concerns in relation to taxpayers, namely that this measure has not addressed the liability of employers to pay their employee entitlements. The FEG has instead shifted the liability from employers to taxpayers, creating the potential for abuse and encouraging illegal activities, such as phoenix companies.<sup>86</sup> Besides this, the FEG does not cover all employee entitlements in the event of insolvency.

Since 457 visa holders are excluded from the protection of the FEG, the only mechanism available to protect 457 visa holders' entitlements is s 556 of the *Corporations Act 2001* (Cth) ('*Corporations Act*').

#### *Section 556 of the Corporations Act/Preferential Treatment*

The *Corporations Act* provides broad priority protection for employee entitlements in the event of insolvency. Section 556 of the *Corporations Act*<sup>87</sup> extends its coverage to provide that wages and all priority entitlements be paid in full.<sup>88</sup> Employee entitlements in such an event are paid ahead of unsecured creditors, however only

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86 Parliamentary Joint Committee on Corporations and Financial Services, Parliament of Australia, *Corporate Insolvency Laws: A Stocktake* (2004) [8.2].

87 *Corporations Act 2001* (Cth) s 556.

88 See, Christopher Symes, *Statutory Priorities in Corporate Insolvency Law: An Analysis of Preferred Creditor Status* (Ashgate, 2008) 115–18.

after secured creditors have recovered their entitlements.<sup>89</sup> In spite of this preferential treatment for employee entitlements, secured creditors, in most insolvency cases, recover the bulk of available assets leaving little or nothing for employee entitlements.<sup>90</sup> Studies have shown that there are often insufficient assets left for distribution to other creditors, notably employees, after secured creditors have been paid.<sup>91</sup> According to the Australian Security and Investments Commission ('ASIC'), in 2014–2015 for example, 85 per cent of small to medium sized corporate insolvencies held assets of \$100 000 or less and only 97 per cent of the creditors in these cases recovered less than 11 cents for each dollar of their entitlements.<sup>92</sup>

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89 Mohammed Al Bhadily, 'The Protection of Australian Employee Entitlements Following Corporate Collapses: Grounds for Special Attention' (7 September 2011) <<http://ssrn.com/abstract=1923537>>.

90 Helen Anderson, *The Protection of Employee Entitlements in Insolvency — An Australian Perspective* (Melbourne University Press, 2014) 219; Mohammed Al Bhadily, 'What is the Fairer Alternative to the Australian Fair Entitlements Guarantee?' (2015) 4(2) *International Journal of Law and Policy* 286.

91 Michael Gronow, 'Secured Creditors of Insolvent Companies: Do They Get too Good a Deal?' (1993) 1 *Insolvency Law Journal* 169; International Labour Office, 'Report III (Part 1B): Protection of Wages — Standards and Safeguards Relating to the Payment of Labour Remuneration' (Paper presented at International Labour Conference, Geneva, 3–19 June 2003) <<http://www.ilo.org/public/english/standards/relm/ilc/ilc91/pdf/rep-iii-1b.pdf>>.

92 Australian Securities & Investments Commission, '15-337MR ASIC Reports on Corporate Insolvencies 2014–15' (17 November 2015) <<http://asic.gov.au/about-asic/media-centre/find-a-media-release/2015-releases/15-337mr-asic-reports-on-corporate-insolvencies-2014-15/>>.

This inadequacy is acknowledged by the International Labour Office, which observes that there are often insufficient assets to pay outstanding employee entitlements.<sup>93</sup> Therefore, despite provisions for preferential treatment of employee entitlements, employees, like unsecured creditors, often see no actual benefit from the protection that has been provided for by the relevant sections of the *Corporations Act*.<sup>94</sup>

Furthermore, employees are not able to use measures that are taken by secured creditors to protect their entitlements in the event of insolvency.<sup>95</sup> Unlike employers, employees lack the bargaining or social power to allow them to take protective measures.<sup>96</sup>

Consequently, the Howard Government established GEERS, which the Labor Government replaced with the FEG in 2012, as a protective measure to overcome deficiencies in the priority payment of employee entitlements provided for by s 556 of the *Corporations Act*.

#### V WHAT DOES THE EXCLUSION OF THE 457 VISA SKILLS WORKERS FROM FEG PROTECTION MEAN?

There is not enough data to show the impact of insolvency cases on 457 visa workers' entitlements. However, the fact that they are excluded from FEG protection means that any 457 visa worker will *prima facie* be negatively impacted by the insolvency of their employer. Below is a discussion of some insolvency cases where 457 visa workers' entitlements have been affected.

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93 International Labour Office, 'Report III (Part 1B)', above n 91.

94 *Corporations Act 2001* (Cth) s 556(1)(e)–(g).

95 Al Bhadily, above n 90.

96 Otto Kahn-Freund, *Labour and the Law* (Stevens & Sons, 1972) 7–8.

In May 2013, Swan Services, a cleaning company, collapsed and 2466 employees lost their jobs and entitlements. Workers were owed two weeks' paid leave and leave loading, as well as superannuation. They earned \$17 per hour for cleaning shopping centres and \$21 for cleaning offices. Of these 2466 employees, 1700 were 457 visa workers and subsequently their entitlements were not covered by FEG protection.<sup>97</sup> The only protection available to them was s 556 of the *Corporations Act*, which was ineffective in providing adequate protection to the 457 visa employees involved. The Federal Government argued that the 457 visa workers employed by Swan Services could pursue civil action to recover their entitlements.<sup>98</sup> However, it would be difficult for the workers to pursue this course of action due to the short timeframe and high costs involved in producing a fruitful result. Even more importantly, many proceedings against a company in liquidation are stayed pending leave of the court making it highly unlikely that a civil claim will be entertained at all.<sup>99</sup>

The Senate Standing Committee Inquiry has recognised that 457 visa workers need sufficient time to pursue a court action; this has been expressed by a recommendation in its report to provide a bridging arrangement for 457 visa workers to be able pursue claims for their entitlements under workplace and occupational health and safety laws.<sup>100</sup> Howe argues that such an option is not a viable

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97 Madeleine Heffernan, 'Foreign Cleaners Miss Payouts in Swan Collapse', *The Sydney Morning Herald* (Sydney), 28 May 2013, Business (1).

98 Ibid.

99 *Corporations Act 2001* (Cth) s 440(D).

100 See, Recommendation 6, Legal and Constitutional Affairs References Committee, Parliament of Australia, *Framework and Operation of*



solution, because even if 457 visa workers were allowed to make a civil claim and succeeded in doing so, in most cases there would be no assets left to pay employee entitlements after secured creditors have recovered their debts.<sup>101</sup> Furthermore, even if there are assets left, 457 visa holders who have lost their employment due to insolvency are given 90 days to find another sponsor or they must leave or face being deported from Australia. Consequently, they do not have the time to pursue legal action. Clearly, this is not a feasible option for 457 visa workers who urgently need their entitlements to survive, and as they are not eligible to access other means of financial support such as social security.

It could be argued that those 457 visa workers, like any other employees in similar circumstances, have been given priority by s 556 of the *Corporations Act*, in that they will be paid by the liquidator in due course. However, this option takes time and involves a long process to be finalised. In addition, and as discussed above, in most cases there are not enough assets left to pay outstanding employee entitlements, as data indicates that only \$187 896 261 has been recovered from employers in comparison to the \$1 432 777 370 paid by the Australian government as entitlements since GEERS was established, as shown in Table 1 below. This constitutes about 13 per cent of the recovery of what has been paid under GEERS/FEG towards employee entitlements. This

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*Subclass 457 Visas, Enterprise Migration Agreements and Regional Migration Agreements* (2013) ix.

101 Joanna Howe, 'Foreign Workers Excluded from the Aussie Fair Go', *The Sydney Morning Herald*, 3 June 2013, Comment.

is one of the reasons why GEERS and the FEG were introduced by the respective Liberal and Labor Federal Governments.<sup>102</sup>

In 2013, the Senate Standing Committee Inquiry acknowledged the unfairness that 457 visa workers endured by being excluded from the protection of the FEG. The acknowledgment has been expressed in its report by recommending that the *Fair Entitlements Guarantee Act 2012* (Cth) be amended to make 457 visa holders eligible for entitlements under the Fair Entitlements Guarantee scheme.<sup>103</sup>

However, the Labour Government at the time did not support this recommendation, as expressed in its response to the report's recommendations.<sup>104</sup> The main reason cited by the government in its rejection of this recommendation was that, to be qualified for the protection of FEG, employees should be either Australian citizens or permanent residents.<sup>105</sup> Obviously, this is not the case for 457 visa workers — and other visa workers for that matter. Furthermore, in its response, the government argued that the exclusion of 457 visa holders from FEG protection did not affect the recovery of their entitlements from the employer assets:

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102 Mohammed Al Bhadily, 'What is the Fairer Alternative to the Australian Fair Entitlements Guarantee?' (2015) 4(2) *International Journal of Law and Policy* 286.

103 See, Recommendation 4, Legal and Constitutional Affairs References Committee, Parliament of Australia, *Framework and Operation of Subclass 457 Visas, Enterprise Migration Agreements and Regional Migration Agreements* (2013) ix.

104 See Australian Government, *Australian Government Response to the Senate Inquiry Report: The Framework and Operation of Subclass 457 Visas, Enterprise Migration Agreements and Regional Migration Agreements* (2014).

105 Ibid 6.

Payments under the Fair Entitlements Guarantee Act 2012 only become necessary in a very small percentage of liquidations and bankruptcies. In the vast majority of cases employees are able to get their entitlements through the assets of their former employer. Ineligibility for assistance under the *Fair Entitlements Guarantee Act 2012* in no way affects a subclass 457 visa holders' rights to recover unpaid entitlements from former employers in the liquidation or bankruptcy process applicable to that employer.<sup>106</sup>

It must be noted that the Coalition, in opposition, supported extending the FEG to 457 visa holders, with dissenting senators stating '[c]oalition Senators support the extension of the *Fair Entitlement Guarantee Act 2012* to protect workers let down by employers who have not left provision for employee entitlements at the time of company insolvency or bankruptcy'.<sup>107</sup>

In 2016, the Coalition, then in power, back-flipped on this view stating, amongst other things, that as a taxpayer funded programme, the FEG should only benefit citizens.<sup>108</sup>

The assertion that the FEG is only needed in a very small percentage of liquidations does not seem to be accurate. The problem remains that there are usually not enough assets to pay employee entitlements in the event of insolvency, or it would beg the question as to why the Federal Government introduced GEERS/FEG in the first place. As evidenced in Table 1 below, it is clear that there are

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106 Ibid.

107 Legal and Constitutional Affairs References Committee, Parliament of Australia, *Framework and Operation of Subclass 457 Visas, Enterprise Migration Agreements and Regional Migration Agreements* (2013) 123.

108 Senate Standing Committee on Education and Employment, above n 80, 334.

insufficient assets available to pay employee entitlements after secured creditors have recovered their debts.

**Table 1: Advanced and Recovered Payments Under GEERS and FEG for Employee Entitlements in the Event of Insolvency**

<b>Year</b>	<b>Amount Paid (AUD)</b>	<b>Number of Recipients</b>	<b>Number of Insolvencies</b>	<b>Amount Recovered</b>
2002-03	\$63 124 520	8700	923	Nil
2003-04	\$60 307 473	9243	1219	\$5 191 391
2004-05	\$66 659 194	9329	568	\$12 053 589
2005-06	\$49 242 592	7790	912	\$26 015 352
2006-07	\$72 972 489	8624	1097	\$9 487 140
2007-08	\$60 779 791	7808	972	\$16 787 789
2008-09	\$99 756 911	11 027	1350	\$8 790 000
2009-10	\$154 058 670	15 565	1617	\$18 000 000
2010-11	\$151 497 218	15 412	NA	\$16 861 000
2011-12	\$195 534 647	13 929	NA	\$21 000 000
2012-13	261 650 549	16 023	2111	\$37 230 000
2013-14	\$197 193 316	11 255	1536	\$16 480 000
<b>Total</b>	<b>\$1 432 777 370</b>	<b>134705</b>	<b>12 305</b>	<b>\$187 896 261</b>

*The Department of Employment Annual Reports for the years 2002-2003, 2003-2004, 2004-2005, 2005-2006, 2006-2007, 2007-2008, 2008-2009, 2009-2010, 2010-2011, 2011-2012, 2012-2013 and 2013-2014.*

## VI HUMAN RIGHTS CONCERNS

The Australian Human Rights Commission in its submission to the Senate Standing Committee Inquiry expressed its discontent at the exploitation of 457 visa workers, observing that:

If the Australian industrial relations system conforms to international human rights standards, then it follows that all local workers will be guaranteed the opportunities of employment to which they are fairly entitled because employers will have no incentive to use the 457 visa program as a means to avoid the employment entitlements of local workers. So long as violations of the rights of migrant workers persist and are tolerated, local workers will be exposed to the risk of degraded labour standards which arise when any worker's entitlements are withheld.<sup>109</sup>

Restricting or limiting a 457 visa worker or their family from access to government services or protections, otherwise available to citizens or permanent residents, purely on the basis of their temporary worker status, is discriminatory and often severely detrimental. Whilst this paper considers that the exclusion of 457 visa workers from FEG is a human rights issue, there are other human rights concerns that will not be specifically explored.<sup>110</sup>

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109 Human Rights Council of Australia, Submission 33: *Framework and Operation of Subclass 457 Visas* (3 May 2015) <[http://www.aph.gov.au/Parliamentary\\_Business/Committees/Senate/Legal\\_and\\_Constitutional\\_Affairs/Completed\\_inquiries/2010-13/457visas/submissions](http://www.aph.gov.au/Parliamentary_Business/Committees/Senate/Legal_and_Constitutional_Affairs/Completed_inquiries/2010-13/457visas/submissions)>.

110 See above n 53.

The United Nations Migrant Worker Conventions includes the *International Convention on the Protection of the Rights of All Migrant Workers and Members of Their Families* which, inter alia, applies rights contained in the International Bill of Rights to migrant workers. It recognises that migrant workers in Australia should receive equal recognition of human rights as Australian citizens.<sup>111</sup> The conventions also include the *International Labour Organization Migration for Employment Convention (Revised)* 1949 that applies the principle of ‘no less favourable’ treatment of migrant workers compared to nationals,<sup>112</sup> and in particular art 6 thereof which calls for the same treatment in relation to legal provisions in respect of unemployment.<sup>113</sup>

Australia, however, has not ratified the Migrant Worker Conventions for various reasons, including that other human rights treaties to which it is a party already protect workers,<sup>114</sup> and that migrant workers are protected by domestic legislation.<sup>115</sup> The Human Rights Council of Australia rejected these arguments stating that existing protections did not address special vulnerabilities experienced by migrant workers.<sup>116</sup> It is submitted that exclusion from the FEG is an example of such vulnerability.

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111 Sanushka Mudaliar et al, ‘Australian Ratification of the Migrant Worker Conventions — Responses to Concerns Raised by the Australian Government’, Human Rights Council of Australia, 2.

112 Ibid 3.

113 International Labour Organization Migration for Employment Convention (Revised) 1949 art 6.1.(b).

114 Letter from the Hon Nicola Roxon, MP Attorney-General and Minister for Emergency Management to Mr Chris Sidoti, Executive Director — The Human Rights Council of Australia, 16 April 2012. Ref number: AG-MC12/02240.

115 Ibid.

116 Mudaliar et al, above n 111, 4.

According to the Australian Human Rights Commission's observations, there are inefficient mechanisms available to protect the human rights of the 457 visa workers:

The UN Migrant Workers Convention is needed because there is clear evidence that the human rights of 457 visa-holders are not adequately protected either by general industrial measures designed to protect the rights of all workers, or by specific regulatory criteria governing the 457 visa framework. There is further evidence that existing Safeguards are not sufficiently enforced.<sup>117</sup>

This concern has not only been articulated by advocacy groups such as the Australian Human Rights Commission, but Australian policy makers also have expressed their disquiet in relation to the adequacy of safeguards that have been provided by relevant legislation to protect 457 visa worker rights and entitlements. The Senate Standing Committee Inquiry expressed this view in 2013 as follows:

The committee recommends that the Government initiate an inquiry into the extent to which relevant workplace and occupational health and safety legislation protects the legal rights, remedies and entitlements of 457 visa holders and whether temporary migrant workers in Australia are adequately protected by the relevant workplace and occupational health and safety laws.<sup>118</sup>

Regardless of the above, non-discriminatory rights that have been recognised by the *International Covenant on Civil and Political Rights* ('ICCPR') and the *International Covenant on Economic,*

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117 Human Rights Council of Australia, above n 109.

118 See, Recommendation 5, Legal and Constitutional Affairs References Committee, Parliament of Australia, *Framework and Operation of Subclass 457 Visas, Enterprise Migration Agreements and Regional Migration Agreements* (2013) ix.

*Social and Cultural Rights* ('*ICESCR*') are also applicable to foreign nationals.<sup>119</sup> Article 2 of the *ICESCR* prohibits discrimination on grounds of race, religion, language, colour, ethnicity and social origin.<sup>120</sup> Furthermore, the United Nations Human Rights Committee prohibits nationality as ground for discrimination.<sup>121</sup>

Article 7 of the *ICESCR* provides all workers — regardless of their nationality — the right of enjoyment of just and favourable conditions. Article 7 has wider implications that could be applicable to 457 visa workers, including the right to access FEG protection.<sup>122</sup> Furthermore, art 9 of the *ICESCR* provides that 'the State Parties to

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119 Human Rights Council of Australia, above n 109.

120 See, art 2(2) of the International Covenant on Economic, Social and Cultural Rights:

The States Parties to the present Covenant undertake to guarantee that the rights enunciated in the present Covenant will be exercised without discrimination of any kind as to race, colour, sex, language, religion, political or other opinion, national or social origin, property, birth or other status, opinion, national or social origin, property, birth or other status.

121 Explanatory Memorandum, Fair Entitlements Guarantee Bill 2012, 1.

122 International Covenant on Economic, Social and Cultural Rights art 7:

The States Parties to the present Covenant recognize the right of everyone to the enjoyment of just and favourable conditions of work which ensure, in particular: Remuneration which provides all workers, as a minimum, with: fair wages and equal remuneration for work of equal value without distinction of any kind, in particular women being guaranteed conditions of work not inferior to those enjoyed by men, with equal pay for equal work; a decent living for themselves and their families in accordance with the provisions of the present Covenant; Safe and healthy working conditions; Equal opportunity for everyone to be promoted in his employment to an appropriate higher level, subject to no considerations other than those of seniority and competence; Rest, leisure and reasonable limitation of working hours and periodic holidays with pay, as well as remuneration for public holidays.



the present Covenant recognise the right of everyone to social security, including social insurance.<sup>123</sup>

The abovementioned arts 7 and 9 indicate that 457 visa holders should not be subjected to any discriminatory policy or act. It could be argued that denying 457 visa holders' access to FEG protection constitutes a discriminatory act on the ground of the workers' nationality. Furthermore, denying 457 visa holders the right to access FEG protection is clearly in breach of art 9 of *ICESCR*, which provides the right to access social security for all workers, including 457 visa holders.<sup>124</sup>

However, the government, in its exclusion of 457 visa workers from the protection of FEG, argues that rights to equality and non-discrimination are not absolute and allow a member State, in limited circumstances, a right to differentiate.<sup>125</sup> The Australian Government cited the United Nations Human Rights Committee that stated '[n]ot every differentiation of treatment will constitute discrimination, if the criteria for such differentiation are reasonable and objective and if the aim is to achieve a purpose which is legitimate under the Covenant'.<sup>126</sup>

It is necessary to examine the 'reasonable and objective' criteria by which the Australian Government justifies its policy to exclude 457 visa workers from the protection of FEG. There should be a relationship of proportionality between the legitimate aims and the differentiation of treatment. The justification of such differentiation

123 International Covenant on Economic, Social and Cultural Rights, No XXI (1966).

124 Al Bhadily, above n 98.

125 Explanatory Memorandum, Fair Entitlements Guarantee Bill 2012, 1.

126 Ibid 2.

of treatment should be measured in relation to the aims and the impacts of the actions or exclusions under consideration.<sup>127</sup> However, Lord Lester argues that the criteria of ‘reasonable’ and ‘objective’ leads to a wider scope for subjective interpretation and application of equality principles.<sup>128</sup> Therefore, it is difficult to determine whether or not an aim is sufficiently reasonable or — objective to be grounds for differential treatment, and it is hard to identify the precise relationship between the measures that have been taken and the outcomes to assess whether or not such different treatment was reasonable and objective.<sup>129</sup> Arguably, using subjective measures to assess the ‘reasonability and objectivity’ criteria makes predictions of any outcomes of its application in any given circumstance impossible.<sup>130</sup>

Nevertheless, it would not seem appropriate to use the United Nations Human Rights Committee comment on reasonable and objective criteria, to justify any action or policy that has a discriminatory nature. This is especially so when commentators assert that the criteria discussed above is established on a case-by case basis.<sup>131</sup>

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127 Li Weiwei, *Equality and Non-discrimination Under International Human Rights Law*, (2004) <<http://www.humanrights.uio.no/forskning/publ/publikasjonsliste.html>>.

128 Lord Anthony Lester, ‘Non-discrimination in International Human Rights Law’ (1993) 19(4) *Commonwealth Law Bulletin* 1658.

129 Jason Pobjoy, ‘Treating Like Alike: The Principle of Non-Discrimination as a Tool to Mandate the Equal Treatment of Refugees and Beneficiaries of Complementary Protection’ (2010) 34(1) *Melbourne University Law Review* 18.

130 Ibid.

131 See, Lester, above n 128; Sarah Joseph, Jenny Schultz and Melissa Castan, *The International Covenant on Civil and Political Rights*:

Regardless of the difficulties in assessing criteria, the rationale for excluding 457 visa workers from the protection of the FEG is difficult to see. As mentioned above, employers must engage 457 visa workers on the same conditions as those applying to local employees.<sup>132</sup> Furthermore, since the actual work, physical conditions, remuneration and tax implications of 457 visa workers are the same as their local counterparts, the justification for excluding 457 visa workers from the protection of the FEG seems to purely relate to the avoidance of expenditure and does not outweigh the benefits provided by 457 visa workers.

In fact, one could argue that the impact of employer insolvency on 457 visa workers is far greater than that experienced by local employees. This is due to relative difficulties in obtaining further work or bringing civil claims in the impossibly short time they have available, their inability to understand their legal rights or to seek help, and their general vulnerability in light of the temporary nature of their visas. Arguably, this is a breach of 457 visa workers' human right to access justice. Consequently, it then seems that protection is denied to those who would need it most, and the reason given for denial of protection — primarily that there are already protections in place pursuant to the *Corporations Act* — is not practically true as it does not outweigh the benefits provided by foreign workers. Therefore, even applying the most liberal interpretation of 'reasonable and objective', the different treatment is not justified and arguably amounts to discrimination.

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*Cases, Materials, and Commentary* (Oxford University Press, 2nd ed, 2004) 679–751.

132 Department of Immigration and Border Protection, Subclass 457 Quarterly Report, above n 4.

The recommendation to extend the FEG to temporary visa holders was made again in 2016 by the Senate Standing Committee on Education and Employment, *A National Disgrace: The Exploitation of Temporary Work Visa Holders*.<sup>133</sup> Referring to the 2013 recommendation,<sup>134</sup> the Committee stated that:

The ability of temporary visa workers to access the FEG was considered by the Senate Legal and Constitutional References Committee inquiry into the framework and operation of subclass 457 visas, Enterprise Migration Agreements and Regional Migration Agreements. That report found the omission of 457 visa workers from the FEG to be, ‘on its face, discriminatory, given that there is no coherent policy basis justifying the distinction between the entitlements of local and 457 visa workers in such circumstances’. That report therefore recommended that the *Fair Entitlement Guarantee Act 2012* (FEG Act) be amended to make temporary visa holders eligible for entitlements under the FEG.<sup>135</sup>

However, the Coalition’s response to this recommendation was, inter alia, that ‘[a]s FEG is underwritten by the taxpayers, it should be a programme reserved for the protection of Australian citizen, who may have decades of entitlements payable after years of working’.<sup>136</sup>

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133 See, Recommendation 18, Senate Standing Committee on Education and Employment, above n 80, xii.

134 See, Recommendation 4, Legal and Constitutional Affairs References Committee, Parliament of Australia, *Framework and Operation of Subclass 457 Visas, Enterprise Migration Agreements and Regional Migration Agreements* (2013) ix.

135 Senate Standing Committee on Education and Employment, above n 80, 159 [6.85].

136 Ibid 334.

If the Coalition's argument to exclude 457 visa workers from the coverage of the FEG is due to the fact that the FEG is funded by taxpayers, this reasoning is flawed since 457 visa workers are also taxpayers. Interestingly, the Coalition's response is diametrically opposite to its support of the extension of the FEG to temporary visa holders in 2013 when it was in opposition,<sup>137</sup> perhaps indicating a favouring of budgetary considerations over genuine protection of human rights.

## VII CONCLUSION

The nature of the relationship between 457 visa workers and sponsors often leads to an imbalance in bargaining power between the parties which undermines the worker's ability to receive fair treatment. The vulnerability of 457 visa workers often results in exploitation which, in the best case scenario, results in them receiving lower remuneration than their local counterparts or, at worst, results in them working in slave-like conditions where they are subject to harassment and threats of termination or visa cancellation.

Whilst protection against exploitation generally has improved over time, this is usually in relation to the workers' course of employment. However, the 457 visa workers' vulnerability extends not only to the course of their employment, but in some cases it extends beyond that — if they lose their employment and entitlements in the event of employer insolvency. In these cases, Australian citizen and resident worker entitlements are protected by the FEG, but this is not the case for 457 visa workers who are excluded from the protection of the FEG.

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137 See above n 107.

The exclusion of 457 visa workers from the FEG has been justified by various Australian Governments on several grounds. Firstly, visa worker entitlements are protected by the *Corporations Act* which provides priority for employee entitlements in the event of insolvency. However, as discussed above, in most cases there are insufficient assets left after secured creditors have recovered their entitlements to satisfy employee entitlements. Therefore, the priority that has been provided by the *Corporations Act* to 457 visa worker entitlements in the event of insolvency is ineffective.

Secondly, 457 visa workers are not Australian citizens or permanent residents. This has been viewed as a discriminatory policy that contradicts Australia's commitment to human rights conventions and principles. However, the Australian Government has justified its policy by citing the United Nations Human Rights Committee statement, explaining that not all differentiation treatments are discriminatory, if such treatment is reasonable, objective, and has a legitimate aim under the convention.

Thirdly, that the FEG is a taxpayer-funded programme and should thus only benefit citizens. This argument is perhaps the least persuasive since migrant workers are taxpayers who often pay more tax than their Australian counterparts.

Some commentators have expressed the view that the criteria referred to by the United Nations Human Rights Committee<sup>138</sup> is subjective and should be determined on a case-by-case basis. It is difficult for the Australian Government to use these criteria — existing protection under the *Corporations Act* and lack of residency or citizenship status — as grounds for its policy to deny 457 visa workers access to FEG protection. This is particularly so given the

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138 Explanatory Memorandum, Fair Entitlements Guarantee Bill 2012, 1.

ineffectiveness of the priority measures provided by the *Corporations Act* and the contribution these workers make to the economy and society. Furthermore, 457 visa workers are meant to be afforded the same legal treatment and protections and incur the same legal, and often higher tax obligations than their local counterparts in every other aspect of their employment.

Therefore, it is recommended that 457 visa workers should be entitled to access FEG protection in the event of their employer's insolvency. The right to be able to access the FEG has been supported by the Parliamentary Committee Report recommendations and various Senate Inquiries. Continuing to deny 457 visa workers of any effective remedy to recover their entitlements, in cases of employer insolvency, in comparison to their local counterparts arguably constitutes a breach of Australia's human rights obligations.

# ***REGULATING HUMAN EMBRYONIC STEM CELL RESEARCH IN AUSTRALIA: BROWNSWORD'S REGULATORY CHALLENGES***

PATRICK FOONG\*

## **Abstract**

*Human embryonic stem cell ('HESC') research is a controversial research as the paramount concern is that all extraction of stem cells from an embryo involves its destruction. Therefore, it is often argued that this research should be stringently regulated. However, in regulating emerging technologies, there are various challenges that regulators may encounter. Professor Roger Brownsword, an expert in issues of technology, ethics and law, identifies the main challenges of regulating innovative technologies as follows: the challenge of achieving regulatory legitimacy, attaining regulatory effectiveness and maintaining the regulatory connection. This article evaluates Australia's current regulatory regime for use of human embryos in research to determine whether it addresses these regulatory challenges and it also considers effective measures that could be adopted by regulators to counter the difficulties.*

## **I INTRODUCTION**

Human embryonic stem cell ('HESC') research is a highly contentious research as extraction of stem cells from a human embryo involves its destruction. The controversy of this research is a compelling point to posit the argument that this type of research should be strictly regulated. However, in regulating new technologies, there are various challenges that regulators face. This



paper draws on the work of Professor Roger Brownsword from Kings College London, a bioethicist and a leading scholar on issues of technology, ethics and law. He recognises the need for the exploration of the social, legal, ethical and regulatory matters arising from the emergence of modern technologies and has written extensively on these challenges.<sup>1</sup>

The primary challenges of regulating innovative technologies identified by Brownsword include achieving regulatory legitimacy, attaining regulatory effectiveness and maintaining the regulatory connection.<sup>2</sup> In regulating new technologies, it is essential that regulators bear in mind the difficulties that they may encounter. Brownsword warns that unless these challenges are adequately addressed, the regulatory environment is defective, 'as opposed to a regulatory environment that supports the development, application and exploitation of technologies that will contribute to such an overarching purpose, an environment properly geared for risk

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1 Professor Roger Brownsword is a founding member of the Centre for Technology, Ethics, Law and Society ('TELOS') at the Dickson Poon School, which aims to engage in policy-relevant research examining the ethical, social and legal implications of innovative technologies. He has been associated with the UK's House of Commons Science and Technology Committee. This committee's role is to ensure that the UK Government policy and decision-making are based on good scientific and engineering advice and evidence.

2 Roger Brownsword, *Rights, Regulation and Technological Revolution* (Oxford University Press, 2008). The fourth challenge, regulatory cosmopolitanism, will not be discussed in this article due to constraints and it will be explored in a separate article.

management and benefit sharing'.<sup>3</sup> Accordingly, in order to establish an effective regulatory framework for emerging technologies, the regulators must first recognise the difficulties likely to be faced and then attempt to design and sustain a regulatory environment that is perceived to be legitimate, effective and is connected to the changing technology. While Brownsword's work refers to regulatory challenges presented by innovative technologies generically, nevertheless they are relevant in the context of the regulation of HESC research.<sup>4</sup> This paper evaluates Australia's current regulatory regime for the use of human embryos in research and determines whether it addresses these regulatory difficulties. An interview was conducted with Brownsword to seek his views on these issues and possible strategies on how to meet the challenges.<sup>5</sup>

## II THE CONTROVERSIES OF HESC RESEARCH

HESC research raises ethical and moral concerns with the paramount issue being the destruction of the embryo when stem cells are harvested from it.<sup>6</sup> Embryonic stem cells are derived from

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3 Roger Brownsword and Han Somsen, 'Law, Innovation and Technology: Before We Fast Forward — A Forum for Debate' (2009) 1(1) *Law, Innovation and Technology* 1, 3.

4 The new technologies that Brownsword outlines include the regulation of cyber technology, nanotechnology, renewable energy technology and biotechnology.

5 Interview with Roger Brownsword (Kings College London, 18 November 2009).

6 Tom L Beauchamp and James F Childress, *Principles of Biomedical Ethics* (Oxford University Press, 6th ed, 2001); President's Council on Bioethics, Human Dignity and Bioethics: Essays Commissioned by the President's Council on Bioethics (2008) <[https://repository.library.georgetown.edu/bitstream/handle/10822/559351/human\\_dignity\\_and\\_bioethics.pdf?sequence=1&isAllowed=y](https://repository.library.georgetown.edu/bitstream/handle/10822/559351/human_dignity_and_bioethics.pdf?sequence=1&isAllowed=y)>.

excess in vitro fertilisation/assisted reproductive technology embryos and cloned embryos created through a process called Somatic Cell Nuclear Transfer ('SCNT')/therapeutic cloning which shares the same technology as the creation of Dolly, the first cloned mammal. Some scientists consider HESC research as the gold standard of stem cell research.<sup>7</sup> In comparison to adult stem cells, embryonic stem cells are easier to identify, isolate, maintain and grow in the laboratory. Embryonic stem cells are more versatile than adult stem cells. Being pluripotent, they have the ability to create every cell type in the body to form skin, bones, organs and other body parts that patients with injuries or illnesses in need of transplants might benefit from receiving. While doctors can transplant tissues and organ cells, a critical constraint is that they are often limited by a lack of organ donors. The medical and scientific importance of using embryonic stem cells as research tools is that they have unique properties as they are unspecialised, capable of dividing and renewing themselves for lengthy periods. These cells will allow the growth of required tissue when it is required.

In 2013, a team led by Shoukhrat Mitalipov at the Oregon Health & Science University and the Oregon National Primate Research Center attained a scientific first by creating embryonic stem cells from cloned human embryos through therapeutic cloning/SCNT research using cells from infants.<sup>8</sup> Subsequently, in 2014 researchers at the Research Institute for Stem Cell Research at CHA Health

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7 Sabine Kobold et al, 'Human Embryonic and Induced Pluripotent Stem Cell Research Trends: Complementation and Diversification of the Field' (2015) 4(5) *Stem Cell Reports* 914; Interview with Professor Loane Skene (University of Tasmania Faculty of Law, 10 August 2009)

8 Masahito Tachibana et al, 'Human Embryonic Stem Cells derived by Somatic Cell Nuclear Transfer' (2013) 153(6) *Cell* 1228.

Systems in Los Angeles produced stem cells using SCNT from adults, bringing them closer to developing patient-specific lines of cells.<sup>9</sup> Further, in 2016 researchers in China believe that they have developed a solution to male infertility by creating sperm out of embryonic stem cells.<sup>10</sup>

### III TO REGULATE HESC RESEARCH OR NOT?

A preliminary inquiry is whether it is essential or even desirable to regulate HESC research at all. It might be argued that it is preferable to adopt a minimum regulation or to leave the research entirely unregulated as this facilitates free, unfettered and uninhibited research for the scientific community in the country. However, there are persuasive insights offered by eminent people in favour of adopting the regulation. Former High Court judge Michael Kirby makes a compelling case in favour of regulation, particularly for contentious areas of research. He gives the example of human reproductive cloning where he asserts that ‘for the law to say nothing about the reproductive cloning of human beings is to give green light to experiments in that technology’.<sup>11</sup> He further explains that ‘nothing then exists to restrain [scientists] except for their own ethical principles, any institutional ethics clearance requirement, the availability of funding and their prospects of a market [and their religious convictions]’.<sup>12</sup> Thus, where there is no regulation to prohibit or regulate an activity, scientists may decide to pursue

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9 Young G Chung et al, ‘Human Somatic Cell Nuclear Transfer Using Adult Cells’ (2014) 14(6) *Cell Stem Cell* 777.

10 Quan Zhou et al, ‘Complete Meiosis from Embryonic Stem Cell-Derived Germ Cells In Vitro’ (2016) 18(3) *Cell Stem Cell* 330.

11 Michael Kirby, ‘New Frontier’ in Roger Brownsord and Karen Yeung (eds), *Regulating Technologies: Legal Futures, Regulatory Frames and Technological Fixes* (Oxford: Hart Publishing, 2008) 375.

12 Ibid 376.

controversial experiments out of pure interest and sheer curiosity. Kirby says that regulatory inaction is, in fact, a decision and he warns that the 'absence of regulation will mean that the society has effectively made a decision to permit the technological advances to occur without impediment'.<sup>13</sup> He asserts that 'proponents of technological innovation have often favoured containment of law and a libertarian approach to development of technology, yet most lawyers recognise that there are limits'.<sup>14</sup> However, he also expresses concern that overregulation could be worse than no regulation at all, as it may impose excessive burdensome constraints on scientists and researchers. Accordingly, he stresses that 'limits must be clearly expressed and upheld in an effective way'.<sup>15</sup>

Political theorist Francis Fukuyama also argues that it is essential to regulate biotechnology.<sup>16</sup> He expresses concern that unregulated biotechnology poses an insidious threat to society's way of life and compromises human dignity.<sup>17</sup> He explains that:

The people in Brave New World may be healthy and happy, but they have ceased to be human beings. They no longer struggle, aspire, love, feel pain, make difficult choices, have families or do any of the things that we traditionally associate with being human. They no longer have the characteristics that give us human dignity.<sup>18</sup>

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13 Ibid 382.

14 Ibid.

15 Ibid 382.

16 Francis Fukuyama, *Our Posthuman Future: Consequences of the Biotechnology Revolution* (Picador, 2003) 6.

17 Fukuyama explained that on one extreme of the continuum is nuclear technology which is extremely dangerous and on the other extreme is information technology ('IT') which is relatively benign. Biotechnology lies in between the two extremes.

18 Fukuyama, above n 16.

He adds there is a 'fear that, in the end, biotechnology will cause us in some way to lose our humanity, that is some essential quality that has always underpinned their sense of who we are and where we are going'.<sup>19</sup> In a similar vein, Brownsword supports the need for regulation, saying:

[N]o regulation is hardly a serious option and there is surely little virtue in leaving eugenics to the play of subjective preference and the market ... if we accept the deeper implications of a liberal eugenics, such an abdication of regulatory responsibility is likely to have highly corrosive consequences ... the dilemmas associated with the regulation of human genetics must be confronted.<sup>20</sup>

Regulation of scientific research is not a new subject. In the context of biotechnology,<sup>21</sup> nations are enacting specific regulatory instruments to regulate controversial areas of research. In Australia, for example, the *Gene Technology Act 2000* (Cth) was passed to regulate research on genetically modified organisms ('GMOs'), the aim is to protect the health and safety of people and to protect the environment. Legislation is not the only form of regulation as there is soft law in the form of guidelines. In Australia, the decision has

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19 Ibid 101.

20 Roger Brownsword, 'Regulating Human Genetics: New Dilemma for New Millennium' (2004) 12 *Medical Law Review* 14, 15.

21 Biotechnology is described as using living things, including plants and animals, to create products or to perform tasks for human beings. Over time, biotechnology has formed the basis of learning about human diseases and the development of medical treatments. It has led the way to a new era in health care with the development of improved methods for detecting, preventing and treating diseases. These include the development of new diagnostic and therapeutic tools, DNA profiling, cloning and stem cells.

already been made to pass legislation to regulate research involving human embryos, primarily because legislation promotes certainty and clarifies what is permissible for scientists. To quote a report examining the regulatory options for stem cell research and human cloning, '[w]e owe it to the scientists to try and clarify, through legislation, those circumstances in which procedures may be acceptable ... and those cases in which a line may be drawn ...'.<sup>22</sup> Passing legislation to regulate HESC research will provide greater likelihood of clear parameters, scope and legal protections to scientists and ensures transparency and accountability.

#### IV BROWNSWORD'S FIRST REGULATORY CHALLENGE: ATTAINING REGULATORY LEGITIMACY

To attain regulatory legitimacy, the position that regulators adopt must be considered by all ethical constituencies<sup>23</sup> in society as acceptably legitimate and ethically appropriate (the legitimacy of regulatory purposes and standards).<sup>24</sup> In a diverse society with a plurality of values, articulating such a regulatory position is a challenge, and attempts to regulate biotechnology are susceptible to this difficulty. In the UK, a report of the Science and Technology Committee provides the following points:

We accept that a society that is both multi-faith and largely secular, there is never going to be consensus on the level of protection accorded to the embryo or the role of the state in

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22 House of Representatives Standing Committee on Legal and Constitutional Affairs, Parliament of Australia, *Human Cloning: Scientific, Ethical and Regulatory Aspects of Human Cloning and Stem Cell Research* (2001) 58.

23 This phrase is used by Brownsword and it is explained in a later section of the paper.

24 Brownsword and Somsen, above n 3, 12.

reproductive decision-making. There are no demonstrably 'right' answers to the complex ethical, moral and political equations involved. We respect the views of all sides on these issues. We recognise the difficulty of achieving consensus between protagonists in opposing camps in this debate, for example the pro-life groups and those advocating an entirely libertarian approach to either assisted reproduction or research use of the embryo. We believe, however, that to be effective this Committee's conclusions should seek consensus, as far as it is possible to achieve ... But it does mean that we accept that assisted reproduction and research involving the embryo of the human species both remain legitimate interests of the state. Reproductive and research freedoms must be balanced against the interests of society but alleged harms to society, too, should be based on evidence.<sup>25</sup>

Particularly relevant in secular societies, a type of pluralism is what Brownsword refers to as a bioethical triangle.<sup>26</sup> This triangle comprises of three important ethical constituencies: the utilitarian

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25 Science and Technology Committee, 'Human Reproductive Technologies and the Law' HC (2004-05) 7-I, [46].

26 There are several articles which are referred to in the discussion of the pluralism and the bioethical triangle. See Roger Brownsword, 'Stem Cells and Cloning: Where the Regulatory Consensus Fails' (2005) 39 *New England Law Review* 535; Brownsword, above n 2, 101–31; Roger Brownsword, 'Bioethics Today, Bioethics Tomorrow: Stem Cell Research and the "Dignitarian Alliance"' (2003) 17(1) *Notre Dame Journal of Law, Ethics & Public Policy* 15; Roger Brownsword, 'Regulating Human Genetics: New Dilemma for a New Millennium' (2004) 12(1) *Medical Law Review* 14; Roger Brownsword, 'Stem Cells, Superman and the Report of the Select Committee' (2002) 65(4) *Modern Law Review* 568; Timothy Caulfield and Roger Brownsword, 'Human Dignity: a Guide to Policy Making in the Biotechnology Era?' (2005) 7(1) *Nature Reviews Genetics* 72.



constituency (green light approach); human rights constituency (amber light approach); and human dignity constituency (red light approach).<sup>27</sup> This kind of pluralism is reflected in the *Universal Declaration on Bioethics and Human Rights 2005*, where art 4 on ‘Benefit and Harm’ provides:

In applying and advancing scientific knowledge, medical practice and associated technologies, direct and indirect benefits to patients, research participants and other affected individuals should be maximised and any possible harm to such individuals should be minimised.

The utilitarian constituency is dedicated to the maximisation of health, wealth and happiness — that is, to human welfare. To this constituency, what is important is the maximisation of utilities and the minimisation of disutilities. Utilities comprise of pleasure, preference, satisfaction, convenience and economy; while disutilities encompass pain, suffering, distress, anxiety, frustration of plans, non-satisfaction of preference, cost, inconvenience and expenditure of resources.<sup>28</sup> Next, the human rights led constituency is founded on the respect for the inalienable and intrinsic dignity of humans.<sup>29</sup> It prioritises the importance of individual interests, which include free and informed consent, respect for autonomous decision-making and the protection of privacy and confidentiality. The third constituency is the relatively new dignitarian or duty driven constituency. Drawing on the mixture of Kantian, Catholic and communitarian credos,<sup>30</sup> this constituency’s fundamental principle is that human

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27 Brownsword and Somsen, above n 3, 15.

28 Brownsword, above n 2, 37.

29 The human rights theory is based on the works of Thomas Hobbes, John Locke and Immanuel Kant.

30 Utilitarianism and human rights tension prevailed during much of the second half of the twentieth century, whereas the dignitarian alliance has emerged in recent years. For more information about the

dignity should not be compromised, and any practice that does compromise human dignity is unethical irrespective of welfare-maximising consequences.

Each constituency has its unique characteristics.<sup>31</sup> Dignitarians are opposed to utilitarianism theorists as they do not believe that ‘consequences, even entirely beneficial consequences ... are determinative’.<sup>32</sup> Similarly, dignitarians do not agree with the human rights constituency as they do not share the belief that informed consent permits and condones the compromise of human dignity.<sup>33</sup> There is conflict between utilitarianism and human rights theorists as the former promotes the maximisation of utilities, whereas the latter impose some limitations to promote individual rights.<sup>34</sup> However, it is noted that some overlap exists between dignitarians and human rights theorists on the basis that the theory of human rights is premised on the principle of human dignity. The difference is that dignitarians focus on human dignity but not on individual autonomy.<sup>35</sup>

As regards the ethics of HESC research, there is little consensus among the three groups. Both utilitarian and human rights constituencies believe that HESC research is a field of significant medical importance, provided that the human embryos do not suffer or are not deemed to have rights and that egg donors donate their

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emergence of the dignitarian alliance, see Roger Brownsword, ‘Bioethics Today, Bioethics Tomorrow: Stem Cell Research and the Dignitarian Alliance’ (2003) 17 *Notre Dame Journal of Law, Ethics & Public Policy* 15.

31 Brownsword, above n 2, 35–41.

32 Ibid 39.

33 Ibid.

34 Ibid 38.

35 Ibid 69.

eggs with free and informed consent.<sup>36</sup> However, dignitarians hold firm and strictly to the view that human cloning, whether for reproductive or therapeutic purposes, compromises human dignity and thus should be prohibited. They condemn cloning as well as HESC research, and their condemnation operates as a ‘conversation stopper’.<sup>37</sup> In the context of harm, there is widespread support in pluralistic communities for the general principle ‘do no harm to others’, and according to Brownsword the interests of ‘the others’ should be respected.<sup>38</sup> John Stuart Mill, an English philosopher, is a proponent of this principle.<sup>39</sup> It provides some guidance to regulators, suggesting that the sovereignty of individual choices should be respected so long as the acts are not harmful to others.

36 Ibid 36–9. The objection that egg donors will be exploited is both dignitarian as well as human rights objection against the instrumentalisation of women and their gametes. However, with informed consent, this will cease to be an issue with human rights theorists but not with dignitarianism. For more information on the rights of egg donors, see Loane Skene, ‘Donating Eggs for Research is Tough — So Why Not Pay for it?’ *Sydney Morning Herald* (online), 13 July 2009 <<http://www.smh.com.au/federal-politics/donating-eggs-for-research-is-tough--so-why-not-pay-for-it-20090712-dhca.html>>; Catherine Waldby et al, ‘From Altruism to Monetisation: Australian Women’s Ideas about Money, Ethics and Research Eggs’ (2013) 94 *Social Science & Medicine* 34; Loane Skene, “‘Women Should be Paid for Donating Eggs’ says academic”, *The Australian* (online), 7 July 2009; Pamela Foohey, ‘Paying Women for their Eggs for Use in Stem Cell Research’ (2010) 30 *Pace Law Review* 900.

37 Brownsword, above n 2, 39.

38 Roger Brownsword, ‘Cloning, Zoning and the Harm Principle’ in Sheila McLean (ed), *First Do No Harm: Law, Ethics and Healthcare* (Ashgate, 2006) 527, 527–42.

39 John S Mill, ‘On Liberty’ in Mill J (ed), *Utilitarianism* (Fontana Press, 1962) 181.

Regulators should not limit freedom unless the actions are considered harmful to others. However, in pluralistic societies, there are different interpretations as to both the concept of ‘harm’ and the notion of ‘others’ among the three different constituencies.

Utilitarians associate harm with disutilities like pain and suffering, distress and anxiety.<sup>40</sup> They do not object to the termination of the early development of a mere blastocyst, that is, a 100-cell human embryo, on the basis that the embryo experiences no pain and suffering at that early stage of embryonic development. As for the concept of ‘others’, utilitarians interpret the word to mean beings who are capable of experiencing pain and suffering. For this constituency, at that point of development the embryo has not developed to fit into the category of beings capable of feeling any pain.

Human rights theorists interpret harm by reference to the ideals of the concept of human rights.<sup>41</sup> With informed consent, they consider that rights-holders have the capacity of authorising actions that would involve a violation of rights, and so, human rights-holders are the relevant others. However, human rights theorists disagree about the stage at which a foetal life attains rights-holding status. They argue that a 100-cell human embryo, in such an early stage of development, is not regarded as a rights-holder on the basis that it will be a long time before it has the capacity of active participation in a community of rights. Accordingly, the harm principle offers no reason to prohibit HESC research. However, Brownsword raises an indirect argument, stating:

... the implication that members of communities of rights have responsibilities that go beyond their individual obligations to

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40 Brownsword, above n 38, 538.

41 Ibid.

one another and their collective support for public goods and that as stewards, they owe it not only to one another but also to future generations to pass on sustainable conditions.<sup>42</sup>

Dignitarians interpret the harm principle as any act that compromises human dignity.<sup>43</sup> ‘Others’ is understood ‘individually, collectively and inclusively as members of the community’. The embryo is considered as an ‘other’ as it is instrumentalised. They argue that this procedure is harmful to the embryo which is one of the ‘others’, thus violating human dignity.<sup>44</sup>

With such contested plurality, the views of these three constituencies are difficult to reconcile. The greater the plurality of values in society, the more challenging it is for regulators to strike positions that will meet the demands of, and are recognised as legitimate by, each and every group. It is inevitable that, under such conditions of pluralism, there will continue to be divergent opinions about the ethics of HESC research.<sup>45</sup> This area is not unlike the classic contentious subjects of abortion and euthanasia where questions of life and death arouse deep ethical divisions and emotions.

The different constituencies in a community also comprise various religious groups. Brownsword believes that religious constituencies, with their deep religious beliefs, accentuate the difficulties. He stresses that while these people do have one thing in common, that is, that they are anxious to do the right thing, they have different views about some fundamental questions. He explains:

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42 Ibid 539.

43 Ibid.

44 Ibid.

45 With reproductive cloning, there is consensus reached nevertheless.

When you bring together a society of different religious constituencies, there are going to be differences that will really go deep. You can't say it doesn't matter; it does matter ... I don't believe that at the end of this, those constituencies whose views did not prevail are going to easily accept the position. They are still going to think that their view is the right view.<sup>46</sup>

He further explains that this challenge is a difficult one to resolve:

It is not all that easy. I believe that a decent/rational case to be made for a set of values in a community of rights. It's the most defensible form of political association. But those with religious conventions and commitments, they are going to think they are right as well. And there is no reason to be tolerant of 'their views' because 'I'm right'. We've got to have some sort of process but I don't think the process would have a reasonably satisfactory resolution. Regulators try to calculate what their community want at an acceptable level of risk but that would not suit everybody ... the process may have some real conviction that it is the best we can do. If we use the process to resolve deep moral divisions, that's much more problematic. To get these process/model to work, we have to bring people to the table ... If we expect them to set aside their fundamental values, that seems unreasonable. The reason to bring them to the table is because they have differences.<sup>47</sup>

As Brownsword points out, the challenge of achieving regulatory legitimacy is compounded in societies where the different constituencies also comprise of various religious groups with their respective deep religious convictions.

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46 Interview with Roger Brownsword (Kings College London, 18 November 2009).

47 Ibid.

So the question in pluralistic societies is: How are regulators to articulate their regulatory position that is consistent with each constituency and thus meet the standards of legitimacy? Will they be able to accommodate the different groups that make up an ethical plurality and how are they to defend the regulatory positions that they adopt? In democracies, differences of opinion could be settled by reasoned debates. As Kirby explains:

The very process of consultation and public debate promote a broad community understanding of the issues, an appreciation of different viewpoints and an acceptance of any regulation adopted, even when they give effect to conclusions different from one's own.<sup>48</sup>

The present world bears witness to religious fundamentalism and in some nations, where open debates on sensitive subjects are not allowed, issues are interpreted and determined as final and conclusive by their leaders.

While it is not reasonable to expect religious leaders to set aside their deep religious differences at open forums, some provisional resolutions may be achieved. As Brownsword says, 'in a community of rights, the only solution is to find some process/ proceduralism ... We have to have deliberative democracy ... this is probably the best we can do'.<sup>49</sup> He continues, 'it is the procedure that is crucial; such procedure is a hallmark of a democratic society. Moreover, regulators need to gather as much consensus as possible ...'.<sup>50</sup> He cautions:

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48 Kirby, above n 11, 387.

49 Deliberative democracy is a system of political decision-making that relies on consultation to make policy and legitimate lawmaking can arise only through public deliberation.

50 Interview with Roger Brownsword (Kings College London, 18 November 2009).

So the policy has to be designed in a way, although it arrives at a provisional one, it still leaves it open for debate. You just can't close off; it has to be a continuing dialogue and we have to hope the people will see that this kind of political resolution is a better way than a violent conflict.<sup>51</sup>

Even provisional settlements must be respected. June Osborn, a Professor of Public Health at the University of Michigan, stressed that there is a danger of regulatory responses 'based on assumptions, religious dogmas, intuitive beliefs or popular opinion' and regulatory interventions should be based on concrete scientific and technological understanding, that is, on good science.<sup>52</sup>

There is no easy way out of deep moral and ethical divisions. Attempting to resolve differences of moral and religious interpretations in societies with ethical plurality is and will remain a challenging task in reaching a complete consensus in the ethics of HESC research. However, there is scope for disagreement in a community. Brownsword argues that in plural societies, it is essential that there be some process that will ensure all voices are heard and seek to resolve the disagreement. There is a need for the public to be engaged in debates. While the outcome might be provisional, 'the dialogue must not just close off'. Rational deliberations in an environment of the calm debate could lead to reasonable responses. Regulators need not claim that the regulatory position adopted is in accordance with every constituency's interpretation, and it is honourable that a good faith attempt has been made to fulfil their obligation of taking a public position on those difficult issues. With fair, open and transparent processes to produce regulatory outputs, regulators should invite regulatees to respect the

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51 Ibid.

52 Kirby, above n 11, 386.



regulatory regime eventually adopted. After all, good faith regulatory settlements should be respected by all including dissenters.

#### V BROWNSWORD'S SECOND REGULATORY CHALLENGE: ACHIEVING REGULATORY EFFECTIVENESS

Regulators achieve regulatory effectiveness when their intervention works and is fit for purpose, that is, it needs 'to be beyond reproach ... a regulatory intervention must be backed by legitimate regulatory purposes, and the regulatory means employed must be both morally clean and effective'<sup>53</sup> or else the regulatory environment is deficient. However, setting a threshold of regulatory effectiveness is particularly challenging. If the bar is set at a level of complete control, then virtually all regulatory interventions are said to be ineffective.<sup>54</sup> On the other hand, if the bar is set at a much lower level, 'the regulatory intervention is declared effective when the ex-post state of affairs merely represents an improvement over the ex-ante situation'<sup>55</sup> (similarly, if they make any contribution, however small, to the reductions in the number of crimes).

There are some key sources of regulatory weakness according to Brownsword.<sup>56</sup> He explains, '[t]he first key point lies with the regulators themselves ... the problem they could be captured/corrupted or the problem of not getting the right advice or the problem of not getting sufficient resources'.<sup>57</sup> Powerful and

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53 Brownsword, above n 2, 132.

54 *Ibid.*

55 *Ibid.*

56 Brownsword and Somsen, above n 3, 23–5.

57 Interview with Roger Brownsword (Kings College London, 18 November 2009).

influential regulatees could corrupt or capture the agencies that handle the implementation of the regulation. In the business world, this may be a realistic assessment of how some business is conducted, but among scientists and researchers it is less likely to be the case. While it is hard to ascertain how rampant corruption is, if it exists at all, there is no doubt that regulatory agencies that lack integrity are vulnerable in that they can be captured and dominated by powerful regulatees. Another source of the problem lies with the regulatees, including habitual blue-collar criminals as well as white collar criminals. Brownsword says:

These are the people who don't want to comply for example, professional criminal classes who are not disposed to comply. Also, business people won't comply if it doesn't make business sense. No one is going to be green and environmentally friendly. Professions like the medics, the scientists, the lawyers — they all have their own internal codes that they think set the right kind of standard.<sup>58</sup>

Finally, a regulatory intervention fails because of circumstances that lie beyond the control of regulators and regulatees such as 'some externality/external disruptive influence like the global financial crisis that just knocks the regulation sideways'.<sup>59</sup> He continues, '[w]hen we're thinking about regulatory effectiveness, we need to look at these three key nodes. In a larger picture, we need to think about these ... as to why regulation won't work. The answer is going to lie in one of the three ...'.<sup>60</sup>

It is also important to recognise that full compliance with the law is an unrealistic ideal, and the fact that a law cannot be fully enforced is not by itself a good reason to reject it. Fukuyama refers to the

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58 Ibid.

59 Ibid.

60 Ibid.

example of murder, which is a crime and yet murders still occur.<sup>61</sup> He explains that the fact murders occur has never been a reason for giving up on the law or on attempts to enforce it. He questions whether homicide laws are judged to be effective only if they succeed in putting an end to murders or if they significantly reduce the number of murders.

Some recommendations have been made to assist in attaining regulatory effectiveness. Brownsword referred to Professor Stuart Biegel's principal regulatory guidelines with respect to the effective regulation of cyber technology.<sup>62</sup> Being generalised guidelines, they are potentially applicable in the context of the regulation of HESC research. Beigel's guidelines are as follows:

- Before acting, regulators should consider whether regulatory intervention is necessary or desirable. Intervention may not always be the right option. Intervention might be wasteful in using disproportionate resources to produce a marginal improvement (violating principles of regulatory economy and/or efficiency) or it might be futile. Further, in some cases intervention might make things worse, either directly or through indirect and unintended effects.
- Where regulators decide that a regulatory intervention is appropriate, they should be clear about their objectives.
- In setting their goals, wherever possible, regulators should strive to build a consensus (regulate with the grain).
- Regulators should consider the full range of regulatory instruments, from law-like intervention to strategies of self-regulation to code-based approaches.

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61 Fukuyama, above n 16, 6.

62 Brownsword, above n 2, 146–8.

- Regulators should also consider the optimal combination of regulatory instruments. They should identify combinations of strategies that may serve to move things in the right direction.
- Where regulators adopt a law-like approach, the standards should be clear, direct and understandable and their requirements should be realistic
- Where the activity reaches beyond national boundaries, regulators should first consider the impact of federal legal intervention and if such a response seems inadequate, they should seek to at the appropriate global or regional level.
- Regulators should be sensitive to the strains that they might be putting on their enforcement resources.<sup>63</sup>

Beigel's guidelines can be summarised as follows. Regulators should act on the basis of consensus because they perform better when they act with the backing of regulatees rather than without it. Brownsword stresses that:

The important thing is that regulatees take ownership in the matter. It will be effective if they are involved on the groundwork and if no work has to be done. It is not going to take ground, it's only going to be any good when the groundwork is prepared in the way that the regulatees are already disposed to act in this way. For example, in England when the ban on smoking in public places was introduced and it has been very effective. Actually there isn't very much work to do. By the time the enactment took place, the public was already by and large disposed not to smoke. The hearts and the minds of the people have already been won. They knew it is

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63 Stuart Biegel is a Professor at the University of California, Los Angeles. These principles are discussed in Stuart Biegel, *Beyond our Control? Confronting the Limits of Our Legal System in the Age of Cyberspace* (MIT Press, 2003) 359–64.

bad for health, that it's anti-social. It's really endorsing a situation already in practice. So the extent in which the regulatees have been brought on board is very important. It's only going to be good when the groundwork is prepared in the way the regulatees are disposed to act in this way. The real challenge is where there's no disposition to act in this way, where there's real resistance on the ground. It becomes a major challenge, you're fighting a losing battle all the time. One of the paradoxes of the law is that it works very well, it works very effectively when it has no work to do.<sup>64</sup>

The roots of the regulatee resistance may be economic, cultural, professional or moral in nature. As Brownsword points out, 'while regulations can enforce minimum standards, they cannot enforce common sense and social responsibility'.<sup>65</sup> Thus, the regulatees who internalise the regulations and their purpose will outperform those who mechanically apply the prescribed standards without internalising the spirit.

Another strategy to attain regulatory effectiveness is to assign inspectors to monitor licensees' compliance with the law. Brownsword agrees that:

[t]he inspectorate system might achieve regulatory effectiveness. It is a natural feature of a regulatory regime ... having set the standard, you then have to monitor and an inspection is what you do. You will expect inspection to be part of the package. Then the question is will this guarantee compliance, to which the answer is no.<sup>66</sup>

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64 Interview with Roger Brownsword (Kings College London, 18 November 2009).

65 Brownsword, above n 2, 148.

66 Interview with Roger Brownsword (Kings College London, 18 November 2009).

He cautions that an inspection system is no guarantee of conformity with reference to some hypothetical scenarios.<sup>67</sup> Where the regulatory regime requires the inspector to give prior notice before the day of inspection, as opposed to making random visits, the notice enables preparations to be done before the audit is conducted. Where regulators face a lack of resources, the number of inspections could be limited. Where frequent inspections are conducted, a cosy relationship between the inspector and the researcher might develop and thus the inspector is said to be captured by the regulatee. Especially if it is not entirely transparent and largely unaccountable, the regulatory authority is prone to being captured by its licensees from whom the body derives its funds. While these situations suggest that monitoring compliance by inspectors does not guarantee regulatory effectiveness, it is nevertheless a natural feature and significant to include such monitoring as part and parcel of the package of the regulatory system.

In order to achieve regulatory effectiveness, Brownsword said that:

Regulators should consider the necessity for making an intervention, that they need to be clear about their objectives and smart in their approach, and that the more that regulators are able to act with the grain of regulatees' values, the more likely it is that their intervention will be effective.<sup>68</sup>

#### VI BROWNSWORD'S THIRD REGULATORY CHALLENGE: MAINTAINING REGULATORY CONNECTION

Kirby explains that as the caravan of controversy moves on, that is, earlier controversies are displaced by recent ones, 'a law drafted too early may freeze in time the resolution of earlier controversies which

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67 Ibid.

68 Brownsword, above n 2, 143.

may later be considered as immaterial or insignificant'.<sup>69</sup> He refers to Napoleon's practice of not responding to letters for at least one year on the basis that if the matter continued to persist for that timeframe, it would have already received the Emperor's attention. It is inevitable that scientific knowledge increases and technological changes occur over time, probably in a relative short timespan. It is not fair to expect law making institutions to foresee and then address all future possible technological developments. As contemporary technologies change rapidly, regulatory frameworks may lose connection with the technological state of the art since the 'law can never rival the innovativeness of technology'.<sup>70</sup> The more the law attempts to be precise and detailed, the more likely it is going to be disconnected from developing technologies.<sup>71</sup>

Brownsword explains that such regulatory disconnection causes a mismatch, leading to a regulatory crisis and a deficient regulatory environment.<sup>72</sup> When regulatees do not know with certainty where they stand, a fundamental principle of the rule of law is violated—that is, that the present regulatory position should be communicated clearly by regulators to regulatees. Such regulatory void causes regulatees to face uncertainties and encounter challenges in interpreting the legal position. As a consequence, they face a difficult choice: either they assume that their acts are permitted or they understand these acts are prohibited. This uncertainty is unsettling, especially for law abiding regulatees. If and when a particular case goes to court, judges are faced with a choice. Brownsword explains that they could adopt a literal form of statutory interpretation, that is, to interpret and apply the law as

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69 Kirby, above n 11, 373.

70 Brownsword and Somsen, above n 3, 3.

71 Ibid.

72 Brownsword, above n 2, 160.

declared on the face of the legislation. Alternatively, they could use a more creative purposive approach, that is, they can seek to be creative and make an attempt to reconnect the law to the modern technology, focusing on the underlying purpose of the legislation. Either approach is problematic.<sup>73</sup> While the literal approach fulfils the principle of congruence,<sup>74</sup> it leaves a regulatory void until the legislature reconnects the law to the technology.<sup>75</sup> If the court adopts the creative purposive approach, it might then be able to reconnect the law. However, this breaches the principle of congruence that is central to the ideals of the Rule of Law.<sup>76</sup>

*R v Secretary of State for Health ex parte Quintavalle (on behalf of Pro-Life Alliance)* is an English case which succinctly demonstrates the disconnection between the *Human Fertilisation and Embryology Act 1990* (UK) and the development of new SCNT.<sup>77</sup> The facts are as follows. An action was brought against the Human Fertilisation Embryology Authority ('HFEA') by Josephine Quintavalle, a campaigner for the Pro-life Alliance. The Pro-Life Alliance, which opposes any form of embryo destruction, sought a declaration that embryos created by SCNT do not fall within the ambit of *Human Fertilisation and Embryology Act 1990* (UK), which regulates the use and creation of embryos in the UK. The main argument was that these organisms created by the new technology did not fall within the definition of 'embryo' in the Act. In the High Court, the challenge was successful but on appeal, it failed before both the

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73 Ibid.

74 The principle of congruence is Fuller's eighth constitutive elements of legality; the principle of the administration of law should be congruent with the rules as promulgated.

75 Brownsword, above n 2, 161.

76 Ibid.

77 [2001] 4 All ER 1013 (*Quintavalle*).



Court of Appeal and the House of Lords. Section 1(1) of the Act provides that an embryo is a live human embryo where fertilisation is complete. The question arises as to whether the Act applied to embryonic clusters and how the prohibition related to such developments. The Pro-Life Alliance argued that the Act did not cover an SCNT embryo because it did not have the identical properties, namely the combination of haploid cells and that did not go through the process of fertilisation. The High Court, adopting a literal approach, held that the Act applied only to human embryos produced by a process involving fertilisation. In his speech, Justice Crane said that he was compelled to consider only the intention of the government in 1990 rather than present-day government, and therefore declined an invitation to attempt to rephrase any sections of the 1990 Act to make them apply by analogy to organisms produced by SCNT.<sup>78</sup> The restrictive wording precluded his lordship from including what Parliament had not foreseen or intended. However, the Court of Appeal and House of Lords reversed the decision by adopting a creative purposive approach to making a reconnection.<sup>79</sup> They held that such embryos fell within the ambit of s 1(1) albeit they were not produced by fertilisation. The Court of Appeal held that even though the original drafters of the law did not have the intention to include SCNT embryos, it did not strain the language of the Act to breaking point by adding them.<sup>80</sup> In the House of Lords, Lord Bingham in his leading speech said that fertilisation in s 1(1) could not have been intended to signal a

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78 *R v Secretary of State for Health ex parte Quintavalle (on behalf of Pro-Life Alliance)* [2001] 4 All ER 1013 [57].

79 *R (on the application of Quintavalle on behalf of Pro-Life Alliance) v Secretary of State for Health* [2002] QB 628; *R v Secretary of State for Health ex parte Quintavalle (on behalf of Pro-Life Alliance)* [2003] UKHL 13.

80 *R (on the application of Quintavalle on behalf of Pro-Life Alliance) v Secretary of State for Health* [2002] QB 628 [27].

difference between human embryos produced by natural fertilisation of an egg by sperm and human embryos created by SCNT technology, since Parliament could not have contemplated at the time that the latter technology was possible.<sup>81</sup> He said the crucial point was that ‘... this was an Act passed for the protection of live human embryos created outside the human body and ... The essential thrust of section 1(1)(a) was directed to such embryos, not the manner of their creation ...’.<sup>82</sup> The appellate courts relied heavily on Lord Wilberforce’s speech in *Royal College of Nursing of the United Kingdom v Department of Health and Social Security*,<sup>83</sup> where he said that:

In interpreting an Act of Parliament, it is proper and indeed necessary to have regards to the state of affairs existing and known by Parliament to be existing at the time ... where a new state of affairs or a fresh set of facts bearing on policy, comes into existence, the courts have to consider whether they fall within the Parliamentary intention. They may be held to do so, if they fall within the same genus of facts as those to which the expressed policy has been formulated. They may also be held

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81 *R v Secretary of State for Health ex parte Quintavalle (on behalf of Pro-Life Alliance)* [2003] UKHL 13 [14].

82 Ibid.

83 [1981] AC 800. For other articles that discuss this case see Dianne Nicol et al, ‘Regulating Biomedical Advances: Embryonic Stem Cell Research’ [2002] (2) *Macquarie Law Journal* 31, 48–9; B Gogarty, ‘What Exactly is an Exact Copy? And Why it Matters when Trying to Ban Human Reproductive Cloning in Australia?’ (2003) 29(2) *Journal of Medical Ethics* 84, 85–6; B Gogarty and Dianne Nicol, ‘The UK’s Cloning Law: A View from the Antipodes’ (2002) 9(2) *Murdoch University Electronic Journal of Law* 1; Derek Morgan and Mary Ford, ‘Cell Phoney: Human Cloning after Quintavalle’ (2004) 30(6) *Journal of Medical Ethics* 524; Roger Brownsword, ‘Stem Cells, Superman and the Report of the Select Committee’ (2002) 65(4) *Modern Law Review* 568.

to do so if there can be detected a clear purpose in the legislation which can only be fulfilled if the extension is made ... There is one course that the courts cannot take, they cannot fill gaps ...<sup>84</sup>

Lord Wilberforce stressed that the courts must not gap-fill and second-guess the intention of Parliament. The equivalence between an embryo produced by natural fertilisation of egg by sperm and an embryo produced by SCNT technology persuaded the appellate courts to decide that if research on the former could be licensed under the Act, the latter too could be licensed. There is sound justification for this conclusion, on the basis that an SCNT embryo is a potential human being that is created and used as a tool for research. Therefore, the spirit of the regulatory scheme extends to the creation and use of these embryos in research. In the lead-up to the 1990 legislation, there was grave concern about permitting human embryos to be used for research purposes in the UK, and it is therefore argued that the appeal courts were right in suggesting that the Parliamentarians in 1990 would not have drawn a distinction between an embryo produced by fertilisation and one created without it. If the appellate courts had decided that SCNT embryos fall outside the jurisdiction of the regulatory authority, then the regulatory position would have been that research on these embryos and reproductive cloning was unconditionally permitted. Before the Court of Appeal reached its decision, the UK Parliament rushed through *sui generis* legislation on 4 December 2001 to pass the *Human Reproductive Cloning Act 2001* (UK) in order to fill the legislative gap created by Justice Crane's decision.

The *Quintavalle* case is a classic example of the challenge of regulatory disconnection. Since the framework legislation was

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84 *Royal College of Nursing of the United Kingdom v Department of Health and Social Security* [1981] AC 800, 822.

enacted in 1990 in the UK, embryology and its associated techniques have progressed. SCNT is a relatively recent development and on a literal reading, the legislative language did not cover this new technology. The Act defined an embryo, assuming that it was the product of a natural process of fertilisation of the egg by sperm. The development of SCNT caused the disconnection with s 1(1) of the Act, and Brownsword describes this case as one of ‘descriptive disconnection’.<sup>85</sup> The appellate courts maintained a connection by interpreting the regulation in a purposive way, treating the guiding spirit and intent of the legislation as more important than its letter. Brownsword supports such creative intelligent purposive interpretation as it did not threaten the principle of congruence and remained within the spirit and intent of the regulation.<sup>86</sup> However, his concern is that in other circumstances the purposive approach may breach of the rule of congruence that is central to the ideal of the rule of law and warns that this approach should not be resorted to at all costs.<sup>87</sup>

So how is regulation able to be connected to, and evolve with, the ever-changing technology of stem cell science? Various strategies could be considered to reconnect a disconnected regulation to developing technology. It is essential to undertake a review of the law within a reasonable timeframe after the enactment of the legislation or after the adoption of the amended legislation. In the interests of regulatory legitimacy, it is crucial to debate entirely on the latest developments in the technology and explore how the regulatory framework could be amended. It is also important that the recommendations resulting from reviews of the law see the swift implementation. Concerns have been raised about legislative

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85 Brownsword, above n 2, 166.

86 Ibid 183–4.

87 Ibid.

logjams and adapting legislative time-table. As Brownsword explains, the challenge of the Parliamentary time-table leads to the ‘roller coaster’ effect and the issues ‘swing back and forth’.<sup>88</sup> Delegated legislation is appropriate in the circumstances, that is, by delegating regulatory powers to the relevant minister. In the UK, a fast track system to implement the Law Commission reports was adopted when the *Legislative and Regulatory Reform Act 2006* (UK) was passed. The Act allows a minister, by ministerial order, to implement recommendations of the Law Commission. Next, encourage a culture of purposive interpretation in the courts as illustrated in the appellate courts in the *Quintavalle* case. Lastly, regulatory responses should be geared for flexibility and adaptability. If the draftsmen in the *Quintavalle* case had drafted technology neutral language in general terms in the statute, this would have enabled judges to use the literal interpretation and still maintain the regulatory connection. Draftsmen could use language such as ‘any means of human reproduction’. This approach will not reduce the law to irrelevancy by technological progress. The UK Parliament’s expedition in enacting the *Human Reproductive Cloning Act 2001* (UK) demonstrates that legislatures have the capacity to respond rapidly to new technological developments when they see fit to do so.

The recommendations should be considered to ensure that the law is kept up-to-date, and can stay connected to the ever-changing technology.<sup>89</sup> It is important that law review is conducted within a

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88 Interview with Roger Brownsword (Kings College London, 18 November 2009).

89 In face of rapidly changing technology, the Lockhart Report raised three recommendations, 50, 51 and 52, that would give the NHMRC Licensing Committee power to make binding rulings in the interpretation of the legislation on certain conditions.

reasonable time frame after enactment of the legislation and that its recommendations are implemented. These methods will assist in maintaining the regulatory connection.

## VII AUSTRALIA'S REGULATORY SCHEME AND DOES IT ADEQUATELY ADDRESS THE REGULATORY CHALLENGES?

A significant feature of Australia's regulatory regime over HESC research is its stringent statutory licensing scheme. The *Research Involving Human Embryos Act 2002* (Cth) ('*RIHE Act 2002*') creates a national licensing system whereby researchers must be licensed for each research project that involves the use of a human embryo. The object of the Act is to permit research on embryos but only in strictly limited circumstances. Its key feature is the licensing regime for the use of 'excess' assisted reproductive technology ('ART') embryos and, at present, SCNT embryos as well. The Act creates a series of offences relating to the use of the embryos without a licence. It is an offence to use an embryo that is not an excess ART embryo or SCNT embryo<sup>90</sup> and to breach a licence condition.<sup>91</sup> The seriousness with which the legislature views these offences is reflected in the penalties, which impose a maximum of five years' imprisonment.

The *RIHE Act 2002* establishes the Embryo Research Licensing Committee,<sup>92</sup> whose principal task is to license the use of excess ART embryos and SCNT embryos in research.<sup>93</sup> It is important to note that there are two stages to the issue of a licence. Section 21(3) provides that the licensing committee must not issue the licence

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90 *Research Involving Human Embryos Act 2002* (Cth) s 11.

91 *Ibid* s 12.

92 *Ibid* s 13.

93 *Ibid* s 20.

unless it is satisfied of the fulfilment of some conditions, one of which is that the applicant must have obtained approval for the project by the Human Research Ethics Committee, in accordance with, and acting in compliance with, the *National Statement on Ethical Conduct in Human Research 2007* (National Statement 2007). Next, s 21(4) provides that in deciding whether to issue the licence, the licensing committee is directed to have regard to various matters including ‘any relevant guidelines ... issued by the CEO of the National Health and Medical Research Council (NHMRC) ...’ and ‘HREC’s [Human Research Ethics Committee’s] assessment of the application ...’. The NHMRC guidelines accompany the Act, and set out the steps that researchers should follow. While these guidelines are not legally enforceable, failure to follow them is likely to result in non-issuance of a licence to conduct the research.<sup>94</sup> As explained, the licensing committee will not issue a licence to a scientist who wishes to pursue SCNT research unless his or her research proposed in the application is assessed and approved by a research ethics committee. This committee will ensure that the researcher has acted in accordance and compliance with the *National Statement 2007*. The research approval of the application by the committee is a condition for the issuing of a licence.

This section explores whether Australia’s regulatory scheme on human embryonic stem cell research meets Brownsword’s regulatory challenges. As discussed, regulatory legitimacy refers to the extent to which the regulatory position adopted by the regulators is considered by all constituencies as legitimate and ethically appropriate. Articulating such a regulatory position is a challenge in Australia, a diverse society with a plurality of values. While it is a secular nation, today it is a multi-cultural society consisting of

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94 Loane Skene and Brendan Gogarty, ‘Stem Cell Research and Cloning: Legal Loopholes’ (2002) 23(8) *Australasian Science* 31.

different religious and moral values. The most realistic approach is to ensure that public consultations are held prior to the enactment of legislation or amendments, and issuing fresh guidelines or revision of existing guidelines. These debates will allow the balancing of diverse views of its community. The conduct of such consultations will not only lead to the attainment of regulatory legitimacy but also, as Brownsword argues, will allow regulators to gather greater consensus from regulatees. This will help achieve regulatory effectiveness, the second regulatory challenge.

There are consultative mechanisms such as the Australian Law Reform Commission ('ALRC').<sup>95</sup> The ALRC is an independent federal statutory authority that was set up after the model of Lord Scarman's Law Commission in the UK. It reviews Australia's laws to ensure that they are fair, up-to-date and efficient. Extensive consultations are conducted with the legal profession, interested organisations and the community to inform its research. The ALRC advises the Parliament on the reform and modernisation of the federal law. One of the earliest tasks assigned to the ALRC was in the area of biotechnology, namely human tissue transplantation in 1976. This led to the adoption of the law in the Australian Capital Territory ('ACT'), which was later replicated throughout other states in Australia as well as in other countries.

In addition, there are independent inquiries including the 'Legislation Review Committee on the *Prohibition of Human Cloning Act 2002* and the *Research Involving Human Embryos Act 2002*' ('Lockhart Review') conducted in 2005 and the '2010 Legislation Review of the *Prohibition of Human Cloning for Reproduction Act 2002* and *Research Involving Human Embryos Act*

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95 Australian Government, Australian Law Review Commission <<http://www.alrc.gov.au>>.



2002' ('Heerey Review') conducted in 2010 and 2011. After the creation of Dolly in 1997, the Australian government released the 'Scientific, Ethical and Regulatory Considerations Relevant to Cloning of Human Being' ('AHEC Report') in 1998. There was no public consultation held in the preparation of the AHEC Report. However, a draft of the report was circulated to a broad range of persons knowledgeable in the field, including scientists and ethicists, for their feedback. In 1981, the 'Human Cloning: Scientific, Ethical and Regulatory Aspects of Human Cloning and Stem Cell Research' ('Andrews Report') was released. Both reports led to the enactment of *Prohibition of Human Cloning Act 2002* ('PHC Act 2002') and *RIHE Act 2002*. This was followed by the enactment of legislation in all states and one territory. Both national Acts had sunset clause provisions that led to the establishing of the Lockhart Review, and the release of the Legislation Review Committee Report ('Lockhart Report') in 2005. The committee was formed to examine both 2002 Acts in light of latest scientific developments, which led to the passing of the *Prohibition of Human Cloning for Reproduction and the Regulation of Human Embryo Research Amendment Act 2006* (Cth) (Amendment Act 2006). This Act too has a sunset clause provision that resulted in the establishment of the Heery Review, chaired by Peter Heerey, to review the Act in the light of latest scientific developments. The 'Report of the *Independent Review of the Prohibition of Human Cloning for Reproduction Act 2002 and Research Involving Human Embryos Act 2002*' ('Heery Report') was released in June 2011.

In 2001, prior to the publication of the Andrews Report, which led to the enactment of *PHC Act 2002* and *RIHE Act 2002*, there were two public consultations conducted as the committee intended to involve the public at large to explain and explore the range of views. Moreover, the committee collected written submissions and exhibits. In 2005, prior to the release of the Lockhart Report, which led to the *Amendment Act 2006*, the review committee held extensive

consultations that involved a cross-section of the Australian society, with attempts to balance the diverse views of the society. The broad range of discussions conducted included facilitating forums, carrying out public hearings and private meetings, conducting a review website, reviewing written submissions, holding meetings with stakeholders, facilitating site visits, reviewing results of focus groups and telephone survey research into public attitudes to stem cell technologies, and conducting literature reviews of the latest scientific and technological advances in human cloning, human embryo research and related matters including stem cell technologies. Data collected from these sources have led to the recommendations in the report.

In 2010, there were public submissions and appearances prior to the release of the Heerey Report. It recommended some changes to the legislation, with the majority of them concerned with increasing the powers of the licensing board. The Report recommended that the primary structure of the legislation introduced in 2002, as amended in 2006, should remain. It was noted that, like the Lockhart Review, the Heerey Review held broad consultations that sought the various views from the Australian public. The opportunity to make public written submissions was available via the website. A total of 264 submissions were received, and 170 were from private individuals. One hundred and eighty-eight were from the general community or non-scientific organisations. Six were international, and the remainder from scientists or scientific groups. Having considered the written submissions, selected individuals and institutions were invited to meet with the Heerey Review committee face-to-face. Those invited represented a broad range of views including those from the religious, ethical and scientific communities. Scientific experts were asked to respond to enquiries from the Heerey Review. Thus, it can be seen that differences of opinions can be reconciled by forums and this will ensure that the Australian regulatory environment pass muster as legitimate.

Furthermore, the greater the consensus regulators could gather from regulatees, the more likely they will achieve regulatory effectiveness, the second regulatory challenge. As Brownsword says, the more that regulators can act with the grain of regulatees' values, the greater the probability their regulatory intervention will be effective and fit for purpose. The main features and operations of the 'National Health and Medical Research Council Licencing Committee ('NHMRC Licencing Committee') include the issue of licences; the imposition of licence conditions, variation and revocation of licences; and monitoring compliance, reviews and appeals by applicants for licences, offences under the Act, transparency and cost recovery mechanism. This regulatory authority has played a major role in the effective regulation of research involving human embryos in Australia since 2003, and continued after the *Amendment Act 2006* was passed. There is general support for the need of oversight of embryo and stem cell research, and the NHMRC Licencing Committee fulfils a valuable role in this process based on submissions in the Lockhart Review. These favourable submissions influenced Recommendations 34, 35 and 38, which provided for the continuity of the NHMRC Licencing Committee as the regulatory body in this area of enforcement.

The regulatory architects in Australia apply Professor John Braithwaite's theory of regulation,<sup>96</sup> and its regulatory design illustrates three rungs of the pyramid of regulatory instruments. This

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96 Sonia Allan, 'Regulatory Design Strategies and Enforcement Approaches for Research Involving Human Embryos and Cloning in Australia and the United Kingdom — Time for a Change' (2010) 32(4) *Sydney Law Review* 617. While Allan offers some criticisms of the current type of regulation, it is argued that as a whole, the present system is on the whole effective.

pyramid incorporates a mix of different strategies, namely, education followed by guidelines and strict statutory licensing system at the top of the apex. Smart regulation explores many options which help achieve regulatory effectiveness. These options include: (a) the evolving responsive Australian regulatory regime; (b) incorporating a mix of statutory licensing schemes; (c) adherence to NHMRC guidelines; (d) education and promoting awareness of responsibilities; (e) regulation is supported by monitoring and inspection system for facilitating monitoring compliance with the legislation. Education visits to research centres by the NHMRC Licencing Committee create awareness among researchers of their responsibilities under the Acts. The Committee has strict criteria which it must adhere to in issuing licenses — specifically, only where it is satisfied that the proposed activity has been considered and approved by an HREC acting in compliance with the NHMRC's *National Statement*.<sup>97</sup> The NHMRC Licencing Committee must also have regard to relevant guidelines issued by the NHMRC.<sup>98</sup> The role of inspectors in monitoring researchers' compliance with legislation is essential to ensure the enforcement of the law. As argued by Brownsword, a regulatory architecture that comprises a collective mix of regulatory instruments leads to regulatory effectiveness.

Finally, the question arises whether the Australian regulatory framework is responsive and evolves with the changing times and thus maintains the regulatory connection. As provided by the Andrews Report, the regulatory framework must be transparent, accountable and responsive.<sup>99</sup> Shortly after the creation of Dolly in 1997, the Australian government responded rapidly with the release

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97 Research Involving Human Embryos Act 2002 (Cth) s 21(3)(c).

98 Ibid s 21(4)(c).

99 House of Representatives Standing Committee on Legal and Constitutional Affairs, above n 22, xxviii.

of AHEC Report in 1998, and this was followed by the release of Andrews Report in 2001. Both reports led to the enactment of *PHC Act 2002* and *RIHE Act 2002*. Subsequently, legislation was enacted in all states and territory. It is mandatory to undertake a review of the law within a reasonable time frame after the enactment of the legislation or after the adoption of the amended legislation. Section 25A of *PHC Act 2002* and s 47A of *RIHE Act 2002* require a review of the statute be undertaken three years after its enactment.<sup>100</sup> The effect of the sunset clauses in both Acts provide for a mandatory review of the legislation to be conducted within a reasonable time frame. The sunset clause provisions led to the appointment of the Lockhart Review and the release of Lockhart Report in 2005. Two of the most significant recommendations in the Lockhart Report include Recommendation 23, which proposed legalising the conduct of SCNT under strict conditions, and Recommendation 21, which recommended that fresh ART embryos that are unsuitable for implantation are permitted to be used in research). Equally important is the rapid implementation of the recommendations of the Lockhart Report by the enactment of amending legislation. Following the review, the Lockhart Committee handed its findings to the Australian Government and the developments post-release of the Report. The *Amendment Act 2006* was passed just one year after the release of the Lockhart report, where the majority of its recommendations were implemented. There were also enactments of complementary state amending legislation in most states and territory.

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100 This sunset clause provides that the Minister must cause a further independent review of the operation of Act in three years after the Amendment Act 2006 has received the Royal Assent. This is in line with Recommendation 53 of the Lockhart Report. In comparison, in the UK, the Human Fertilisation and Embryology Act 1990 (UK), was amended only in 2008.

The amending legislation was accompanied by revisions made in 2007 to the *National Statement on Ethical Conduct in Research Involving Humans 1999* (National Statement 1999) and *Ethical Guidelines on Assisted Reproductive Technology 2004* (ART Guidelines 2004) to reflect the amendments made in the Acts. In the same year, the *Objective Criteria* was developed by the NHMRC as recommended in the Lockhart Report. Collectively, the statutory and guidelines amendments ensure regulatory connection with the scientific developments. The *Amendment Act 2006* too has a sunset clause provision and the most recent legislation review, the Heerey Report, was conducted in 2010 and 2011. In addition, the Heerey Report recommends a mandatory law review be conducted five years after the amendment Act is passed.<sup>101</sup>

The sunset clause provisions in the Acts that provide for a mandatory law review to be conducted within a few years are essential. Equally important is the implementation of the recommendations in the report by the enactment of amending legislation and revisions to the NHMRC guidelines. These amendments and changes collectively ensure regulatory connection of the law with scientific developments. From these piecemeal developments, it is evident that the Australian regulatory regime on cloning and stem cell technology, principally through the sunset review provisions of both Acts, is responsive and maintains the regulatory connection. This responsiveness reflects the Andrews

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101 Legislation Review Committee, Commonwealth of Australia, *Report of the Independent Review of the Prohibition of Human Cloning for Reproduction Act 2002 and Research Involving Human Embryos Act 2002* (2011) 19.

Report, which provided that the regulatory regime be not only transparent and accountable but also responsive.<sup>102</sup>

## VIII CONCLUSION

As illustrated in the law reviews conducted by the Lockhart Review and the Heerey Review, the overall Australian experience has been a relatively positive one. There have been no prosecutions to date, which may be an indicator of its success, and it is a model regulatory scheme that can be emulated by other nations. A remarkable aspect is that many public forums were held before the passing of legislation or amending laws, and issuing fresh guidelines or amendment of existing guidelines. In pluralistic Australia, consisting of various ethics, religious and moral values, the conduct of these consultations will enable regulators to meet the standards of legitimacy. As Brownsword asserts, the more consensus regulators can gather from the regulatees (regulate with the grain), the greater the likelihood they will also achieve regulatory effectiveness. Australia's regulatory design, based on Braithwaite's theory of regulation, incorporates a mix of regulatory instruments which ultimately achieve an effective regulated system. From its early days until the present, its regulatory framework is one that has evolved with the changing times and thus exhibited regulatory connection. While it is not perfect, the Australian regulatory regime on human embryonic stem cell research attains regulatory legitimacy, achieves regulatory effectiveness and maintains the regulatory connection.

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102 House of Representatives Standing Committee on Legal and Constitutional Affairs, above n 22, xxviii.

# ***THE FALL OF SOVEREIGNTY: INVESTOR- STATE DISPUTE SETTLEMENT IN AUSTRALIA***

TRACY ALBIN\*

## **Abstract**

*The use of Investor-State Dispute Settlement clauses in Bilateral Investment Treaties and Free Trade Agreements by the Australian Government has been highly criticised as a threat to its sovereignty. The apparent 'regulatory chill' which results from the operation of such clauses has arguably inhibited the government's ability to appropriately legislate for public policy areas such as environment and health. On this background, this work explores these and other criticisms, as well as the way such clauses have been used both in Australia and in other jurisdictions, to evaluate whether such clauses are necessary for their intended purpose, or whether they threaten the very nature of Australia's democratic society.*

## **I INVESTOR-STATE DISPUTE SETTLEMENT IN AUSTRALIA**

### *A Overview*

Investor-State Dispute Settlement ('ISDS') arrangements are a mechanism of public international law found in Free Trade Agreements ('FTAs') and Bilateral Investment Treaties ('BITs'),

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which provide protection to both Australian investors overseas and foreign investors in Australia. The inclusion of such clauses give investors standing to challenge a host State before an international arbitral tribunal where the host State has violated an investor's rights under the relevant agreement. This process is known as 'investor-state arbitration'. Australia has entered into 21 BITs with nations such as China, Hong Kong, India, Indonesia, Sri Lanka and Vietnam. For example, art 11.16 of the Korea-Australia FTA (KAFTA), issued on 12 December 2014, states:

Notwithstanding paragraph 1, if an investor of a Party, in the situations referred to in paragraph 1, suffers a loss in the territory of the other Party resulting from:

- (a) requisitioning of its covered investment or part thereof by the latter's forces or authorities; or
- (b) destruction of its covered investment or part thereof by the latter's forces or authorities, which was not required by the necessity of the situation,

the latter Party shall provide the investor with restitution, compensation, or both as appropriate, for such loss. In the event of providing both restitution and compensation, their combined value shall not exceed the loss suffered.

Another prominent example of such a clause is contained within art 9.8 of the Trans-Pacific Partnership ('TPP'),<sup>1</sup> another FTA, signed on 4 February 2016:

No Party shall expropriate or nationalise a covered investment either directly or indirectly through measures equivalent to expropriation or nationalisation (expropriation), except:

- (a) for a public purpose; 17, 18
- (b) in a non-discriminatory manner;

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1 Trans-Pacific Partnership, signed 4 February 2016, [2016] ATNIF 2 (not yet in force).

- (c) on payment of prompt, adequate and effective compensation in accordance with paragraphs 2, 3 and 4; and
- (d) in accordance with due process of law.

Compensation shall:

- (a) be paid without delay;
- (b) be equivalent to the fair market value of the expropriated investment immediately before the expropriation took place (the date of expropriation);
- (c) not reflect any change in value occurring because the intended expropriation had become known earlier; and
- (d) be fully realisable and freely transferable.

While such clauses have regularly been incorporated into international trade agreements by the Australian Government, they have received continuous vilification by academics, politicians, regulatory bodies, interest groups and the media, who argue that such provisions are skewed too far in favour of investor protection.<sup>2</sup> The recent signing of the TPP has enlivened these issues again, with the FTA purporting to cover as much as 36 per cent of the world's economy if ratified by all of the negotiating parties.<sup>3</sup> The substance of these criticisms will be the focus of this paper, evaluating them in an international light with a consideration of possible ways to cure the pitfalls of these provisions.

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2 Arseni Matveev, 'Investor State Dispute Settlement: The Evolving Balance Between Investor Protection and State Sovereignty' (2015) 40 *The University of Western Australia Law Review* 348, 350.

3 Department of Foreign Affairs and Trade, Trans-Pacific Partnership Agreement <<http://dfat.gov.au/trade/agreements/tpp/Pages/trans-pacific-partnership-agreement-tpp.aspx>>.

## II THE PERSECUTION OF ISDS CLAUSES IN AUSTRALIA

### *A Recent Criticisms by Australian Influencers*

In 2011, the Productivity Commission warned that the Australian Government should avoid ISDS provisions highlighting the multiplicity of international arbitration, alluding to the fact that by the end of 2009, 357 known treaty-based cases had been initiated. This proposition has gained considerable support; in particular, by Peter Whish Wilson, Senator for Tasmania, who introduced the Trade and Foreign Investment (Protecting the Public Interest) Bill 2014 (Cth) on 3 March 2014.

In his Second Reading Speech for the Bill, Senator Ludlam stated:

But we owe it to ourselves and to our constituents, and to the future flexibility of this legislature to be able to do its job, to protect ourselves from predator capitalism and from these corporate interests, unelected, on the other side of the world, who would like nothing more than to subordinate the law-making power of this chamber and the other place to their own interests. All you would need to prove — and not even really prove; all you would need to be able to show — is your future potential profits in fracking underneath a residential subdivision or farmland, your future potential profits in opening up a carcinogenic uranium mine or your future profits in being able to track down and prosecute teenagers BitTorrenting stuff that they cannot get any other way, to be able to sue a government, to sue this parliament.<sup>4</sup>

This paragraph illustrates the concern surrounding the use of ISDS provisions in Australia, and the potential for ISDS to deter the

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<sup>4</sup> Commonwealth, Parliamentary Debates, Senate, 12 February 2015, 551 (Scott Ludlam).

government from legislating in the public interest where there is potential for disadvantage to be afforded to a foreign investor, which may result in them being awarded damages. This concept is colloquially known as ‘regulatory chill’<sup>5</sup> and will be discussed later in this paper.

The solicitude for diminishing sovereignty was further referenced by Senator Milne where she stated:

The big point here is this: we have a parliament to make the laws that govern this country in the public interest. That is fundamentally what parliament is about. That is why we are elected to this place. And what is going on at the moment is a negotiation — in secret — of a text of a trade agreement that the Australian community cannot see ... The fact of the matter is, this government — are negotiating away Australia's sovereignty, and placing it in the hands — particularly in this case — of corporations based in the United States ... Why am I saying that it is an assault on Australia's sovereignty, and an assault on decisions of the parliament and the judiciary? It is not just parliamentarians like the Greens who are objecting to this; the judiciary is worried as well — because the chilling effect of this is that corporations can sue a government if a government moves to take legislative action which undermines their profits.<sup>6</sup>

These statements outline one of the biggest criticisms surrounding the implementation of ISDS provisions in Australia. The apparent influence of ISDS on the government, in a way that impinges on

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5 Charles N Brower and Sadie Blanchard, ‘What’s in a Meme? The Truth about Investor-State Arbitration: Why It Need Not, and Must Not, Be Repossessed by States’ (2014) 52 *Columbia Journal of Transnational Law* 689, 749–50.

6 Commonwealth, Parliamentary Debates, Senate, 12 February 2015, 558 (Christine Milne).

their ability to introduce legislation which has beneficial public policy effects, has created sufficient contention in this area. This is due to the fear of potential repercussions that would result if a foreign investor was to challenge the legislation as breach of a FTA or BTI.

A similar perspective was also offered by Dr Thomas Faunce of the Australian National University in his submissions to the Committee of the TPP.<sup>7</sup> Dr Faunce contended that the incorporation of an ISDS provision in the TPP would put Australia at a significant disadvantage against the economies of non-TPP nations which plan to withdraw from existing ISDS obligations. It was asserted that it would affect Australia in three ways: first, by inhibiting the capacity of the Australian Government to utilise the scientific cost-effectiveness system in the pharmaceutical benefits scheme; second, it would make it harder for the Australian Government to regulate the banking and finance sectors; and third, it would undermine Australian sovereignty by exposing the policy and legislative outputs to challenges by foreign investors who have no regard for domestic governance beyond that which affects their investment opportunities.<sup>8</sup>

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7 Dr Thomas Faunce, Submission to Foreign Affairs, Defence and Trade Committee, Trade and Foreign Investment (Protecting the Public Interest) Bill 2014, 9 April 2014, 4.

8 Chief Justice RS French AC, 'Investor-State Dispute Settlement — A Cut Above the Courts?' (Speech delivered at the Supreme and Federal Courts Judges' Conference, Darwin, 9 July 2014), 11 <<http://www.hcourt.gov.au/assets/publications/speeches/current-justices/frenchcj/frenchcj09jul14.pdf>>.

### III AN INTERNATIONAL PERSPECTIVE

These criticisms have also found footing with other nations. Many critical scholars have warned of the shortcomings of ISDS; including the Head of Investment Law and Policy at Columbia University, the Director of the Columbia Centre on Sustainable Investment and the Director of the Earth Institute at Columbia University.<sup>9</sup> These academics note the significant substantive and procedural rights that ISDS provisions afford to individuals and corporations based solely on their foreign nationality, as well as the indirect transfer of law-making power to these foreign corporations and individuals that ISDS enables.

Other important limitations of the ISDS mechanism highlighted include:

- the limited avenues of appeal from decisions of the arbitral tribunals;
- the often exponentially large awards of compensation that may have the effect of crippling the host State's ability to fund other important aspects of domestic governance;
- the limited system of checks on tribunals' power of interpretation;
- the reduced impartiality and transparency of the tribunal process; and
- appointment of arbitrators and the inability of host States to initiate proceedings themselves, creating an obvious imbalance of power.<sup>10</sup>

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9 Lise Johnson, Lisa Sachs and Jeffrey Sachs, 'Investor-State Dispute Settlement, Public Interest and US Domestic Law' (CCSI Policy Paper, Columbia Centre of Sustainable Investment, May 2015) 1.

10 Ibid 2.

## IV SOME CRITICISMS IN DETAIL

*A The Concept of 'Regulatory Chill'*

ISDS provisions were originally intended to protect investors in underdeveloped countries with weak legal systems.<sup>11</sup> However, in the past two years, the number of cases brought under an ISDS provision at an international level has increased with 36 per cent of those cases coming from developed nations with a rule of law.<sup>12</sup> The United Nations Conference on Trade and Development 2015 noted that in 2008 there were 326 known cases.<sup>13</sup> This has significantly accelerated to 608 by the end of 2014.<sup>14</sup> It has been argued that the size, frequency and cost of the ISDS process acts as a deterrent — influencing the reluctance of the Australian and other governments to legislate in areas of public interest such as health and environment.<sup>15</sup> It is also argued that the increase in ISDS arbitration

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11 Roderick Abbott et al, 'Demystifying Investor-State Dispute Settlement (ISDS)' (Occasional Paper No 5, European Centre for International Political Economy, 2014) 5.

12 Ruth Townsend, 'When Trade Agreements Threaten Sovereignty: Australia Beware' (15 November 2013) *The Conversation* <<https://theconversation.com/when-trade-agreements-threaten-sovereignty-australia-beware-18419>>.

13 United Nations Conference on Trade and Development, 'World Investment Report 2015' (United Nations, 2015), 123–5 <[http://unctad.org/en/PublicationsLibrary/wir2015\\_en.pdf](http://unctad.org/en/PublicationsLibrary/wir2015_en.pdf)>.

14 Ibid.

15 Matveev, above, n 3; Elizabeth Warren, 'The Trans-Pacific Partnership clause everyone should oppose', *The Washington Post* (online), 25 February 2015 <[http://www.washingtonpost.com/opinions/kill-the-dispute-settlement-language-in-the-trans-pacific-partnership/2015/02/25/ec7705a2-bd1e-11e4-b274-e5209a3bc9a9\\_story.html](http://www.washingtonpost.com/opinions/kill-the-dispute-settlement-language-in-the-trans-pacific-partnership/2015/02/25/ec7705a2-bd1e-11e4-b274-e5209a3bc9a9_story.html)>.

is inextricably linked to the increase in globalisation over the past few decades, meaning that decisions brought under ISDS provisions involving states other than Australia also have this deterrent effect.<sup>16</sup>

For example, in *Ethyl Corporation v Government of Canada*,<sup>17</sup> the American manufacturer of a fuel additive known as MMT brought an action against the Canadian Government after it decided to ban its use, concluding that the additive could be a threat to human health as well as the environment. As a result of the suit, the Canadian Government reversed the ban, published a statement declaring that MMT was safe, and paid Ethyl US\$3 million in compensation. Another influential example involves the award of US\$353 million against the Czech Republic, an amount equating to its entire healthcare budget,<sup>18</sup> which will be discussed below.

Further, in 2012 an Ecuadorian court ordered global resources company Chevron to pay \$18 billion in clean-up costs and damages to the 30 000 people that had been harmed by the company's dumping of 16 billion gallons of toxic water into waters, used by

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16 Scott Miller and Gregory N Hicks, 'Investor State Dispute Settlement: A Reality Check' (Report, Centre for Strategic and International Studies, January 2015) v, 6 <[https://csis-prod.s3.amazonaws.com/s3fs-public/legacy\\_files/files/publication/150116\\_Miller\\_InvestorStateDispute\\_Web.pdf](https://csis-prod.s3.amazonaws.com/s3fs-public/legacy_files/files/publication/150116_Miller_InvestorStateDispute_Web.pdf)>.

17 *Ethyl Corporation v Government of Canada* (Award on Jurisdiction) (North American Free Trade Agreement Chapter 11 Arbitral Tribunal, 24 June 1998).

18 *CME v Czech Republic* (2006) 9 ICSID Rep 264; ABC Radio National, 'ISDS: The Devil in the Trade Deal', Background Briefing, 14 September 2015 (Jess Hill) <<http://www.abc.net.au/radionational/programs/backgroundbriefing/isds-the-devil-in-the-trade-deal/5734490#transcript>>.



locals for drinking, in the Amazon.<sup>19</sup> Despite this, an ad hoc investor-state tribunal ordered Ecuador not to enforce the decision under the US-Ecuador Bilateral Investment Treaty.<sup>20</sup> Again, when US-based Renco Group failed to install sulphur removal plants in its metal smelter in La Oroya after Peru had already given the company two extensions, they threatened to sue Peru for \$800 million under the US-Peru Free Trade Agreement. This sufficiently convinced Peru to allow Renco to recommence operations despite its lack of environmental compliance.<sup>21</sup>

These cases demonstrate the ability of foreign investors to influence the law making abilities of governments of host states, particularly because ISDS provides them with a way to circumvent the local court system and, in some cases, completely override the decisions made by them. This is the situation in relation to the ongoing arbitration concerning the tobacco plain packaging laws in Australia, the first and only case to be brought under an ISDS provision involving the Australian Government.<sup>22</sup>

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19 *Chevron Corporation and Texaco Petroleum Corporation v The Republic of Ecuador* (Order for interim measures) (Ecuador- United States Bilateral Investment Treaty, PCA Case No. 2009-23, 9 February 2011).

20 Eduardo Garcia, 'Ecuador seeks to end investment protection treaty with US', Reuters (online), 12 March 2013 <<http://uk.reuters.com/article/2013/03/12/ecuador-us-treaty-idUKL1N0C401C20130312>>.

21 Public Citizen, 'TPP's Investment Rules Harm the Environments' (2013) <<http://www.citizen.org/documents/fact-sheet-tpp-and-environment.pdf>>; Public Citizen, US Pharmaceutical Corporation Uses NAFTA, (March 2013), 2 <<http://www.citizen.org/documents/Eli%20Lilly%20Briefing%20Paper%20Mar%202013%20FINAL.pdf>>.

22 Agreement between the Government of Australia and the Government of Hong Kong for the Promotion and Protection of

In this case, Phillip Morris was unsuccessful not once, but twice in the High Court of Australia in its challenge against the *Tobacco Plain Packaging Act 2011* (Cth). Following its unsuccessful attempt to argue the illegality of the Act, Phillip Morris initiated Investor-State arbitration under art 6 of the 1993 Hong-Kong Agreement, arguing that the laws constitute expropriation of its investments in Australia. These types of disputes, especially those concerning legislation relating directly to issues of controversy like public health, have led to the apparent ‘regulatory chill’ that anti-ISDS advocates have highlighted as being an attack on state sovereignty.

### *B The Status of an Ad-hoc Tribunal*

Some arguments arise concerning the status of arbitrators appointed to the ad-hoc tribunals hearing ISDS claims. One such argument is the significant inhibitor on the impartiality of those arbitrators by way of the ‘double hat dilemma’.<sup>23</sup> This concept argues that the nature of ad-hoc tribunals, made up of three individually appointed members who ‘go back and forth between representing corporations one day and sitting in judgement the next’,<sup>24</sup> acts as a barrier to transparency in the arbitration system.<sup>25</sup>

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Investments, Philip Morris Asia Ltd (Hong Kong) — The Commonwealth of Australia, signed 15 September 1993, [1993] ATS 30 (entered into force 15 October 1993) art 6.

23 Elizabeth Warren, ‘The Trans-Pacific Partnership clause everyone should oppose’, *The Washington Post* (online), 25 February 2015 <[http://www.washingtonpost.com/opinions/kill-the-dispute-settlement-language-in-the-trans-pacific-partnership/2015/02/25/ec7705a2-bd1e11e4-b274-e5209a3bc9a9\\_story.html](http://www.washingtonpost.com/opinions/kill-the-dispute-settlement-language-in-the-trans-pacific-partnership/2015/02/25/ec7705a2-bd1e11e4-b274-e5209a3bc9a9_story.html)>.

24 Ibid.

25 Eduardo Zuleta, ‘The Challenges of Creating a Standing International Investment Court’ in Jean E Kalicki and Anna Jounbin-Bret (eds),

There is also commentary to support the view that the objective appointment of arbitrators to such tribunals can address concerns of partiality. The fact that each party appoints one arbitrator and the third is a mutually agreed appointee, lends itself to the position that parties will act objectively, choosing those arbitrators that may favour their cause, or at least avoiding appointment of those that will sympathise with the other side.<sup>26</sup> This is furthered by the fact that arbitrators do not have secure tenure which is enjoyed by judges, meaning they are open to favour one particular side, in the interests of gaining a tactical alignment with that party and possible re-appointment in future matters.<sup>27</sup>

Some scholars argue that the inconsistency emerging from decisions made under the North American FTA ('NAFTA') and KAFTA have given rise to the need for the development of an appellate system.<sup>28</sup> Of relevance here are the cases of *CME v Czech Republic*<sup>29</sup> and *Lauder v Czech Republic*.<sup>30</sup> Some have referred to these parallel

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*Reshaping the Investor-State Dispute Settlement System: Journeys for the 21st Century* (Brill, 2015) 403, 409.

26 Anne can Aaken 'Delegating Interpretative Authority in Investment Treaties: The Case of Joint Administrative Commissions' in Jean E Kalicki and Anna Joubin-Bret (eds), *Reshaping the Investor-State Dispute Settlement System- Journeys for the 21st Century* (Brill, 2015) 21, 35–6.

27 Ibid 33.

28 Sachet Singh and Sooraj Sharma, 'Investor-State Dispute Settlement Mechanism: The Quest for a Workable Roadmap' (2013) 29(76) *Utrecht Journal of International and European Law* 88, 99.

29 (2006) 9 ICSID Rep 264.

30 9 ICSIC Rep 66.

decisions as the ‘ultimate fiasco in investment arbitration’.<sup>31</sup> In 1993, US national Ronald Steven Lauder invested in private Czech television broadcaster TV Nova through his German company, which was later succeeded by Central European Media (‘CME’).

After Lauder’s business partner effectively deprived CME of its investment by breaking the deal between the companies, around 20 suits came before the Czech courts; with Lauder and CME seeking damages for the interference of the Czech Media Council which allegedly contributed to Lauder’s losses. Dealing with the same facts, the tribunals gave two contradictory decisions, with Lauder’s claim being dismissed while CME was awarded \$270 million in damages with 10 per cent interest.

It has also been advocated that the establishment of an appellate system would be more impartial and efficient than allowing the current practice of review by local courts to continue. It has been proposed that local courts reviewing decisions of such ad hoc tribunals may be susceptible to government influence and the process may therefore hinder, rather than promote, the independence and transparency of the arbitration system.<sup>32</sup> The ability to regulate such an appellate system with uniform rules and procedures is also seen as an advantage.<sup>33</sup>

The proposal for an appellate scheme has not come without reservations. Many scholars have noted that, should an appellate mechanism be introduced, regard should be given to the fact that

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31 Isabelle Buffard et al, *International Law between Universalism and Fragmentation: Festschrift in Honour of Gerhard Hafner* (Brill, 2008) 116.

32 Ibid.

33 Ibid 101.

allowing reviews for errors of fact would warrant a hearing de novo, which should be avoided in order to maintain the efficiency of this system.<sup>34</sup> Further, a significant issue which would arise from such appeals is the conflict of laws, and the development of a system for determining the appropriate applicable law in such proceedings.<sup>35</sup> Nevertheless, the procedural benefits and enhanced efficiency of the international arbitration system that would come about from the establishment of an appellate mechanism is considered to far outweigh the potential costs to achieve it.<sup>36</sup>

## V THE COUNTER-ARGUMENT

### *A The Myth of Multiplicity*

While there are significant arguments against the use of ISDS, advocates in favour of ISDS note that the most apparent reason for the rise in arbitration is the concurrent rise in the stock of foreign direct investment and increased globalisation.<sup>37</sup> Furthermore, there are currently around 2400 BITs in force, 90 per cent of which have continued to operate without a single investor claim for breach of the treaty.<sup>38</sup> This is not to deny the fact that in some instances, states do become vulnerable to an ISDS claim. However, of the thirteen ISDS cases brought to judgement against the United States ('US') to date, none have been decided against the US.<sup>39</sup> From a local

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34 Ibid.

35 Ibid 100.

36 Singh and Sharma, above n 34, 99–101.

37 Miller and Hicks, above n 19, 6.

38 Ibid.

39 Jeffrey Zients, 'Investor-State Dispute Settlement (ISDS) Questions and Answers' (26 February 2015) The White House <<https://www.whitehouse.gov/blog/2015/02/26/investor-state-dispute-settlement-isds-questions-and-answers>>.

perspective, Australia has only been a party to one ISDS case, the ongoing Phillip Morris dispute as mentioned above.<sup>40</sup>

### *B The Myth on Costs*

Another significant argument, particularly demonstrated by the case of *CME v Czech Republic*,<sup>41</sup> is the ability for an ISDS arbitration award to financially cripple a state so it is unable to successfully allocate funds to areas of importance. However, while in some cases there have been large and substantial awards of damages handed down, investors are also exposed to the risk of significant financial backlash following an unsuccessful ISDS claim. Through the arbitrary exercise of sovereign power, investors are quaking at the potential to lose millions, or even billions, of dollars in situations where states legislate in a way which affects their investment opportunities — especially those investors lacking the resources to successfully utilise the ISDS system.<sup>42</sup> Furthermore, states are successful in ISDS claims about twice as often as investors, and in those cases where investors do win, their awards are on average less than 10 per cent of their initial claim.<sup>43</sup>

### *C The Benefits of ISDS Systems*

It is notable to recognise that, while there have been some legitimate criticisms of ISDS, as described above, there are important economic and social benefits that these systems facilitate. The extension of fair treatment and equal opportunity to foreign

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40 Department of Foreign Affairs and Trade, Investor State Dispute Settlement <<http://dfat.gov.au/trade/topics/pages/isds.aspx>>.

41 (2006) 9 ICSID Rep 264.

42 Matveev, above n 3, 359.

43 Ibid.

investors by a host state enables those parties to foster and develop potentially long-lasting relationships of co-operation and mutual trust.<sup>44</sup> Further, by lowering the risk associated with such investment, ISDS promotes economic growth and job creation.<sup>45</sup> The potential for an ISDS to create a predictable and transparent environment for foreign investors has enabled the de-politicisation of international disputes, and afforded a surge in both financial and social relationships between the parties involved.<sup>46</sup>

## VI WHAT DOES FOREIGN INVESTMENT MEAN TO AUSTRALIA?

In 2014, foreign direct investment in Australia contributed 11 per cent of its total investment.<sup>47</sup> This amounted to approximately \$45.1 billion in capital. As a resource rich environment, Australia frequently relies upon foreign capital to meet the shortfall of domestic saving needs. To remove foreign direct investment, or to place significant limitations on it by removing the protection afforded to foreign investors by way of ISDS, would result in a combination of lower living standards and the loss of unfunded investment opportunities.

Foreign investment in Australia not only generates capital gain, but it has broader implications for the Australian economy. Foreign investment supports economic growth, creates new employment opportunities, and brings about potential technology and innovation

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44 Ibid 3.

45 Ibid.

46 Ibid.

47 Australian Bureau of Statistics, *International Investment Position, Australia: Supplementary Statistics*, 2015 (11 May 2016) <<http://www.abs.gov.au/AUSSTATS/abs@.nsf/Lookup/5352.0Main+Features12015?OpenDocument>>.

transfers. Foreign investment can also facilitate competitiveness and productivity performance, for example, by providing infrastructure and bridging a connection to global supply chains and markets.

While the quantitative data for measuring the contribution of foreign investment to the Australian economy is limited, in 2012 the Australian Treasury estimated that a reduction in foreign capital investment equal to 1 per cent of gross domestic product would reduce Australia's national gross income by about half a percent each year over a 10 year period.<sup>48</sup> Additionally, a paper prepared by Access Economics for the Business Council of Australia in 2010 suggested that an increase of 10 per cent in foreign investment would increase real gross domestic product by 1.2 per cent or \$16.5 billion by 2020, 0.3 per cent in employment and 1.1 per cent in real wages.<sup>49</sup>

The importance of foreign investment in Australia is seen everywhere. Even in particularly recent times, with the calling of the double dissolution election for 2 July 2016, one of Prime Minister Malcolm Turnbull's biggest criticisms of his oppositions' campaign promises is the threat that higher taxes will have on foreign investment in Australia. This issue is prevalent in everyday society, and foreign investment forms an integral part of Australia's national economic plan and success as a nation. Therefore, the answer is not to eliminate ISDS altogether, but to find a way to harmonise the

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48 Jyothi Gali and Bruce Taplin, 'The Macroeconomic Effects of Lower Capital Inflow' (Report, The Treasury, 2012) <[http://www.treasury.gov.au/PublicationsAndMedia/Publications/2012/Economic-Roundup-Issue-3/Report/The-macroeconomic-effects-of-lower-capital-inflow#P9\\_141](http://www.treasury.gov.au/PublicationsAndMedia/Publications/2012/Economic-Roundup-Issue-3/Report/The-macroeconomic-effects-of-lower-capital-inflow#P9_141)>.

49 Foreign Investment and Trade Policy Division, 'Foreign Investment into Australia' (Working Paper, Treasury, Australian Government, 2016) 11.



need for protection of foreign investors in Australia to encourage and sustain investment, and the need to reduce the amount of power given to investors, so as to not put Australia's economy or domestic governance at risk.

## VII THE SOLUTION

### *A Suggested Solutions*

The Senate Committee, on 27 August 2014, presented its Report recommending against the enactment of the anti-ISDS Bill.<sup>50</sup> In conclusion, the Committee was:

... Not convinced that legislation is the best mechanism by which to address the concerns raised about risks associated with ISDS provisions ... the risks associated with ISDS can and should be managed more effectively and in ways which do not require legislation, including careful treaty drafting (of both old and new agreements) and development of a well-balanced Model Investment Treaty.<sup>51</sup>

Similarly, Professor Luke Nottage of the University of Sydney Law School agrees that:

It is premature and ill-advised for Australia to reverse its longstanding treaty practice by refusing to include any form of ISDS in future treaties. No other developed country adopts such a stance.<sup>52</sup>

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50 Senate Foreign Affairs, Defence and Trade Legislation Committee, Parliament of Australia, Trade and Investment (Protecting the Public Interest) Bill 2014 (2014).

51 Ibid 17 [2.59].

52 Professor Luke Nottage, Submission No 21 to Senate Foreign Affairs, Defence and Trade Legislation Committee, Trade and Investment (Protecting the Public Interest) Bill 2014, 2 April 2014, 5.

Accordingly, there are several other suggestions as to how to improve ISDS claims and how they operate in relation to treaties to which Australia are a party, as opposed to completely doing away with them. These are explored below.

### *Improved Drafting*

It has been noted that the obligations that are enforceable under ISDS provisions are often drafted too broadly or are open to overly wide interpretations. This can have a negative impact on the state's ability to initiate changes and develop improvements in areas of public policy such as health, environment and education.<sup>53</sup> It is suggested that clearer and more precise drafting may give states the ability to draft ISDS provisions which fairly balance the interests of both host states and foreign investors.<sup>54</sup>

For example, Arseni Matveev recognises that 'more detail is good for State sovereignty as it makes clearer the scope of permissible State regulatory action as well as the scope of States' obligations'.<sup>55</sup> This clarity also has remedial effects for investors, giving them greater certainty as to the expected standard of treatment they will receive under the agreement, and what recourse they have should any breaches occur.<sup>56</sup>

The implementation of a limitation period on bringing ISDS claims has also been put forward as a way of drafting ISDS provisions in a way that balances the interests and concerns of both parties to the

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53 Matveev, above n 3, 378.

54 Ibid 379.

55 Ibid 380.

56 Ibid.

agreement.<sup>57</sup> A current three-year limitation period is currently in place under the KAFTA and the NAFTA. This limitation, in conjunction with more concise drafting, which allows for the consolidation of claims, and the placing of greater emphasis on settling claims through alternative means of dispute resolution, may help to ease the burden of ISDS provisions and make such claims more manageable for states.<sup>58</sup> This may therefore help to reduce the impact of concepts such as ‘regulatory chill’ and promote the legitimate creation of legislation in areas of public policy.

### *Regular Reviews*

It is generally accepted that older agreements such as the Hong Kong-Australia BIT may fall behind the newer agreements like the KAFTA.<sup>59</sup> One way to remedy this is to implement a system of regularly reviewing and updating older International Investment Agreements to harmonise with the newer generation of agreements. There are three suggested ways to achieve this: first, amending the treaty; second, terminating the agreement and renegotiating them on new terms; or third, introducing binding interpretations through the Joint Commission.<sup>60</sup> This last solution is beyond the scope of this paper and will not be explored.

### *Establishing a Permanent International Investment Court*

Establishing a standing International Investment Court could help to improve the legitimacy and transparency of the ISDS procedure.<sup>61</sup>

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57 Ibid 379.

58 Ibid.

59 Ibid 381.

60 Ibid.

61 Ibid 382.

As noted earlier in this paper, there is considerable controversy surrounding the legitimacy of awards handed down by ad hoc tribunals hearing ISDS claims, arising from the nature of how the members are appointed and the substantial 'double hat dilemma'.<sup>62</sup> By introducing a permanent court to hear these disputes, the arguments for profiling by arbitrators and the issues pertaining to inconsistency of decisions could potentially dissipate.<sup>63</sup> Inherent in establishing a permanent court is the need to introduce an appropriate appellate system, which would enhance the transparency and fairness of the ISDS process.

### *B Author's Suggestions*

#### *Establishing a Threshold*

It is the author's suggestion that, as well as the changes discussed above, establishing a threshold, or in other terms, placing a cap on the amount of damages an investor can claim against a host State, would potentially facilitate the balance of interests between the host state and the investing parties. A general cap on damages recoverable, at a reasonable rate, would perhaps be 50 per cent of the investment amount, which could not only ensure that states are not pressured to avoid regulating in the area concerning investors' business in fear of an ISDS claim, but could also reduce the amount of ISDS claims being brought.

By imposing such a limitation, foreign investors may choose not to bring a claim for which they may not have a strong case, because the value of what they would receive by way of damages would not cover the loss suffered by the breach as well as the losses incurred

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62 Zuleta, above n 29, 411.

63 Matveev, above n 3, 382.

through litigation costs. Care would be required when implementing this change, to avoid significantly disadvantaging investors and subjecting them to a cap that would severely cripple any chance of making legitimate claims and recovery of losses.

### *Involving the Public*

Another suggestion from the author is to increase the amount of public involvement in the ISDS drafting process. While it is accepted that the general public do not have the requisite mandate to legislate for the public benefit, by involving them in the process and encouraging active feedback, particularly from those involved in foreign investment processes or those directly affected by them (ie, business owners), the public confidence in these processes could increase.

A considerable amount of the criticism surrounding ISDS claims currently stems from uncertainty — specifically, the fact that so far, Australia has only been subjected to one ISDS claim which is yet to be decided. On the background of ISDS claims involving host states such as the US, Czech Republic and Canada, which involved large amounts of money and adversely impacted public policy legislation in some instances, it is understandable for the Australian public to be concerned about what ISDS means for them, and the Australian Government's ability to effectively manage the country.

## VIII CONCLUSION

While there is potential for ISDS provisions to pave the way for investors to bring claims against host states such as Australia that may lead to considerable damages being awarded, there are also several benefits to such provisions. ISDS protects Australian foreign investors when investing in other states, particularly those with less developed legal systems, which is the original purpose of this system. With improved drafting, and upgrades to the process such as the empanelment of a permanent International Investment Court with an appellate system, ISDS provisions could be seen as more beneficial than harmful.

Legislating against the use of ISDS claims is not the answer, as demonstrated by the ultimately unsuccessful anti-ISDS Bill. In order to be actively involved in foreign investment both within Australia and outside, and to be adequately protected when engaging in these activities, ISDS provisions need to stay. By reducing the liability of host states to an appropriate amount so as to not completely prejudice the foreign investors under those agreements, the impact of ISDS on states' abilities to legislate for areas of public policy will be reduced. A happy medium needs to be found, and currently existing BITs and FTAs need to be amended when that medium is found.



# Book Reviews





# ***Review of: Confronting the Shadow Economy: Evaluating Tax Compliance and Behaviour Policies***

Stephanie Bruce\*

Title & Edition: *Confronting the Shadow Economy:  
Evaluating Tax Compliance and  
Behaviour Policies*

Author: Colin C Williams

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## **1 Author's Background**

Colin C Williams is a Professor of Public Policy and Associate Dean of Research and Innovation at the University of Sheffield's Management School. In addition, Williams is the editor of two academic journals: *The International Journal of Sociology and Social Policy*, and the *International Journal of Community Currency Research*. Renowned as a prominent scholar, Williams specialises in the study of the informal economy. Accordingly, he is frequently invited to assist European governments in understanding the undeclared economy, advising them on the significance and complexities of this area.

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## 2 Introduction

Recently, there has been growing recognition that the shadow — or informal/undeclared — economy has expanded exponentially and is no longer solely composed of unscrupulous employers who participate in large exploitative, waged employment.<sup>1</sup>

In light of this development, *Confronting the Shadow Economy: Evaluating Tax Compliance and Behaviour Policies* is a monographic book that investigates the shadow economy in-depth. It logically explores the newly recognised variable nature of the undeclared economy whilst identifying a myriad of policy approaches that authorities can adopt to reduce the significance, presence and impact of the shadow realm. The book assesses these measures and posits supported conclusions drawn from research conducted globally but largely of European influence. Ultimately, the book's central thesis is that the type of shadow work sought to be diminished, will dictate which approach should be adopted to reduce that particular form of non-compliant economic engagement — one approach is simply not effective for all.

## 3 Chapter Summaries

Chapter One introduces the concept of the shadow economy and provides context as to why this informal sphere needs to be confronted: shadow work has evolved into a multitude of forms, necessitating the need to reconsider the approaches adopted by authorities to effectively and appropriately minimise non-compliant behaviour. The author adopts the Organisation for Economic Co-operation and Development's understanding of 'underground

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1 Colin C Williams, *Confronting the Shadow Economy: Evaluating Tax Compliance and Behaviour Policies* (Edward Elgar, 2014) 1.

production', when defining the shadow economy. The definition reads as follows:

All legal production activities that are deliberately concealed from public authorities [...] to avoid payment of income, value added ['VAT'] or other taxes; to avoid payment of social security contributions; to avoid having to meet certain legal standards such as minimum wages, maximum hours, safety or health standards and so on.<sup>2</sup>

To further substantiate tackling the shadow realm, the chapter succinctly explores various rationales for confronting the informal economy from the perspective of different groups including wholly declared businesses, self-employed individuals, employees of the shadow economy, consumers and governments. In conclusion, the chapter provides a synopsis outlining the structure and main points of the proceeding chapters.

#### *A Part I: Extent and Nature of the Shadow Economy*

The variable magnitude of the shadow economy is comprehensively discussed in Chapter Two. Here, indirect<sup>3</sup> and direct<sup>4</sup> measurement methods are introduced and compared, illustrating that discrepancies in ascertaining the size of the shadow economy can arise depending on which technique is used.

Simultaneously, two distinct trends are observed: the extent of the shadow economy varies geographically, and indirect measurement methods, which are preferred, tend to produce higher estimates of

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2     *Organisation for Economic Co-operation and Development, Measuring the Non-Observed Economy* (2002), quoted in Williams, above n 1, 4.

3     Williams, above n 1, 14–22.

4     Ibid 23–34.

size than their direct measurement counterparts.<sup>5</sup> In addition, reference is made to the Global Financial Crisis to assert the position that the shadow economy has progressively reduced in size over time.<sup>6</sup> Through extensive examination of the available measurement methods, the author dispels the preconceived ideology that the shadow economy's size cannot be determined as people engaged in shadow economic activities will not be forthcoming about the true extent of their involvement in this 'hidden phenomenon',<sup>7</sup> which can wield significant ramifications for participants.

Chapter Three expands on the foundations established in the previous chapters by analysing the 2013 Special Eurobarometer No 402<sup>8</sup> survey conducted across the European Union. Ultimately, the data reiterates the multifarious nature of shadow work and echoes the geographical variance observed in determining the informal economy's size. The chapter documents the character of the shadow economy by examining the behaviour of those who participate in this realm, such as shadow consumers<sup>9</sup> and the suppliers of shadow goods and services.<sup>10</sup> It identifies that those

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5 Ibid 35. It should be noted that the accuracy of either measurement method remains unknown.

6 Ibid 20.

7 Ibid 13.

8 European Commission, *Special Eurobarometer 402: Undeclared Work* (2014).

9 Williams, above n 1, 38–46. There is no definitive demographic of those who purchase from the shadow economy. However, shadow consumers are more likely to be educated males. Some of the goods and services that shadow consumers tend to purchase include home repairs/renovations, car repairs, domestic cleaning and food products.

10 Ibid 46–60. Babysitting, waitressing, and the provision of administrative or IT assistance are amongst some of the goods and services supplied.

engaged in shadow work in Western Europe and Nordic nations are likely to voluntarily participate, whilst those residing in Southern and East-Central Europe are more likely to be involved with the shadow economy out of necessity.<sup>11</sup> Upon exploring the present nature of the informal sphere, the author notes that current management of the shadow economy is ineffective, stating:

The conventional deterrence approach that sought to eradicate the shadow economy is now widely believed to result in governments eliminating with one hand precisely the entrepreneurship and enterprise culture that they wish with the other hands to nurture.<sup>12</sup>

Due to the variances evident in the composition of the informal realm, the conclusion is that confronting the shadow economy will require carefully targeted policy approaches rather than a single, uniform deterrence approach.<sup>13</sup>

## *B Part II: Policy Approaches*

Chapter Four evaluates the policy options available to combat the shadow economy. This includes doing nothing, deregulating the declared economy, eradicating the shadow economy and moving shadow work into the declared realm.<sup>14</sup> In assessing these options, the benefits and disadvantages of each are discussed. Nevertheless, it is argued that the last option — transferring shadow work into the declared economy — is most likely the way forward as the benefits are manifold for all stakeholders when compared to the other

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11 Ibid 44–6, 54–6.

12 Ibid 47–8.

13 Ibid 50.

14 Ibid 65.

options.<sup>15</sup> The chapter concludes by affirming the notion that adopting a single approach to tackling shadow work is not practicable for all forms of shadow economic engagement; approaches should be used in conjunction with one another in order to effectively tackle this sphere.<sup>16</sup>

Chapter Five explores the subsidiary roles of the first three available policy options discussed in Chapter Four and provides a framework of analysis for Parts III–IV. The chapter considers exactly where shadow behaviour is sought to be altered and refers to approaches implemented across European nations and other institutional disciplines (for example, human resource management) in order to analyse the effectiveness of these policy approaches. The measures evaluated consist of indirect and direct controls which are utilised to deter proscribed conduct. Indirect controls attempt to foster a high trust, high commitment environment by enhancing the psychological contract apparent between the State and its citizens.<sup>17</sup> Meanwhile, direct controls seek to deter non-compliant behaviour by way of punishment and/or incentives for good behaviour.<sup>18</sup> Summarily, the current approach to confronting participation in the shadow economy appears to be by implementing direct deterrence controls. However, the author notes there is little evidence to suggest these direct deterrence measures are more effective than their indirect counterparts.<sup>19</sup>

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15 Ibid 71–3. The benefits of this option include (but are not limited to): removal of unfair competitive advantages for businesses; increased legal protection and rights for employers, employees and consumers; and increased tax revenue for governments.

16 Ibid 74.

17 Ibid 84.

18 Ibid 80.

19 Ibid 90.

*C Part III: Direct Controls*

Chapters Six through Nine examine, with reference to both the supply and demand side, the direct controls available to elicit certain conduct or deter shadow economic participation. These are discussed in the form of deterrence measures or incentives and together ‘they seek to increase the costs of working in the shadow economy or ... reduce the costs and increase the benefits of working in the declared economy’.<sup>20</sup>

Deterrence measures are often implemented to increase engagement costs by increasing the perceived or actual likelihood of detection and increasing the penalties for non-compliance.<sup>21</sup> The objective of this approach is to dissuade potential shadow participants from engaging in the informal realm as the cost-benefit ratio of participating is exceeded.<sup>22</sup> Effect has been given to this approach by altering labour laws and processes, and by increasing the presence of enforcement officials wherever shadow work is conducted. Despite this, there is inconclusive and insufficient evidence to suggest these deterrence measures contribute to a reduction in the shadow economy.<sup>23</sup>

Given the supposition in Part II, that moving shadow work into the declared economy is the most practicable policy option, the author comments that incentivising and rewarding compliant behaviour assists in formalising this policy option.

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20 Ibid 171.

21 Ibid.

22 Ibid 120.

23 Ibid 120.



As such, the focus of Chapter Seven turns to documenting the supply-side incentives for businesses. Some of the initiatives discussed include simplifying regulatory compliance,<sup>24</sup> improving the provision of business support,<sup>25</sup> and reversing VAT charges or introducing indirect and direct tax incentives.<sup>26</sup> The ultimate goal of introducing these initiatives is to make it easier for businesses to operate in the declared economy and to reward them for doing so.

Following the examination of introducing incentives for businesses, Chapter Eight investigates a plethora of incentives available to increase an individual's participation in the declared economy compared to the shadow economy. In-depth, the chapter discusses simplifying compliance in terms of pre-filling tax returns and universal self-assessment — the benefit of which is to raise awareness of the existing regulations whilst also reducing any excess regulations, thereby effectively eliminating intentional and unintentional non-compliance.<sup>27</sup> Moreover, the introduction of new categories of declared jobs (such as mini-jobs which are tax-free if less than €400), tax liability amnesties, and the creation of direct tax and social security incentives which prevent the need to seek alternate employment if an individual is suddenly without a job, are discussed.

Chapter Nine continues the discussion concerning the introduction of various incentives. However, this is conducted from the position of those demanding shadow economic goods and services, namely consumers. The primary focus of this chapter is to encourage consumers to purchase from the declared economy. Implementing

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24 Ibid 121–5.

25 Ibid 131–8.

26 Ibid 125–9.

27 Ibid 140.

targeted direct tax measures, such as tax deductions, and waged cost subsidies are explored, with the concept of potentially reducing tax rates altogether being dismissed.<sup>28</sup> Despite this, there is evidence to suggest that reducing VAT on specific goods and services can be effectual where the shadow economy is prevalent.<sup>29</sup>

In canvassing the incentives available to be introduced, the author notes that there has been limited research conducted on the evaluation of these methods.<sup>30</sup> In turn, this has resulted in the incapability to accurately determine the effectiveness of each incentive in confronting the shadow economy.<sup>31</sup> Furthermore, it is argued that direct controls disregard human perception and motive, which has contributed to the preferential shift of using indirect controls.<sup>32</sup>

#### *D Part IV: Indirect Controls*

Chapters Ten and Eleven explore the indirect controls available in tackling the informal economy.

The focus of Chapter Ten is on exemplifying the ‘psychological and social allegiance to compliant behaviour’.<sup>33</sup> This is largely completed by means of reducing the incongruence evident between the norms, values and beliefs of informal institutions (such as society or certain population groups) when aligned with the laws,

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28 Ibid 158.

29 Ibid 168.

30 Ibid 171.

31 Ibid.

32 Ibid 172.

33 Ibid 175.

regulations and codes of formal institutions.<sup>34</sup> The chapter explores the extent of the incongruence before examining the possibility of improving tax knowledge, organising awareness-raising campaigns and using normative appeals in order to foster congruence by improving tax morality amongst individuals. On the contrary, improving the perceived procedural justice and fairness associated with formal institutions to align their laws with the views held by wider society is also discussed.

The themes apparent within Chapter Eleven correlate with those expressed in Chapters Two and Three, and evaluate the broader economic and social policies involved in utilising indirect controls to stimulate behavioural change. To do this, the chapter considers competing theories<sup>35</sup> on the prevalence of cross-national variations in the shadow economy. On this matter, the variations are observed to stem from underdevelopment, the presence of high taxes, corruption within the public sector and varying levels of interference.<sup>36</sup> Consequently, the focus then shifts to evaluating these theories in order to determine exactly which broader economic and social conditions can assist in reducing the size of the shadow realm. In particular, it is noted that shadow economies tend to be smaller in locations where there is equality, stability and greater general protection of stakeholders by the State. To conclude, the chapter posits the following: '[t]ackling the shadow economy ... require[s] not only targeted policy measures but also the introduction of these broader economic and social policies'.<sup>37</sup>

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<sup>34</sup> Ibid.

<sup>35</sup> Such as the modernization, neo-liberal and political economy theories.

<sup>36</sup> Williams, above n 1, 200.

<sup>37</sup> Ibid 216.

Chapter Twelve summarises the book by revisiting each Part in isolation and restating the main points as they arise under each chapter respectively. The third-last paragraph of the chapter succinctly recapitulates the essence of the book:

[T]he shadow economy is recognised to be composed of multifarious forms of work and this has necessitated a shift away from an eradication approach that primarily uses deterrents and towards a facilitating formalization approach that results in a wider array of policy measures being used. These range from direct controls that make working on a declared basis easier and more beneficial to indirect controls that seek to improve the psychological contract between the state and its citizens or pursue wider economic and social developments in recognition that the shadow economy is in large part a by-product of broader economic and social conditions.<sup>38</sup>

In light of the above, the author notes that there are still numerous gaps to be filled in terms of which measures or broader economic policies work best and in what combinations for differing contexts.

#### **4 Analysis and Conclusion**

In *Confronting the Shadow Economy: Evaluating Tax Compliance and Behaviour Policies*, Williams has provided a comprehensive analysis of the shadow economy and the various policy approaches that can be implemented in order to combat this informal space. The author skilfully blends research with original ideas in a logical and well-constructed manner so that individuals with an interest — regardless of how adept in the subject matter — are able to

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<sup>38</sup> Ibid 223–4.

comprehend the significance and complexities involved with this realm.

Wherever feasible, the author has referred to a variety of resources, extracting any relevant data, to support the ideas expressed — a commendable feat considering research to date has primarily focused on ascertaining the shadow economy's size. In light of the relevance that surrounds determining an accurate representation of the undeclared economy (ultimately so that the policy approaches can be examined for effectiveness), it will be interesting to observe future developments in the methods used to discover the true extent of the 'hidden', informal economy. In particular, the findings of the Cluster for Research on the Informal Sector and Policy's research, which specifically seeks to discover the situations in which policy approaches are most effective, will be interesting to read and determine whether or not further clarification into the ideal way forward has been generated.

Conclusively, the book is a welcomed addition to the currently limited literature evident on this topic. It combines extensive contextual information into what the shadow economy is and why it needs to be confronted whilst also examining some of the reasons as to why people firstly engage in this prohibited conduct. The end result is that the book explores all facets of the shadow economy to develop sound hypotheses founded on a complete, unbiased understanding of the topic itself. Despite exploring some technical theories and ideas, the author limits his use of technical jargon and as a result, *Confronting the Shadow Economy: Evaluating Tax Compliance and Behaviour Policies* is suitable not only for scholars or policy makers, but also for anyone with a general interest in this subject.

# Case Notes



***CAVENDISH SQUARE HOLDING BV v  
MAKDESSI; PARKINGEYE LTD V BEAVIS  
[2015] 3 WLR 1373***

JESSICA BORDER\*

I INTRODUCTION

In November 2015, the Supreme Court of the United Kingdom handed down its decision in *Cavendish Square Holding BV v Makdessi; ParkingEye Ltd v Beavis*,<sup>1</sup> reinforcing the validity of the penalty doctrine in English law and defining its boundaries. The court, which consisted of Lord Neuberger PSC and Lords Mance, Clarke, Sumption, Carnwath, Toulson and Hodge JJSC, criticised the High Court of Australia's approach in *Andrews v Australia & New Zealand Banking Group Ltd* ('*Andrews*'),<sup>2</sup> leaving commentators curiously waiting for the next High Court decision on the matter.

II FACTS

*A Cavendish*

In *Cavendish Square Holding BV v Talal El Makdessi* (*Cavendish*), Makdessi agreed to sell Cavendish a controlling interest in the company he had founded. Cavendish agreed to pay up to \$174 million, in installments, with a large amount reflecting goodwill. The agreement provided that Makdessi was not to compete with his

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<sup>1</sup> [2015] 3 WLR 1373.

<sup>2</sup> (2012) 247 CLR 205.



old business for a period after the sale; and if he did, he would not be entitled to any further payments (cl 5.1) and Cavendish could buy Makdessi's remaining shares at a price which disregarded goodwill (cl 5.6).

Makdessi breached the non-competition provision, and Cavendish sought a declaration that he was not entitled to further payments. At first instance, Burton J made the declarations. On appeal, it was held that the clauses were not genuine pre-estimates of loss, but instead deterrents, and therefore both clauses were unenforceable penalties. Cavendish appealed, arguing that the clauses were not penal, and that the rule that contractual penalty clauses were unenforceable should be abolished or restricted so as not to apply to commercial transactions where the parties were of equal bargaining power and each acted on skilled legal advice.

### *B ParkingEye*

In *ParkingEye Ltd v Beavis (ParkingEye)*, Beavis parked his car in a car park managed by ParkingEye, where notices displayed at the entrance and throughout the car park stipulated that the maximum permitted stay was two hours; parking was free up to that time; and those who stayed longer than two hours would be charged £85.

Beavis drove out of the car park after the permitted stay time and was charged £85, which he did not pay. ParkingEye brought proceedings, where the judge rejected Beavis' argument that the charge was unenforceable at common law because it was a penalty. The Court of Appeal also dismissed Beavis's appeal. Beavis appealed the decision.

### III ISSUE

The issue in both appeals was whether the penalty doctrine applied to the stipulation, and, if so, whether the stipulations were penal.

### IV JUDGMENT

Each member of the court allowed the Cavendish appeal and dismissed the Beavis appeal, with the exception of Lord Toulson who would have allowed the Beavis appeal. The majority in this case consisted of Lords Neuberger and Sumption, with whom Lord Carnwath and Lord Clarke agreed.<sup>3</sup>

#### *A History*

The majority commenced their judgment with a detailed historical review of the penalties doctrine, stating '[t]he penalty rule in England is an ancient, haphazardly constructed edifice which has not weathered well ...'.<sup>4</sup> After an analysis of the rule's equitable origins, the court concluded that the equitable jurisdiction of the penalty rule is no longer relevant since the defeasible bonds to which the rule applied have no application in modern times. From the 19<sup>th</sup> century onwards, the law on penalties was developed through the common law courts.

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<sup>3</sup> The term 'majority' used loosely being the joint judgment of Lords Neuberger and Sumption with whom Lord Carnwath agreed, and Lord Clarke for the most part agreeing.

<sup>4</sup> [2015] 3 WLR 1373, 1380 [3].

## *B Principles*

The court then moved to discussing two critical questions: in what circumstances is the penalty rule engaged, and what makes a contractual provision penal?

The majority held that the penalty rule is only engaged where there has been a breach of contract, stating ‘there is a fundamental difference between a jurisdiction to review the fairness of a contractual obligation and a jurisdiction to regulate the remedy for its breach’.<sup>5</sup>

Detailed discussion of the development of the doctrine revealed that prior courts were hesitant to articulate a concrete test for what constituted a penalty, but the phrase ‘unconscionable and extravagant’ proved frequent in the judgments and formed a suitable basis for analysing a provision.

Further, the authorities asserted that whether a sum was a penalty was a matter to be decided in the individual circumstances of each case, and regard could be had to the ‘wider interests’ of a party. Courts could consider whether a ‘commercial justification’ for a potential penalty clause existed. The court stated:

[a] damages clause may properly be justified by some other consideration than the desire to recover compensation for a breach. This [depends on] whether the innocent party has a legitimate interest in performance extending beyond the

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<sup>5</sup> Lord Hodge implied a similar understanding of the law, holding that clauses which authorised the withholding of sums otherwise due to the contract-breaker, and which require the transfer of property to an innocent party, may fall within this scope: [2015] 3 WLR 1373, [222]–[228].

prospect of pecuniary compensation flowing directly from the breach in question.’<sup>6</sup>

The majority stated the test as ‘whether the impugned provision is a secondary obligation which imposes a detriment on the contract-breaker out of all proportion to any legitimate interest of the innocent party in the enforcement of the obligation’.<sup>7</sup> Lord Hodge, with whom Lord Toulson agreed, chose to state the test as ‘whether the sum or remedy stipulated as a consequence of a breach of contract is exorbitant or unconscionable when regard is had to the innocent party’s interest in the performance of the contract’.<sup>8</sup>

Following this analysis, the court briefly considered whether the penalty rule should be abolished or extended, answering both questions in the negative.<sup>9</sup> It was at this point that the majority considered *Andrews*, referring to the decision as ‘a radical departure from the previous understanding of the law’. The court held that any extension of the penalty doctrine was the responsibility of the legislature, not the judiciary.

### *C Decision*

In *Cavendish*, the majority held that neither clause was a secondary provision. Even so, *Cavendish* had a legitimate interest in the observance of the restrictive covenants which extended beyond the

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<sup>6</sup> [2015] 3 WLR 1373, 1391 [28]. These assertions were consistent with the judgment of Lord Mance.

<sup>7</sup> Lord Clarke agreeing; Lord Mance applying an alternative wording, but in substance came to the same conclusion: [2015] 3 WLR 1373, 1391 [152].

<sup>8</sup> [2015] 3 WLR 1373, 1466 [255].

<sup>9</sup> [2015] 3 WLR 1373, [162] (Lord Mance); [2015] 3 WLR 1373 [261]–[266] (Lord Hodge).

recovery of that loss; the interest being protection of the goodwill of the business based on the loyalty of Makdessi. Lord Mance came to the same conclusion, albeit applying the ‘*Dunlop* factors’,<sup>10</sup> stating neither clause was exorbitant or unconscionable when viewed in the context of the commercial dealings and arm’s length relationship.<sup>11</sup> Lord Hodge, despite stating a ‘strong argument’ existed that cl 5.1 may be a primary stipulation, held the clause was ‘neither exorbitant nor unconscionable but is commensurate with Cavendish’s legitimate interests’,<sup>12</sup> coming to a similar conclusion in relation to cl 5.6.<sup>13</sup>

In *ParkingEye*, the majority held the £85 sum was a charge for contravening the terms of the contractual licence, in this case staying longer than the permitted two hours. Therefore, the sum was a secondary obligation and the penalty rule was engaged.<sup>14</sup> Despite this, the court found *ParkingEye* had a legitimate interest in charging overstaying motorists which extended beyond the recovery of any loss.<sup>15</sup> Since *ParkingEye* met the costs of its parking scheme from charges for breach of the terms, and there was no evidence that the charge was out of all proportions to this interest, the sum could not be classified as penal.<sup>16</sup> The dissenting judgment of Lord Toulson focused on the other issue raised in the *Beavis* appeal, arguing the

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<sup>10</sup> *Dunlop Pneumatic Tyre Co Ltd v New Garage and Motor Co Ltd* [1915] AC 79.

<sup>11</sup> [2015] 3 WLR 1373, 1445 [181], 1446 [185].

<sup>12</sup> [2015] 3 WLR 1373, [278].

<sup>13</sup> [2015] 3 WLR 1373, 1471 [280]–[282]; Lord Clarke agreeing on this point at [291].

<sup>14</sup> The same conclusion was reached by Lord Hodge: [2015] 3 WLR 1373, 1472 [284].

<sup>15</sup> [2015] 3 WLR 1373, [199] (Lord Mance).

<sup>16</sup> [2015] 3 WLR 1373, [199] (Lord Mance), 1472 [287]–[288] (Lord Hodge).

test under the *Unfair Terms in Consumer Contracts Regulations* 1999 was more favourable when applied to the facts of the case, on the basis that consumers should be protected in such scenarios.<sup>17</sup>

#### V COMMENTARY

The decision of the Supreme Court of the United Kingdom is not binding on Australian courts, but it is persuasive. In the case of *Andrews*, the High Court of Australia held that a stipulation could be deemed penal even if it was not triggered by a breach of contract, stating the test as:

[a] stipulation prima facie imposes a penalty on a party (the first party) if, as a matter of substance, it is collateral (or accessory) to a primary stipulation in favour of a second party and this collateral stipulation, upon the failure of the primary stipulation, imposes upon the first party an additional detriment, the penalty, to the benefit of the second party.

The Supreme Court's decision in *Cavendish* wholly rejected this test, declaring that the High Court's reasoning was based on equitable principles which are no longer relevant in the modern day, and that the decision did not address 'major legal and commercial implications'. The majority of the Supreme Court were also of the opinion that having to search for an 'additional detriment' would require courts to review the content of the substantive obligations, many of those obligations contingent on the way the parties choose to perform the contract. Their Honours were of the opinion that this would expand the courts' supervisory jurisdiction into 'uncertain boundaries' that were previously treated as 'wholly governed by mutual agreement'.

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<sup>17</sup> [2015] 3 WLR 1373, 1476 [309].

The decision in *Andrews* significantly changed the law relating to penalties in Australia, consequently broadening the void between the English and Australian understanding of the doctrine. Under the Australian position, the inclusion of provisions that are not consequential upon breach means the scope of the doctrine is expanded, arguably protecting contract-breakers from compliance with stipulations not previously considered to fall within the doctrine. Conversely, the English position places great emphasis on the legitimate interests of the innocent party, taking a commercial stance which values parties' freedom to contract.

After the Supreme Court's uncharacteristic criticism of the *Andrews* decision, it will be interesting to hear the High Court's position on the law when the judgment is handed down in the pending *Paciocco* case.<sup>18</sup>

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<sup>18</sup> The appeal of the decision in *Paciocco v Australia and New Zealand Banking Group Ltd* (2015) 236 FCR 199.

# ***D'ARCY V MYRIAD GENETICS INC (2015) 89 ALJR 924***

JESSICA BORDER\*

## I INTRODUCTION

*D'Arcy v Myriad Genetics Inc*<sup>1</sup> was a case which considered the meaning of the term 'manner of manufacture' in the context of a product claim for a gene patent. The High Court unanimously held that an isolated nucleic acid involving certain mutations or polymorphisms in the human BRCA1 polypeptide was not subject matter which fell within the meaning of a 'manner of manufacture' under s 18(1)(a) of the *Patents Act 1990* (Cth). It has been said the decision 'reversed years of accepted practice with regards to the patentability of genes in Australia'.<sup>2</sup>

## II FACTS

The respondent, Myriad Genetics Inc. (Myriad) was granted a patent over 30 claims, three of which were for a nucleic acid coding for a BRAC1 protein which had been isolated from its environment. The BRAC1 protein is one which expresses itself in the cells of breast tissue, and can bear variations referred to as mutations. Where a mutation exists in the protein, a susceptibility to breast and ovarian cancers arises.

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<sup>1</sup> (2015) 89 ALJR 924.

<sup>2</sup> Lucas McCallum 'Myriad voices against Gene Patents in the High Court' (2015) 23 *Journal of Law and Medicine* 322, 325.



D'Arcy commenced proceedings in the Federal Court, seeking revocation of the three claims on the basis that the subject matter of the claims did not constitute a 'manner of manufacture' and therefore were not patentable inventions.<sup>3</sup> The primary judge dismissed the application, holding that the claims satisfied the requirement of a new manner of manufacture and were valid.<sup>4</sup> The Full Federal Court upheld the decision of the trial judge, holding the claimed isolated nucleic acid was not the same as the 'naturally occurring product' because it 'could only be transcribed or translated by artificial intervention'.<sup>5</sup>

### III ISSUE

The issue was whether the claims to isolated nucleic acids constituted subject matter which satisfied the requirement of being a 'manner of manufacture' for the purposes of s 18(1)(a) of the *Patents Act 1900* (Cth).

### IV JUDGMENT

Despite a unanimous decision to allow the appeal and reverse the decision of the lower courts, three separate judgments were delivered.

*A French CJ, Kiefel, Bell and Keane JJ*

Their Honours held the isolated nucleic acids did not satisfy the manner of manufacture requirement because the essential integer of

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<sup>3</sup> *Patents Act 1900* (Cth) s 138(3)(b).

<sup>4</sup> *Cancer Voices Australia v Myriad Genetics Inc* [2013] FCA 65 (15 February 2013).

<sup>5</sup> *D'Arcy v Myriad Genetics Inc* (2014) 224 FCR 479, 517 [211].

the claims, the genetic information, was not ‘artificially created’ or ‘made’.<sup>6</sup>

Their Honours began by reviewing the statutory framework, identifying the question to be asked when determining whether an invention is a ‘manner of manufacture’ to be ‘[i]s this a proper subject of letters patent according to the principles which have been developed for the application of s 6 of the Statute of Monopolies?’<sup>7</sup> The court in *NRDC* established that a manner of manufacture relates to an ‘artificially created state of affairs of economic significance’, but the majority emphasised that these criteria were not to be applied as an exhaustive formula to product claims.<sup>8</sup> What constitutes a manner of manufacture needs to be analysed ‘case-by-case’,<sup>9</sup> having regard to factors including the creation of monopolies which hinder innovation, the coherence of the law relating to inherent patentability, and whether according patentability to a certain class of invention is best left to the legislature.<sup>10</sup>

Following an in-depth explanation of the scientific background concerning the claims,<sup>11</sup> the majority came to the conclusion that the claim was to molecules in the isolated nucleic acids which were arranged in the same sequence as the ‘DNA from which they were derived’.<sup>12</sup>

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<sup>6</sup> (2015) 89 ALJR 924, 929 [6]; 948 [91].

<sup>7</sup> *National Research Development Corporation v Commissioner of Patents* (1959) 102 CLR 252, 270 (‘*NRDC*’).

<sup>8</sup> The claim in *NRDC* was to a process.

<sup>9</sup> (2015) 89 ALJR 924, 934 [23].

<sup>10</sup> *Ibid*, 936 [28].

<sup>11</sup> *Ibid* [39]–[73].

<sup>12</sup> *Ibid*, 944 [73].

The majority held that the Full Court's 'identification of the subject matter of the claims as a class of chemical compounds' elevated 'form over substance', and that the nucleic sequence was instead 'information'.<sup>13</sup> Since the claims related to the 'information' in the isolated nucleic acid, as oppose to the 'chemical, structural or functional differences' between an isolated and naturally occurring nucleic acid, the claimed invention could not be said to have been 'made'.

The court identified the implications of making genetic information patentable, stating that the patent could be unknowingly infringed, a point which was elaborated on in the judgment of Gordon J. Further, the fact that the class of isolated nucleic acids were 'very large' and 'unquantified' increased the possibility of restricting 'legitimate innovative activity outside the formal boundaries of the monopoly' and creating a monopoly which '[impedes] the activities of legitimate improvers and inventors'.

### *B Gageler and Nettle JJ*

In their joint judgment, Gageler and Nettle JJ held that since the claim was, in substance, to a naturally occurring phenomenon, it lacked the threshold element of inventiveness and therefore was not patentable.

Their Honour's judgment began by identifying that the patent claim was to a monopoly over the right to 'manufacture' the 'product' which results from the isolated nucleic acid, as the actual process of method of manufacture for doing so is long-established. The judgment then briefly considered what constitutes patentable subject matter, also highlighting that the *NRDC* factors are not 'the only

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<sup>13</sup> Ibid, 947 [89].

considerations relevant to whether an invention is a “manner of manufacture””.<sup>14</sup>

Their Honours held that the threshold test of inventiveness needed to be satisfied, emphasising the point that for an invention to amount to a manner of manufacture it must be something more than a mere discovery.<sup>15</sup> Their Honours went on to state ‘[t]he question ... is whether the subject matter of the claim is sufficiently artificial, or in other words different from nature, to be regarded as patentable’.<sup>16</sup> The argument of the Full Federal Court, that ‘there is no statutory or jurisprudential limitation of patentability to exclude “products of nature”’, was rejected by their Honours, who stated a limit exists in the sense that products of nature do not involve human intervention and therefore lack inventiveness.

On this basis, the BRCA1 gene was not patentable because ‘it [was] a naturally occurring phenomenon which [lacked] the quality of inventiveness necessary to qualify as a manner of new manufacture’. Their Honours also criticised the decisions of the lower courts, emphasising that satisfying the *NRDC* criteria was not enough to found a claim for a monopoly over a product.<sup>17</sup>

### *C Gordon J*

Gordon J characterised the claims as claims to a ‘product’, being ‘an isolated nucleic acid which has one or more specific mutations or polymorphisms in the BRCA1 gene’. Her Honour held that the

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<sup>14</sup> Ibid, 953 [125].

<sup>15</sup> ‘[W]hether a product amounts to an invention depends on the extent to which the product “individualise[s]” nature’: *ibid*, 953 [126].

<sup>16</sup> Ibid, 953 [127].

<sup>17</sup> Ibid, 961 [167].

claims were not to patentable subject matter for a number of reasons.

After a discussing the scientific background, her Honour turned to whether the claimed subject matter was a manner of manufacture, stating ‘it is necessary to look at the subject matter of each claim separately and independently from other claims ... [i]t is approached on a case-by-case basis’.<sup>18</sup> Her Honour took the view that whether the claim was a manner of manufacture would depend on the identification of the subject matter of the claims.<sup>19</sup>

Gordon J identified the subject matter of the claim as ‘the combination of isolated nucleic acid and the existence of one or more of the mutations or polymorphisms’.<sup>20</sup> Her Honour was of the opinion that the claim could not be to a patentable product for five reasons: the claim was to multiple products, not a single product;<sup>21</sup> although Myriad claimed a class of chemical compounds as a product, it could not delineate the bounds of its claim by reference to chemical composition;<sup>22</sup> Myriad did not create, make or alter the characteristic, the code;<sup>23</sup> there was no idea, concept or principle embodied in a manner of new manufacture;<sup>24</sup> and the claim was too broad.<sup>25</sup>

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<sup>18</sup> Ibid, 967 [221].

<sup>19</sup> Ibid, 968 [226].

<sup>20</sup> Ibid, 968 [229].

<sup>21</sup> Due to the fact that every person’s DNA is different: *ibid*, [231]–[239].

<sup>22</sup> Ibid [240]–[243].

<sup>23</sup> Ibid [244]–[249].

<sup>24</sup> Ibid [250]–[258].

<sup>25</sup> Ibid [259]–[264].

In relation to the claim being too broad, Her Honour stated ‘if claim 1 is valid, it will in practice prevent isolation and testing of the BRCA1 gene even if a researcher or medical practitioner is diagnostically testing for a purpose unrelated to detection of predisposition to one of the identified cancers’,<sup>26</sup> and concluded that this would extend the concept of patentable subject matter too far and grant too large a monopoly.

Her Honour also commented on the decision of the Full Court, stating that their rigid application of the ‘artificially created state of affairs with an economically useful result’ criteria was incorrect. The ‘more fundamental questions’ relate to the subject matter of the claim, whether the claim constitutes an invention, and the supporting evidence that justify a conclusion that the claim contains and invention.<sup>27</sup>

#### V COMMENTARY

The High Court’s decision in the case is important as it clarifies the meaning of what constitutes a ‘manner of manufacture’ with regard to a product claim. Even though three separate judgments were delivered, a key message was articulated in each: the *NRDC* principles are not to be restrictively applied to patent claims for products, and broader policy considerations are to be taken into account when deciding whether an invention is patentable.

Aside from factors such as coherence in the law and consistency with the law of other jurisdictions, the consideration of the possible creation of monopolies which extend too far is paramount. As was articulated in each judgment, to grant a monopoly over subject

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<sup>26</sup> Ibid, 971 [260].

<sup>27</sup> Ibid, 973 [278].

matter which hinders innovation would be contrary to public policy. If Myriad, or any other claimant, were granted a patent over the BRAC1 gene, the obstacles faced by women who are at risk of the breast or ovarian cancer would increase, as only the patent holder would be able to provide testing and diagnostic procedures. A decision which subjects the public to reduced health care options in favour of a company's desire to monopolise and create profit would undoubtedly spark outrage within the Australian community.

Despite this, one of the key aims of the patent regime is to incentivise investment in creative effort and the dissemination of information. Arguably, striking down patent claims such as the three in *D'Arcy* does the opposite of incentivising creative effort and dissemination, instead deterring potential research into the field. If companies do not expect a return on their research efforts, the incentive to create and to disseminate is lost.

Even so, the court's decision to leave such matters in the hands of the legislature is one which protects them from accusations of judicial activism, and upholds the separation of powers doctrine. Rejection of the patent claim in this instance does not bar all future claims with similar subject matter from being successful, but instead articulates that policy is a paramount consideration in the assessment of patent claims. After the comments in *D'Arcy*, it is likely courts are eagerly awaiting clarification from the legislature to guide future judgments with similar claims.

# ***THE QUEEN v BECKETT [2015] HCA 38***

WHITNEY CORFIELD<sup>\*</sup>

## I INTRODUCTION

*The Queen v Beckett* is an important decision that clarified the law with respect to perverting the course of justice under s 319 of the *Crimes Act 1900* (NSW). In overturning the decision of the Supreme Court of New South Wales,<sup>1</sup> the High Court of Australia established that an intention to prevent the course of justice can be committed even in circumstances where no curial proceedings have commenced. Additionally, the Court helpfully elucidates the elements which the prosecution is required to satisfy beyond reasonable doubt under s 319, preventing further confusion as to the scope of the offence.

This case was decided by Chief Justice French and Justices Kiefel, Bell, Keane and Nettle in the High Court on 23 October 2015.

## II FACTS

The respondent, Barbara Beckett, is a solicitor who was approved by the Chief Commissioner of State Revenue to electronically lodge a range of duties transactions and tax payments in accordance with the *Tax Administration Act 1996* (NSW) ('*TA Act*'). Beckett was authorised to stamp transfers of real property using accountable

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<sup>1</sup> *Beckett v The Queen* (2014) 315 ALR 295.



stamps on the condition that the duty payable was available to her prior to processing the transactions electronically.

On 11 June 2010, the respondent completed an online assessment of duty payable for the transfer of a residential unit. However, she failed to lodge the payment to the Office of State Revenue ('OSR') on or before 17 June 2010. As a result, the respondent received a letter from the OSR advising that an audit of her practice would be conducted into the outstanding duty. She was further advised that prosecution action could be considered if contraventions of the *TA Act* or the *Duties Act 1997* (NSW) were detected. Consequently, the respondent was compelled to attend an interview,<sup>2</sup> and provide her conveyancing files for the unit transfer to OSR officers.

The appellant alleged that the photocopies of the two bank cheques produced during the interview were forged and that the respondent had intentionally made false statements in order to prevent her possible prosecution for offences under taxation law.<sup>3</sup>

The respondent was arraigned for trial on indictment in the New South Wales District Court on a charge under s 319.

Section 319 in pt 7 of the *Crimes Act 1900* ('the Act') provides:

A person who does any act, or makes any omission, intending in any way to pervert the course of justice, is liable to imprisonment for 14 years.

The District Court dismissed the respondent's motions to have the indictment set aside. Sweeney DCJ held that Beckett could be prosecuted under s 319 despite the fact that there were no existing

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<sup>2</sup> *The Tax Administration Act 1996* (NSW) s 72(1).

<sup>3</sup> *The Queen v Beckett* [2015] HCA 38, [21].

judicial proceedings in existence when the respondent had allegedly perverted the course of justice.

On appeal,<sup>4</sup> the Court of Criminal Appeal of the Supreme Court overturned Sweeney DCJ's decision and held that as there was no course of justice in existence at the time, the respondent could not be prosecuted under s 319. Furthermore, the Court stated that Sweeney DCJ had erred in finding that at the time of the OSR interview there was a "course of justice" in existence.<sup>5</sup> Consequently, prosecution for s 319 was permanently stayed.

### III ISSUE 1: CONTEMPLATED OR EXISTING PROCEEDINGS?

The Director of Public Prosecutions ('DPP') appealed to the High Court contending that impugned conduct done before the jurisdiction of a court is invoked, may constitute an offence under s 319 where the accused contemplates the possibility of proceedings and acts to intentionally pervert the course of justice. Therefore, the legal issue to be determined by the Court was whether s 319 is confined to acts with the intention of perverting an existing course of justice.

#### *A Reasoning*

The respondent relied upon the 'universal principle' enunciated in *R v Murphy*, which purportedly required that a course of justice 'have been embarked upon' before the accused could be liable for an offence under s 319. However, the Court rejected this argument stating that *R v Murphy* had not intended to announce a 'universal principle' relating to the scope of liability for perverting or

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<sup>4</sup> *Beckett v The Queen* (2014) 315 ALR 295.

<sup>5</sup> *Ibid*, 319 [205] per Beazley P.

attempting to pervert the course of justice.<sup>6</sup> Contrary to the respondent's argument, the Court explained that *Murphy* stated the offence of perverting the course of justice could be committed at a time when no curial proceedings had been instituted.<sup>7</sup>

The Court ultimately held that s 319 does not confine the liability to conduct with an intention to pervert existing proceedings. The accused may be liable for an offence under s 319 if he or she does an act or makes an omission with the intention to pervert the course of justice in any way.<sup>8</sup>

Section 312 indicates that any reference to 'perverting the course of justice' within pt 7 of the *Crimes Act* includes:

... obstructing, preventing, perverting or defeating the course of justice or the administration of the law.<sup>9</sup>

As the phrase 'perverting the course of justice' includes 'preventing ... the course of justice', the Court highlighted that it was evidence of Parliament's intention to extend the liability to acts done with the requisite intention in relation to contemplated proceedings. Therefore, the provision is dependent upon an intention to pervert, and not upon the accused's actual success in perverting the course of justice.<sup>10</sup>

Part 7 of the Act had abolished the two substantive common law offences of perverting the course of justice and attempting or conspiring to pervert the course of justice and were enacted as a single offence under s 319. However, the Court reasoned there was

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<sup>6</sup> *The Queen v Beckett* [2015] HCA 38, [34].

<sup>7</sup> *Ibid.*

<sup>8</sup> *Ibid* [36].

<sup>9</sup> *Crimes Act 1900* (NSW) s 312 (emphasis added).

<sup>10</sup> *The Queen v Beckett* [2015] HCA 38, [36].

nothing in the language of s 319 that indicated liability should be confined to acts done with the intention to pervert existing proceedings.<sup>11</sup>

#### IV ISSUE 2: IS TENDENCY A REQUIREMENT?

The second issue raised by the appellants was whether s 319 offences required proof that the accused's act or omission possessed the tendency to pervert the course of justice. If proof of tendency was required, the appellants further questioned whether the nature of tendency should be determined by the objective quality of the act or whether there was a tendency to fulfil the proscribed intention.

##### *A Majority's Reasoning*

In relying upon *Meissner v The Queen*,<sup>12</sup> it is clear there must be proof of the 'objective tendency of the accused's conduct to pervert the course of justice'.<sup>13</sup>

The Court clarified that it is irrelevant whether or not the impugned conduct is successful with respect to criminal liability under s 319,<sup>14</sup> as the offence hinges on the intention to pervert the course of justice. An accused's tendency to pervert the course of justice helps infer whether the accused possessed the requisite intention to obstruct contemplated curial proceedings. In this instance, the respondent had made false statements and forged bank cheques with a view of preventing foreseeable prosecution by misleading the OSR officers.

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<sup>11</sup> Ibid [37].

<sup>12</sup> *Meissner v The Queen* (1995) 184 CLR 132.

<sup>13</sup> Ibid, 142–3 per Brennan, Toohey and McHugh JJ.

<sup>14</sup> Ibid.

This illustrates that she possessed the requisite objective tendency to pervert the course of justice.

Consequently, the majority established that proof of an offence under s 319 required proof beyond reasonable doubt that:

- A. The accused did the act, or made the omission; and that
- B. At the time ... it was the accused's intention in any way to obstruct, prevent, pervert, or defeat the course of justice.<sup>15</sup>

### *B Minority Reasoning*

Whilst Nettle J substantially agreed with the majority and allowed the appeal, his Honour dissented with respect to the elements of a s 319 offence. Nettle J proposed, in addition to the two elements outlined by the majority, that trial judges should instruct the jury to consider whether 'the act or omission had a tendency to pervert the course of justice'.<sup>16</sup>

His Honour considered *R v Charles*,<sup>17</sup> where the Court interpreted s 319 and determined that:

it was necessary for the Crown to establish that the conduct ... was doing an act which had a tendency, and was intended, to pervert the administration of public justice ...<sup>18</sup>

Therefore, Nettle J suggested that the Court should not depart from the principle expounded in *R v Charles* until the bench has heard a

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<sup>15</sup> *The Queen v Beckett* [2015] HCA 38, [46].

<sup>16</sup> *Ibid* [49].

<sup>17</sup> (Unreported, New South Wales Court of Criminal Appeal, 23 March 1998).

<sup>18</sup> *R v Charles* (Unreported, New South Wales Court of Criminal Appeal, Gleeson CJ, 23 March 1998) 5.

‘full and convincing argument on the point in a case in which the issue truly arises’.<sup>19</sup>

## V CONCLUSION

The High Court quashed the Criminal Court of Appeal’s order to permanently stay the prosecution for the s 319 offence, enabling the prosecution against Beckett to continue. This is a significant decision because it clarifies that an offence under s 319 is not confined to perverting the course of justice in existing proceedings. The Court broadened the scope of liability by extending the offence to impugned conduct committed prior to curial proceedings if the accused contemplates the possibility of prosecution. Given the penalty for perverting the course of justice is 14 years imprisonment, a broader scope should further act as a deterrent to those who intend to deflect or obstruct the course of justice. It is clear that an interference with the administration of the law will be severely punished in order to protect the integrity of the criminal justice system.

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<sup>19</sup> *The Queen v Beckett* [2015] HCA 38, [64].

# ***R v JOGEE [2016] UKSC 8 AND RUDDOCK V THE QUEEN (JAMAICA) [2016] UKPC 7***

WHITNEY CORFIELD<sup>\*</sup>

## I INTRODUCTION

The case of *R v Jogee and Ruddock v The Queen* is a landmark judgment which concerns the law of complicity and secondary liability for criminal offences. Both cases were appeals against murder convictions based upon the principle ‘parasitic accessory liability’<sup>1</sup> derived from *Chan Wing-Siu v The Queen*.<sup>2</sup> In a joint judgment the UK Supreme Court and the Privy Council clarified the common law position with respect to criminal joint enterprise in murder trials, determining that *Chan Wing-Siu* took a ‘wrong turn’ 30 years ago.<sup>3</sup> *Jogee and Ruddock* is a fundamental decision to the law of secondary liability as it reverses the contentious doctrine and restores the common law to its position prior to *Chan Wing-Siu*.

The judgment was handed down by Lord Neuberger, Lady Hale and Lords Hughes, Toulson and Thomas on 18 February 2016.

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<sup>1</sup> Professor Sir John Smith, ‘Criminal Liability of Accessories: Law and Law Reform’ [1997] 113 *Law Quarterly Review* 453.

<sup>2</sup> [1985] AC 168.

<sup>3</sup> *R v Jogee* [2016] UKSC 8 and *Ruddock v The Queen* (Jamaica) [2016] UKPC 7, [87].

## I FACTS

### *A R v Jogee*

The appellant, Jogee, and his co-defendant, Hirsi, were convicted of the murder of Paul Fyfe at Nottingham Crown Court on 28 March 2012. On the evening of 9 June 2011, Jogee and Hirsi had been drinking excessively and taking drugs, becoming increasingly aggressive as a result. The pair arrived at the home of a woman, Naomi Reid, shortly before midnight. Reid told the pair she was expecting Fyfe to return, to which they replied they were not scared of him and would sort him out. The pair returned three times that night. On the last occasion, Hirsi entered Reid's house, and an angry exchange between him and Fyfe ensued. Jogee had remained outside, grasping a bottle and shouting encouragement at Hirsi to do something to Fyfe. At one point, the appellant came to the doorway and threatened to smash the bottle over Fyfe's head. Hirsi then stabbed Fyfe with a kitchen knife obtained from Reid's home.

### *B Ruddock v The Queen*

The appellant, Ruddock, and his co-defendant, Hudson, were convicted of the murder of Peter Robinson in the Circuit Court at Montego Bay, Jamaica. The prosecution's case was that the murder had been committed during the course of robbing Robinson of his car. The victim's body was found on a beach, with his throat cut and his hands and feet bound. In a statement to police, Ruddock admitted that he had been actively involved in committing the robbery, however, he did not cut the deceased's throat and claimed no part in the murder.



## II LEGAL ISSUE

In both cases, the appellants were convicted of murder after directions were made to the jury based upon the principle derived from *Chan Wing-Siu*. The appellants contended that the principle was based on a misunderstanding of earlier authorities.<sup>4</sup>

Therefore, the Court was required to review the common law in order to determine whether *Chan Wing-Siu* ‘took a wrong turn’ in merely requiring foresight as a mental element in order to be criminally liable as an accessory.

## III HISTORY

### *A Common Law Position Prior to Chan Wing-Siu*

The Supreme Court and the Privy Council dedicated the majority of the judgment examining the development of the common law prior to *Chan Wing-Siu*.<sup>5</sup> The fundamental starting point of the criminal law relating to secondary responsibility was that any person who participated in a serious criminal offence would be ‘liable to be tried, indicted and punished as a principal offender’.<sup>6</sup>

The Court elucidated that accessorial liability required proof of the secondary party’s intention to encourage or assist the principal in committing the offence. Regardless of whether assistance was provided to commit a specific offence, or commit one of a range of

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<sup>4</sup> *R v Jogee* [2016] UKSC 8 and *Ruddock v The Queen* (Jamaica) [2016] UKPC 7, [3].

<sup>5</sup> *Ibid* [4]–[35].

<sup>6</sup> *Accessories and Abettors Act 1861*, 24 & 25 Vic, s 8.

possible offences, the secondary party would be guilty if he or she possessed the requisite mental element of intention.<sup>7</sup>

Within the context of using violence in furtherance of a criminal venture, the Court clarified principles applicable to all cases, which will briefly be stated below:

- It is necessary to identify the common purpose between the two parties. If there is a shared intention to commit crime B if the occasion arose, then the secondary party will be criminally liable as an accessory. However, if the common purpose was merely to commit crime A, then the secondary party will not be guilty.<sup>8</sup>
- In some cases, whilst there might be a common purpose to use violence to avoid being apprehended, not all participants will intend to inflict serious harm or cause death.<sup>9</sup> If the secondary party does not intend to kill or cause grievous bodily harm, but the victim dies, the secondary party should be convicted of manslaughter instead.<sup>10</sup>
- If the principal goes completely beyond what was tacitly agreed as part of their common purpose, the secondary party should not be held criminally liable for the consequences.<sup>11</sup>

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<sup>7</sup> *R v Jogee* [2016] UKSC 8 and *Ruddock v The Queen* (Jamaica) [2016] UKPC 7, [8]–[12], [14]–[16].

<sup>8</sup> *R v Collison* (1831) 4 Car & P 565; *R v Spraggett* [1960] Crim LR 840.

<sup>9</sup> *R v Smith (Wesley)* [1964] 1 WLR 1200; *R v Reid* (1976) 62 Cr App R 109.

<sup>10</sup> *R v Smith (Wesley)* [1964] 1 WLR 1200, 1205–6.

<sup>11</sup> *R v Anderson and R v Morris* [1966] 2 QB 110.

*B Chan Wing-Siu*

In this case, three appellants were each convicted of murder and wounding with intent to cause grievous bodily harm. Each member of the group possessed knives and had planned to go to the victim's flat with the intention of committing a robbery because the victim had owed money to one of them. The victim was stabbed to death, and his wife was slashed across the head.

The Privy Council upheld their convictions, as it could be inferred from the circumstances that the appellants contemplated the possibility that the victim would resist, and because their common purpose involved the use of knives to cause serious harm if the occasion arose.

Sir Robin Cooke, delivering the judgment of the Board, expounded a wider principle of accessory liability:

that if two people set out to commit an offence (crime A), and in the course of it one of them (D1) commits another offence (crime B), the second person (D2) is guilty as an accessory to crime B if he foresaw it as a possibility, but did not necessarily intend it.<sup>12</sup>

In *Chan Wing-Siu* it was unsurprising the appeal was dismissed. However, the application of this doctrine in other cases unfairly makes those who contemplate crime B eventuating, but have no intention for it to occur would be as liable as the principal. *Chan Wing-Siu* was later affirmed by the House of Lords in *R v Powell and R v English*<sup>13</sup> and has remained the authority on parasitic accessory liability for the past 30 years.

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<sup>12</sup> *Chan Wing-Siu v The Queen* [1985] AC 168, [175].

<sup>13</sup> [1999] 1 AC 1.

## IV DECISION

The Court unanimously held that the appeals should be allowed, and their convictions of murder set aside. Following a comprehensive analysis of the past 150 years of common law, it was clear that *Chan Wing-Siu* had established a brand new principle inconsistent with the major authorities relating to secondary liability.<sup>14</sup>

## V REASONING

The conclusion of this Court is that the Privy Council had incorrectly interpreted earlier authorities, which consequently lead to the contentious new principle. The Court observed that the error was to equate foresight and authorisation,<sup>15</sup> highlighting that the two terms are not at all synonymous. It is clear, however, that foresight is powerful evidence of an intention to assist or encourage the commission of an offence, but it is not to be construed as a conclusive authorisation of it.<sup>16</sup>

There were a number of compelling reasons for reversing the decision of *Chan Wing-Siu* and *Powell and English*. First, the Privy Council failed to consider several key authorities with respect to secondary liability arising out of joint criminal ventures: *R v Collison*,<sup>17</sup> *Spraggett*,<sup>18</sup> *R v Skeet*,<sup>19</sup> and *Reid*.<sup>20</sup> So in this case, the

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<sup>14</sup> *R v Jogee* [2016] UKSC 8 and *Ruddock v The Queen* (Jamaica) [2016] UKPC 7, [62].

<sup>15</sup> *R v Jogee* [2016] UKSC 8 and *Ruddock v The Queen* (Jamaica) [2016] UKPC 7, [65].

<sup>16</sup> *Ibid* [66].

<sup>17</sup> (1831) 4 Car & P 565.

<sup>18</sup> [1960] Crim LR 840.

<sup>19</sup> (1866) 4 F & F 931.

<sup>20</sup> (1976) 62 Cr App R 109.

Court had the benefit of a thorough examination of other fundamental decisions preceding *Chan Wing-Siu*.<sup>21</sup> Second, it is a highly controversial doctrine which has created anomalies and complexities, leading to a large number of appeals.<sup>22</sup> Third, it was a serious departure from the rule that was established by a strong line of authorities. *Chan Wing-Siu* extended the liability for murder on a lesser degree of culpability, as it merely required foresight — not intention.<sup>23</sup> Additionally, it was unreasonable that the accessory had a lower mens rea threshold than the principal who actually committed crime B.<sup>24</sup>

Consequently, it was necessary for the Supreme Court to re-state the law in cases of secondary liability arising out of a prior joint criminal venture. The principle now states that for D2 to be liable for a conviction of murder, he must have intentionally provided assistance or encouragement to D1 in the commission of an offence with the requisite mens rea for murder. D2's foresight is evidence from which the jury can infer intention, however, it is not conclusive of their authorisation of crime B.<sup>25</sup>

The Court has set aside the convictions on the basis that the law had been wrongly applied, and because Jogee and Ruddock had both brought their appeals in time. However, it was observed that the effect of this correction would not render previous convictions that applied *Chan Wing-Siu* invalid. The Court has since asked for written submissions on the question whether the conviction of

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<sup>21</sup> *R v Jogee* [2016] UKSC 8 and *Ruddock v The Queen* (Jamaica) [2016] UKPC 7, [80]

<sup>22</sup> *Ibid* [81].

<sup>23</sup> *Ibid* [83].

<sup>24</sup> *Ibid* [84].

<sup>25</sup> *Ibid* [88].

murder should be quashed and order a re-trial or substitute the conviction of murder for manslaughter.

## VI CONCLUSION

*Jogee and Ruddock* is a pivotal decision in the law of complicity because it corrected the law in *Chan Wing-Siu* which had overstated the scope of liability for murder of an accessory. Whilst the High Court of Australia is no longer bound by decisions of the Supreme Court, *Jogee and Ruddock* is certainly a persuasive authority and is likely to have major ramifications in Australia. It is pertinent to note that the High Court had an opportunity to address Australia's position with respect to the law of complicity in 2006,<sup>26</sup> however, stated that any change would be a 'task for legislature and law reform commissions'.<sup>27</sup> This judgment indicated, however, that it was appropriate for the judiciary to correct the law as it was unduly widened by the courts.<sup>28</sup>

The High Court has since heard three joint appeals involving the doctrine of joint enterprise or 'parasitic accessory liability',<sup>29</sup> and it is unclear whether the Court will continue to rely on the Australian precedents, *McAuliffe v The Queen*,<sup>30</sup> which had also applied the *Chan Wing-Siu* principle. It will be interesting to see whether the Court decides to correct the wrong turning, or proceed with *McAuliffe* when the judgment is handed down later this year.

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<sup>26</sup> *Clayton v R* [2006] HCA 58.

<sup>27</sup> *Ibid*, 5 [19].

<sup>28</sup> *R v Jogee* [2016] UKSC 8 and *Ruddock v The Queen* (Jamaica) [2016] UKPC 7, [85].

<sup>29</sup> Transcript of Proceedings, *Miller v The Queen; Smith v The Queen; Presley v The Director of Public Prosecutions for the State of South Australia* [2016] HCATrans 107 (11 May 2016).

<sup>30</sup> (1995) 183 CLR 108.

***FAIR WORK OMBUDSMAN V QUEST SOUTH  
PERTH HOLDINGS PTY LTD (2015) 90 ALJR  
107***

EMMA DE GIORGIO\*

I INTRODUCTION

The ‘sham contracting’ phenomenon is one of the most well-recognised concerns in the context of Australian labour and industrial law.<sup>1</sup> This illegal activity occurs when an employer attempts to disguise an existing or prospective employee as an independent contractor, despite the fact that the relationship has the legal characteristics of an employment contract.<sup>2</sup> Employers generally use sham contracting to avoid compliance with industrial awards and legislation, and consequently employees do not receive their true legal entitlements including minimum wages, superannuation, and workers’ compensation.<sup>3</sup> In recent years, sham contracting returned to the forefront of the national political agenda due to accusations of this illegal activity against many well-known Australian employers including Australia Post<sup>4</sup> and Myer.<sup>5</sup> These

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<sup>1</sup> Helen Anderson, ‘Fraudulent Transactions Affecting Employees: Some New Perspectives on the Liability of Advisers’ (2015) 39(1) *Melbourne University Law Review* 1, 2.

<sup>2</sup> Ibid 9.

<sup>3</sup> Ibid 2.

<sup>4</sup> Madeleine Morris, ‘More Parcel Drivers Come Forward to Claim Underpayment by Australia Post Contractors’, *ABC News* (online), 3

employers allegedly used ‘triangular contracting arrangements’ to avoid contravention of the sham contracting provisions in the *Fair Work Act 2009* (Cth) (‘FW Act’). The sham contracting scheme, headed ‘sham contracting’, appears in div 6 of pt 3-1 of this Act, consisting of ss 357, 358 and 359. Section 357(1) states that:

A person (the employer) that employs, or proposes to employ, an individual must not represent to the individual that the contract of employment under which the individual is, or would be, employed by the employer is a contract for services under which the individual performs, or would perform, work as an independent contractor

This section does not apply if the employer did not know and was not reckless as to whether ‘the contract was a contract of employment rather than a contract for services’.<sup>6</sup> The case of *Fair Work Ombudsman v Quest South Perth Holdings Pty Ltd*<sup>7</sup> was the first to consider whether s 357 extends to misrepresentations made by employers to existing or prospective employees with respect to employment contracts with third parties. This case note will compare the approaches adopted by the High Court of Australia and the Full Federal Court of Australia in interpreting s 357(1).

## II FACTS

In 2009, Quest South Perth Holdings Pty Ltd (‘Quest’), the

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August 2015 <<http://www.abc.net.au/news/2015-07-30/parcel-drivers-claim-underpayment-by-australia-post-contractors/6661142>>.

<sup>5</sup> Pat McGrath, ‘Retail Giant Myer Turns Down Fair Work Ombudsman Offer to Clear Up ‘Sham Contracting’ Scandal’, *ABC News* (online), 18 November 2015 <<http://www.abc.net.au/news/2015-11-18/myer-turns-down-ombudsman-offer/6949642>>.

<sup>6</sup> *Fair Work Act 2009* (Cth) s 357(2).

<sup>7</sup> (2015) 90 ALJR 107.



respondents, operated serviced apartments in South Perth, Western Australia.<sup>8</sup> During this time, Margaret Best and Carol Roden were employed by Quest as housekeepers on a casual basis.<sup>9</sup> In mid-2009, Quest commenced discussions with Contracting Solutions, the second respondents, about converting housekeeping and reception staff to independent contractors.<sup>10</sup> Contracting Solutions is a contract labour hire business which holds a license with ODCO Contracting Systems Australia Pty Ltd, allowing it to engage workers as independent contractors and then subsequently on-hire them to work for its specific clients.<sup>11</sup> Hence, Quest would register their workers as ODCO independent contracts with Contracting Solutions, who would then on-hire the workers to work for Quest.<sup>12</sup> During correspondence, Contracting Solutions told Quest that it would not be bound by Industrial legislation or awards if it adopted its ODCO system. Quest signed the agreement in October 2009, which stated that Contracting Solutions would control the ‘administrational management of Contractors’.<sup>13</sup>

The conversion of existing staff was achieved over several meetings conducted between Quest’s manager and Contracting Solutions’ workplace relations manager, along with Quest’s housekeeping and reception staff including Best and Roden.<sup>14</sup> There was inconsistent evidence between these witnesses about the number of meetings, and what was discussed in each meeting. However, at some point during the initial meetings, numerous representations were made to

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<sup>8</sup> *Fair Work Ombudsman v Quest South Perth Holdings Pty Ltd* (2015) 228 FCR 346 [7].

<sup>9</sup> *Ibid.*

<sup>10</sup> *Ibid* [8]–[10].

<sup>11</sup> *Ibid* [13].

<sup>12</sup> *Ibid.*

<sup>13</sup> *Ibid* [18].

<sup>14</sup> *Ibid* [21].

the employees, urging them to sign up to the new contracting system and emphasising the benefits of conversion.<sup>15</sup> Specifically, employees were told that if they underwent conversion, they would continue to perform work for Quest but would do so as independent contractors of Contracting Solutions rather than employees of Quest.<sup>16</sup> It was also stressed that they would receive higher pay as independent contractors.<sup>17</sup> Employees were walked through the Independent Contractor application form, but were not told about the benefits of remaining as employees, including the receipt of overtime and penalty rates.<sup>18</sup>

After conversion to ‘independent contractors’, Best and Roden completed the same work as they did before conversion.<sup>19</sup> Both worked to the same roster system, which was completed by Quest and placed on a noticeboard at the premises.<sup>20</sup> Quest also provided instructions when housekeepers arrived for their shift from Quest’s job sheets.<sup>21</sup> Best and Roden continued to report any issue or concern about their work to Quest’s manager.<sup>22</sup> Roden continued her regular pattern of shifts, while Best maintained the exact same hours of work, while both continued using Quest’s uniform and equipment.<sup>23</sup> The only change noted was that they received pay and payslips from Contracting Solutions, and their timesheets no longer used Quest’s logo.<sup>24</sup>

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<sup>15</sup> Ibid [24].

<sup>16</sup> Ibid [30].

<sup>17</sup> Ibid [26].

<sup>18</sup> Ibid [25], [27].

<sup>19</sup> Ibid [45].

<sup>20</sup> Ibid.

<sup>21</sup> Ibid.

<sup>22</sup> Ibid.

<sup>23</sup> Ibid [45]–[46].

<sup>24</sup> Ibid [47].

## III PROCEDURAL HISTORY

In 2011, the Fair Work Ombudsman ('FWO') commenced proceedings against Quest in the Federal Court of Australia claiming, *inter alia*, a pecuniary penalty for contravention of s 357(1) of the *FW Act*. McKerracher J dismissed these proceedings on 14 June 2013. In the Full Court, North, Barker and Bromberg JJ dismissed the appeal by the FWO on 17 March 2015. On appeal by special leave to the High Court of Australia, their Honours French CJ, Kiefel, Bell, Gageler and Nettle JJ delivered a joint unanimous judgment on 2 December 2015.

## IV DECISION OF THE FULL FEDERAL COURT OF AUSTRALIA

North and Bromberg JJ considered both a 'broad' and 'narrow' construction of s 357(1). In terms of a 'broad' construction, their Honours held that an actionable representation under s 357(1) would not be confined to misrepresentations by the employer about the contract between the employer and employee. Instead, it would include misrepresentations about the character of an employment contract between the employee and a third party.<sup>25</sup> However, their Honours preferred the 'narrow' view that s 357(1) is directed to misrepresentations about the nature of extant or prospective employment between the representee (the employee or prospective employee) and the representor (the employer).<sup>26</sup> Their Honours arrived at this conclusion by examining the text of s 357(1), which proscribes a representation by the employer to an employee or prospective employee 'that *the* contract of employment is, or would be ... a contract for services'.<sup>27</sup> In their opinion, this phrase

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<sup>25</sup> Ibid [76].

<sup>26</sup> Ibid [75].

<sup>27</sup> Ibid [80].

emphasises that a misrepresentation by an employer must relate to ‘the contract’ between that extant or prospective employee and the employer.<sup>28</sup> This was also the approach upon which Barker J dismissed the appeal.<sup>29</sup> Hence, their Honours concluded that a misrepresentation about a contract between an individual and third party would not be actionable under s 357(1).<sup>30</sup>

To support this conclusion, North and Bromberg JJ also relied on the legislative history of s 357. Their Honours referred to ss 900 and 901 of the *Workplace Relations Act 1996* (Cth) (‘*WR Act*’), as s 357 of the *Fair Work Act 2009* (Cth) was intended to ‘broadly cover the effect of’ these sections.<sup>31</sup> Specifically, s 900(1) of the *WR Act* dealt with misrepresentations about extant employment agreements, while s 901(1) considered representations about proposed employment agreements. Their Honours then referred to the Explanatory Memorandum of the Workplace Relations Legislation Amendment (Independent Contractors) Bill 2006 (Cth), which stated that contravention of s 900 requires a misrepresentation of an employment relationship as an independent contracting relationship where the employer entered into a contract with an individual, and made a representation to that individual that ‘the contract’ was a contract for services, when in fact the contract was actually one of employment.<sup>32</sup>

North and Bromberg JJ also referred to the ‘purpose and policy of

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<sup>28</sup> Ibid.

<sup>29</sup> Ibid [304].

<sup>30</sup> Ibid [77], [304].

<sup>31</sup> Explanatory Memorandum, Fair Work Bill 2008 (Cth) [1447].

<sup>32</sup> Explanatory Memorandum, Workplace Relations Legislation Amendment (Independent Contractors) Bill 2006 (Cth) [4]–[5]; *Fair Work Ombudsman v Quest South Perth Holdings Pty Ltd* (2015) 228 FCR 346 [92].

the provision [s 357(1)] in the context of the legislation as a whole'.<sup>33</sup> Their Honours acknowledged that its broad purpose is the 'avoidance of sham arrangements', including triangular contracting arrangements with third parties.<sup>34</sup> However, their Honours conceded that their preferred construction would be an 'ineffective deterrent against disguised employment relationships achieved through triangular contracting where the end-user employer simply denies the existence of an employment contract with the worker without mischaracterising that contract to be a contract for services'.<sup>35</sup> It was on this basis that their Honours dismissed the FWO's appeal, as the representations made by Quest merely *denied* the existence of employment contracts, rather than misrepresent the nature of the existing employment contracts with the employees.<sup>36</sup> From this, North and Bromberg JJ anticipated claims that their construction would not fulfill the broad purpose of the section.<sup>37</sup> However, in their opinion, this was counteracted by the availability of an alternative remedy under s 359 of the *FW Act*, and the fact that their narrow construction gives effect to the text of the provision.<sup>38</sup>

Hence, the Full Court dismissed the appeal.

#### V DECISION OF THE HIGH COURT OF AUSTRALIA

In a joint and unanimous judgment, their Honours held that there was nothing in the language of s 357(1) warranting the 'narrow'

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<sup>33</sup> *Fair Work Ombudsman v Quest South Perth Holdings Pty Ltd* (2015) 228 FCR 346 [94].

<sup>34</sup> *Ibid* [96].

<sup>35</sup> *Ibid* [97].

<sup>36</sup> *Ibid* [102].

<sup>37</sup> *Ibid* [97].

<sup>38</sup> *Ibid* [97]–[99].

construction that the prohibition in the section is confined to a representation that the relevant contract is one for services *with the employer itself*.<sup>39</sup> The High Court stated that the plain language of the provision requires that the contract, which is the object of the representation, ‘is a contract for services under which the individual performs, or would perform, work as an independent contractor’.<sup>40</sup> The phrase in the provision referring to ‘the contract of employment under which the individual is, or would be, employed by the employer’ is merely the object, and not the content, of the prohibition.<sup>41</sup> Therefore, s 357(1) is actually silent as to the counterparty to the represented contract for services.<sup>42</sup>

The High Court held that adopting the narrow construction of s 357(1), as concluded by the Full Court, would result in the provision doing very little to achieve its stated purpose.<sup>43</sup> The purpose of the provision is to protect employees from being misled ‘about his or her employment status’.<sup>44</sup> Moreover, the court held that giving the provision a narrow construction would give it a ‘capricious operation’.<sup>45</sup> Their Honours provided the example that an employer would contravene s 357(1), according to the narrow construction, if it stated to an employee that ‘you are employed by me as an independent contractor’, however would avoid liability if it said to the same employee ‘you are employed by X as an independent contractor’ even if X was a fictitious third party.<sup>46</sup>

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<sup>39</sup> *Fair Work Ombudsman v Quest South Perth Holdings Pty Ltd* (2015) 90 ALJR 107 [15].

<sup>40</sup> *Ibid.*

<sup>41</sup> *Ibid.*

<sup>42</sup> *Ibid.*

<sup>43</sup> *Ibid* [16].

<sup>44</sup> *Ibid.*

<sup>45</sup> *Ibid* [17].

<sup>46</sup> *Ibid.*

The High Court also held that there was nothing in the legislative history of s 357(1) to compel the conclusion that the provision should be narrowly defined.<sup>47</sup> Their Honours referred to the explanatory memorandum of s 357(1), which stated that the provision intended to restate the effect of ss 900 and 901 of the *Workplace Relations Act 2006* (Cth) in more simplified terms.<sup>48</sup> These sections were introduced into this Act by the *Workplace Relations Legislation Amendment (Independent Contractors) Act 2006* (Cth). The court then referred to the explanatory memorandum of s 900 of this amendment Act, which stated that contravention of s 900 requires a person to ‘have entered into a contract with an individual and have made a representation to that individual that the contract was a contract for services under which the individual would perform work as an independent contractor’.<sup>49</sup> This statement does not suggest that the person would need to have made a representation that the contract was a contract for services with that person.<sup>50</sup> In addition, the High Court also examined the explanatory memorandum for the Bill of the *Independent Contractors Act 2006* (Cth) which was enacted as part of the same legislative package as the aforementioned 2006 Act. This piece of extrinsic material provided the court with strong indication that the purpose of the prohibition in s 357(1) was to prevent misrepresentation as to the nature of the contract under which an employee performed work irrespective of who might be represented to be the counterparty to

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<sup>47</sup> Ibid [18].

<sup>48</sup> Ibid.

<sup>49</sup> Ibid [19]; Explanatory Memorandum, *Workplace Relations Legislation Amendment (Independent Contractors) Bill 2006* (Cth) [5].

<sup>50</sup> *Fair Work Ombudsman v Quest South Perth Holdings Pty Ltd* (2015) 90 ALJR 107 [19].

that contract.<sup>51</sup>

In conclusion, the High Court held that Quest's misrepresentation of the employment contract with Best and Roden as a contract for services with Contracting Solutions fell 'squarely within the scope of the mischief to which the prohibition in section 357(1) was directed'.<sup>52</sup>

## VI CONCLUSION

The decision of the High Court of Australia in this case was very important, as it confirmed that employers cannot avoid the sham contracting provisions of the *FW Act* by creating 'triangular contracting arrangements' with third parties. Fair Work Commissioner Natalie James applauded the decision, stating that it will provide 'greater protection' for employees against sham contracting in situations where employers have attempted to avoid paying minimum wages and entitlements by claiming that employees are independent contractors.<sup>53</sup> The broader construction of s 357(1) appears to be more consistent with the *FW Act* overall, which seeks to ensure 'a guaranteed safety net of fair, relevant and enforceable minimum terms and conditions'.<sup>54</sup> In contrast to the decision of the Full Federal Court, the broader construction avoids a construction of the section which would deprive innocent workers in these triangular arrangements from the remedies that the *FW Act*

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<sup>51</sup> Ibid [20].

<sup>52</sup> Ibid [22].

<sup>53</sup> Cara Waters, 'High Court Finds Quest Engaged in Sham Contracting "Mischief"', *Sydney Morning Herald* (online), 3 December 2015 <<http://www.smh.com.au/small-business/managing/high-court-finds-quest-engaged-in-sham-contracting-mischief-20151202-gle1fe.html>>.

<sup>54</sup> *Fair Work Act 2009* (Cth) s 3.



confers. Hence, the High Court's judgment sent a strong message that any deliberate attempts by employers to disguise an extant or prospective employment contract as a contract for services will not be tolerated.

***JT INTERNATIONAL SA V THE  
COMMONWEALTH OF AUSTRALIA; BRITISH  
AMERICAN TOBACCO AUSTRALIA LIMITED  
v COMMONWEALTH OF AUSTRALIA (2012)  
250 CLR 1***

EMMA DE GIORGIO<sup>\*</sup>

I INTRODUCTION

In Australia, tobacco smoking is one of the most common preventable causes of disease and death,<sup>1</sup> and causes approximately 15 000 deaths each year.<sup>2</sup> Although many factors encourage tobacco use, the marketing and promotion of tobacco products is one of the most effective.<sup>3</sup> Given the increasing restrictions on tobacco advertising and marketing globally, tobacco packaging has emerged as a crucial promotional medium for manufacturers.<sup>4</sup> Ultimately, this

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<sup>1</sup> Australian Bureau of Statistics, 4364.0.55.001 — National Health Survey: First Results, 2014–15 (8 December 2015) <<http://www.abs.gov.au/ausstats/abs@.nsf/Lookup/by%20Subject/4364.0.55.001~201415~Main%20Features~Smoking~24#Anchor1>>.

<sup>2</sup> Collin N Smith, John D Kraemer, Andrew C Johnson, and Darren Mays, ‘Plain Packaging of Cigarettes: Do We Have Sufficient Evidence?’ 2015 *Risk Management and Healthcare Policy* 21, 21.

<sup>3</sup> Ibid.

<sup>4</sup> Lisa Henriksen, ‘Comprehensive Tobacco Marketing Restrictions: Promotion, Packaging, Price and Place’ (2012) 21(2) *Tobacco Control* 147, 147.

led to many jurisdictions globally to consider introducing plain packaging for tobacco products, including Australia, New Zealand, Norway, United Kingdom and India.<sup>5</sup> Advocates argue that plain packaging can help to prevent youths from commencing smoking and promote cessation among current smokers by reducing the appeal of tobacco products and increasing awareness of health warning labels.<sup>6</sup>

In 2012, Australia was the first jurisdiction globally to enact mandatory plain cigarette packaging laws. This was introduced through the *Tobacco Plain Packaging Act 2011* (Cth) ('*TPP Act*'), which operates with the *Tobacco Plain Packaging Regulations 2011* (Cth) ('*TPP Regulations*') and the *Consumer (Tobacco) Information Standard 2011* (Cth) ('*Tobacco Standards*'). The first challenge of the *TPP Act* against the Commonwealth was commenced by multinational companies JT International ('JTI') and British American Tobacco Australasia Ltd ('BAT'), which manufacture, package and sell tobacco products.<sup>7</sup> The proceedings were heard together in the High Court of Australia by French CJ, Gummow, Hayne, Heydon, Crennan, Kiefel and Bell JJ on 17, 18 and 19 April 2012. Their decision was handed down on 15 August 2012.

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<sup>5</sup> Jonathan Liberman, 'Plainly Constitutional: The Upholding of Plain Tobacco Packaging by the High Court of Australia' (2013) 39 *American Journal of Law & Medicine* 361, 363.

<sup>6</sup> Smith, Kraemer, Johnson and Mays, above n 2, 22.

<sup>7</sup> *JT International SA v Commonwealth of Australia; British American Tobacco Australasia Ltd v Commonwealth of Australia* (2012) 250 CLR 1.

## II BACKGROUND OF THE *TPP ACT*

The *TPP Act*, which was assented to on 1 December 2011, imposes ‘severe’ restrictions on the packaging and appearance of tobacco products in order to create a ‘uniform packaging regime’.<sup>8</sup> The purposes of these restrictions are to reduce the appeal of tobacco products to consumers, create greater awareness of graphic health warnings appearing on the packaging, and prevent cigarette manufacturers from misleading consumers about the harmful effects of using tobacco products.<sup>9</sup>

In terms of physical requirements, all cigarette packs and cartons must be flip-top boxes,<sup>10</sup> rectangular,<sup>11</sup> and made of rigid cardboard material.<sup>12</sup> All packaging must also comply with specified dimensions.<sup>13</sup> No embellishments may appear on the outer or inner surfaces of the packaging,<sup>14</sup> and each must have a matt finish.<sup>15</sup> The background colour for the all tobacco packaging must be ‘dark brown drab’.<sup>16</sup> In addition, 90% of the front and 75% of the back of the packaging must comprise of health warnings including graphic images, warning statements and explanatory messages.<sup>17</sup> The *TPP Act* also prohibits any trade marks or ‘marks’ from appearing anywhere on the packaging, except for a limited number

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<sup>8</sup> *Tobacco Plain Packaging Act 2011* (Cth) ch 2 pt 2.

<sup>9</sup> *Ibid* s 3(2).

<sup>10</sup> *Ibid* s 18(3)(b).

<sup>11</sup> *Ibid* s 18(2)(b).

<sup>12</sup> *Ibid* s 18(2)(a).

<sup>13</sup> *Tobacco Plain Packaging Regulations 2011* (Cth) reg 2.1.1(1).

<sup>14</sup> *Tobacco Plain Packaging Act 2011* (Cth) s 18(2)(c).

<sup>15</sup> *Ibid* s 19(2)(a).

<sup>16</sup> *Ibid* s 19(2)(b)(ii).

<sup>17</sup> *Competition and Consumer (Tobacco) Information Standard 2011* (Cth) part 9 div 4 sub-divs 1–2.

of prescribed signs including those permitted by the *TPP Regulations*.<sup>18</sup> One trade mark exempted includes the ‘Quitline’ logo and hotline number, which must appear on all tobacco packaging.<sup>19</sup> The brand, business, company or variant names for tobacco products may also appear on the packaging, but must be in the prescribed size, font, position and colour.<sup>20</sup>

### III CHALLENGE BY THE TOBACCO COMPANIES

*JTI* and *BAT* filed writs of summons in the High Court of Australia on 15 December 2011 and 1 December 2011 respectively, claiming that the *TPP Act* would effect an acquisition of their property on other than just terms.<sup>21</sup> Both parties argued that this is contrary to s 51(xxxi) of the *Constitution*, which confers power upon Parliament to make laws with respect to ‘the acquisition of property on just terms from any State or person for any purpose in respect of which the Parliament has power to make laws’.<sup>22</sup> An important provision in the *TPP Act* is s 15, which states that the Act does not apply to the extent that its operation would be constitutionally invalid by resulting in the acquisition of property otherwise than on just terms.<sup>23</sup>

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<sup>18</sup> *Tobacco Plain Packaging Act 2011* (Cth) ss 20(1), 20(3), 21(1); *Tobacco Plain Packaging Regulations 2011* (Cth) reg 2.4.1.

<sup>19</sup> *Competition and Consumer (Tobacco) Information Standard 2011* (Cth).

<sup>20</sup> *Tobacco Plain Packaging Act 2011* (Cth) ss 20(1), 20(3)(a), 21.

<sup>21</sup> *JT International SA v Commonwealth of Australia*; *British American Tobacco Australasia Ltd v Commonwealth of Australia* (2012) 250 CLR 1, 2, 4.

<sup>22</sup> *Australian Constitution* s 51(xxxi).

<sup>23</sup> *Tobacco Plain Packaging Act 2011* (Cth) s 15(1).

Both parties argued that their ‘property’ which was acquired by the *TPP Act* on other than just terms included a range of intellectual property rights and goodwill.<sup>24</sup> *JTI* claimed that the effect of the *TPP Act* was to acquire the exclusive right under the *Trade Marks Act 1995* (Cth) to sell its products under the ‘Camel’ and ‘Old Holborn’ brands, and the distinctive ‘get-up’ appearing on packaging including arrangements of words, colours, logos and markings that distinguished its products from competitors’ products. *JTI* sought a declaration that the provisions of the *TPP Act* conferring mandatory plain packaging were wholly invalid for contravening s 51(xxxi) of the *Constitution*.<sup>25</sup> On the contrary, *BAT* claimed that the effect of the *TPP Act* was to acquire its trade mark to use the ‘Winfield’ brand, copyright in artistic and literary works appearing on packaging, designs registered under the *Designs Act 2003* (Cth), two patents pursuant to the *Patents Act 1990* (Cth), and the get-up and associated goodwill and reputation from these rights.<sup>26</sup> *BAT* argued that, by reason of s 15, the *TPP Act* did not apply to its packaging.<sup>27</sup> Alternatively, it claimed that the *TPP Act* was invalid for contravening s 51(xxxi).<sup>28</sup>

The High Court was required to determine whether these intellectual property rights were ‘property’ for the purposes of s 51(xxxi), and if so, whether there was an acquisition of this property on unjust terms.

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<sup>24</sup> *JT International SA v Commonwealth of Australia; British American Tobacco Australasia Ltd v Commonwealth of Australia* (2012) 250 CLR 1, 19 [2] (French CJ).

<sup>25</sup> *Ibid* 3.

<sup>26</sup> *Ibid* 24–5 [26] (French CJ).

<sup>27</sup> *Ibid* 5.

<sup>28</sup> *Ibid*.

#### IV WERE THE PLAINTIFFS' INTELLECTUAL PROPERTY RIGHTS 'PROPERTY'?

To interpret 'property' in s 51(xxxi), the High Court endorsed the view that the term should be construed broadly.<sup>29</sup> Most of the plaintiffs' intellectual property interests were created by Commonwealth statutes, including the *Trade Marks Act 1995* (Cth), *Designs Act 2003* (Cth), *Copyright Act 1968* (Cth) and *Patents Act 1990* (Cth). The Commonwealth argued that such interests were not 'property' due to their statutory nature.<sup>30</sup> However, the fact that these rights were conferred by statute does not necessarily conclude that they fall outside the scope of s 51(xxxi).<sup>31</sup> Instead, an examination of the statutes and the nature of the property rights created is required in order to determine whether s 51(xxxi) protects these interests.<sup>32</sup>

In terms of registered trademarks, designs, patents and copyright, the *Trade Marks Act 1995* (Cth), *Designs Act 2003* (Cth), *Patents Act 1990* (Cth) and *Copyright Act 1968* (Cth) provide, respectively, that each of these intellectual property rights are 'personal property'.<sup>33</sup> Each of these Acts confer on the owner of a registered

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<sup>29</sup> *Wurridjal v Commonwealth* (2009) 237 CLR 309, 359–60; *Ibid*, 27 [29] (French CJ), 67 [169]–[170] (Hayne and Bell JJ), 95–6 [263] (Crennan J), 130 [365] (Kiefel J).

<sup>30</sup> *JT International SA v Commonwealth of Australia; British American Tobacco Australasia Ltd v Commonwealth of Australia* (2012) 250 CLR 1, 27–8 [30] (French CJ).

<sup>31</sup> *Ibid*, 48 [103] (Gummow J).

<sup>32</sup> *Ibid*, 27 [29] (French CJ), 47–8 [102] (Gummow J), 99 [277] (Crennan J).

<sup>33</sup> *Trade Marks Act 1995* (Cth) s 21(1); *Designs Act 2003* (Cth) s 10(2); *Patents Act 1990* (Cth) s 13(2); *Copyright Act 1968* (Cth) s 196; *Ibid*,

trade mark, owner of a registered design, a patentee or an owner of copyright the exclusive right to use a registered trade mark;<sup>34</sup> to sell, manufacture, import and use products incorporating the registered design;<sup>35</sup> to exploit the intervention;<sup>36</sup> and to reproduce, publish and communicate a copyrighted work to the public.<sup>37</sup> These registered owners or the patentee can also authorise others to do any of these activities,<sup>38</sup> and assign the property.<sup>39</sup> As summarised by French CJ, each of these intellectual property rights, as conferred by the relevant statutes, constitute property to which the broad

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29-30 [32]–[34] (French CJ), 43-44 [82]–[86] (Gummow J). 79 [203]–[205] (Heydon J), 96 [267] (Crennan J), 125 [347] (Kiefel J).

<sup>34</sup> *Trade Marks Act 1995* (Cth) s 20(1)(a).

<sup>35</sup> *Designs Act 2003* (Cth) s 10(1); *JT International SA v Commonwealth of Australia*; *British American Tobacco Australasia Ltd v Commonwealth of Australia* (2012) 250 CLR 1, 29–30 [32] (French CJ), 43 [85] (Gummow J), 79 [204] (Heydon J), 98 [275] (Crennan J), 125 [347] (Kiefel J).

<sup>36</sup> *Patents Act 1990* (Cth) s 13(1); *JT International SA v Commonwealth of Australia*; *British American Tobacco Australasia Ltd v Commonwealth of Australia* (2012) 250 CLR 1, 30 [33] (French CJ), 44 [86] (Gummow J), 79 [205] (Heydon J), 98 [275] (Crennan J), 125 [347] (Kiefel J).

<sup>37</sup> *Copyright Act 1968* (Cth) s 31(1)(b); *JT International SA v Commonwealth of Australia*; *British American Tobacco Australasia Ltd v Commonwealth of Australia* (2012) 250 CLR 1, 30 [34] (French CJ), 43 [83] (Gummow J), 79 [203] (Heydon J), 98 [275] (Crennan J), 125 [347] (Kiefel J).

<sup>38</sup> *Trade Marks Act 1995* (Cth) s 20(1)(b); *Designs Act 2003* s 10(1)(f); *Patents Act 1990* (Cth) s 13(2); *Copyright Act 1968* (Cth) s 196.

<sup>39</sup> *Trade Marks Act 1995* (Cth) s 196; *Designs Act 2003* (Cth) s 10(2); *Patents Act 1990* (Cth) s 13(2); *Copyright Act 1968* (Cth) ss 36–39B.



interpretation of s 51(xxxi) applies.<sup>40</sup> It follows that the ‘get-up’ used by the plaintiffs is also ‘property’ for the purposes of s 51(xxxi) as it incorporated the plaintiffs’ trademarks and copyright works.<sup>41</sup>

This case was also important as it confirmed that goodwill can constitute ‘property’ for the purposes of s 51(xxxi).<sup>42</sup> French CJ and Gummow and J approved a statement by the majority in *Federal Commissioner of Taxation v Murry*, that goodwill ‘is correctly identified as property ... because it is the legal right or privilege to conduct a business in substantially the same manner and by substantially the same means that have attracted custom to it’.<sup>43</sup>

## V WHAT IS AN ‘ACQUISITION’?

In determining whether there was an ‘acquisition’ of property through the *TPP Act* on unjust terms, the majority held that s 51(xxxi) of the *Constitution* must be ‘given the liberal construction appropriate to such constitutional provision’.<sup>44</sup> Despite this liberal approach, the majority highlighted that a distinction must be still

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<sup>40</sup> *JT International SA v Commonwealth of Australia; British American Tobacco Australasia Ltd v Commonwealth of Australia* (2012) 250 CLR 1, 30 [35] (French CJ).

<sup>41</sup> *Ibid*, 33 [40] (French CJ).

<sup>42</sup> *Ibid*, 32 [39] (French CJ), 49 [106] (Gummow J).

<sup>43</sup> (1998) 193 CLR 605, 615 [23]; *Ibid*.

<sup>44</sup> *Clunies-Ross v Commonwealth* (1984) 155 CLR 193, 201; *JT International SA v Commonwealth of Australia; British American Tobacco Australasia Ltd v Commonwealth of Australia* (2012) 250 CLR 1, 33 [41] (French CJ), 66–7 [169] (Hayne and Bell JJ), 95 [263] (Crennan J), 130 [365] (Kiefel J).

drawn between the mere ‘taking’ versus ‘acquisition’ of property.<sup>45</sup> To highlight this difference, the majority relied the statement of Mason J in *Tasmania v Commonwealth* (‘*Tasmanian Dams*’), where his Honour stated:

To bring the constitutional provision [section 51(xxxi)] into play is not enough that legislation adversely affects or terminates a pre-existing right that an owner enjoys in relation to his property; there must be an acquisition whereby the Commonwealth or another acquires an interest in property, however slight or insubstantial that may be.<sup>46</sup>

This statement was strongly approved by the majority, and was described as an ‘enduring authority’ and a ‘bedrock principle’.<sup>47</sup> From this fundamental principle, it is clear that an ‘acquisition’ involves the receipt of an interest or benefit that is *proprietary* in character.<sup>48</sup> As explained by French CJ, the mere ‘taking’ of property involves a deprivation of property seen from the owner’s perspective, while ‘acquisition’ is concerned with the receipt of something from the acquirer’s perspective.<sup>49</sup> Therefore, a law will

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<sup>45</sup> *JT International SA v Commonwealth of Australia; British American Tobacco Australasia Ltd v Commonwealth of Australia* (2012) 250 CLR 1, 33 [41]–[42] (French CJ); 47 [100] (Gummow J), 99 [278] (Crennan J), 127 [355] (Kiefel J).

<sup>46</sup> (1983) 158 CLR 1, 145.

<sup>47</sup> *JT International SA v Commonwealth of Australia; British American Tobacco Australasia Ltd v Commonwealth of Australia* (2012) 250 CLR 1, 33–4 [42] (Mason J), 53 [118] (Gummow J), 67–8 [169] (Hayne and Bell JJ), 99 [279] (Crennan J), 130–1 [365] (Kiefel J).

<sup>48</sup> *Ibid*, 34 [42] (French CJ), 99 [279] (Crennan J).

<sup>49</sup> *Ibid*, 34 [42] (French CJ); *Georgiadis v Australian and Overseas Telecommunications Corporation* (1994) 179 CLR 297 304–5.

still be valid under s 51(xxxi) even if it takes or totally extinguishes proprietary rights, so long as there is no ‘acquisition’ of property.<sup>50</sup>

However, the plaintiffs rejected Mason J’s fundamental statement in *Tasmanian Dams* and claimed that it ‘need not show the Commonwealth or another person acquires an interest that is proprietary in nature, and instead it need only show that the Commonwealth or other person has obtained some identifiable benefit of advantage *relating to* the ownership or use of property’.<sup>51</sup> To support this argument, the plaintiffs relied on Deane J’s judgement in *Tasmanian Dams*, where his Honour stated, albeit hesitantly, that the absence of any material benefit of a proprietary nature did not, in that case, avoid the conclusion that there had been an acquisition of property.<sup>52</sup> However, the majority disapproved this statement as it was a dissenting view and had not been has been ‘adopted or applied’ in any subsequent cases.<sup>53</sup> The plaintiffs also relied on the judgment of Gaudron and Deane JJ in *Mutual Pools & Staff Pty Ltd v Commonwealth*, where their Honours stated that ‘for there to be an “acquisition of property”, some identifiable benefit or advantage *relating to* the ownership or use of property’ must be

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<sup>50</sup> *JT International SA v Commonwealth of Australia; British American Tobacco Australasia Ltd v Commonwealth of Australia* (2012) 250 CLR 1, 67 [167] (Hayne and Bell JJ).

<sup>51</sup> *Ibid* 1, 8; *Tasmania v Commonwealth* (1983) 158 CLR 1, 286; *Mutual Pools & Staff Pty Ltd v Commonwealth* (1994) 179 CLR 155, 184–5.

<sup>52</sup> *JT International SA v Commonwealth of Australia; British American Tobacco Australasia Ltd v Commonwealth of Australia* (2012) 250 CLR 1, 56 [128] (Gummow J), 68 [172] (Hayne and Bell JJ), 109 [303] (Crennan J); *Tasmania v Commonwealth* (1983) 158 CLR 1, 286.

<sup>53</sup> *Ibid*, 57 [131] (Gummow J), 68–9 [172] (Hayne and Bell JJ), 109 [303] (Crennan J).

obtained.<sup>54</sup> However, the majority held that the plaintiff's argument relying on this statement was not 'soundly based' as the words 'relating to' do not suggest that something less than a proprietary interest may be acquired to amount to an 'acquisition'.<sup>55</sup>

French CJ and Gummow J found that the imposition of controls by the *TPP Act* could amount to a 'taking' or deprivation of the plaintiffs' property.<sup>56</sup> French CJ found that the relevant provisions of the *TPP Act* restrict 'the plaintiffs' enjoyment of their intellectual property rights and related rights', which may amount to a 'taking'.<sup>57</sup> However, this question remained unresolved by the majority as 'the relevant constitutional question is whether there has been an acquisition or property, not whether there has been a taking'.<sup>58</sup>

#### VI WAS THERE AN 'ACQUISITION' FOR THE PURPOSES OF S 51(XXXI)?

By a 6:1 majority, Heydon J dissenting, the High Court found in favour of the Commonwealth, and held that there was no 'acquisition' of property for the purposes of s 51(XXXI) of the *Constitution*.<sup>59</sup> Relying on Mason J's fundamental principle in *Tasmanian Dams*, the majority held that the controls imposed by the

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<sup>54</sup> (1994) 179 CLR 155, 185.

<sup>55</sup> *JT International SA v Commonwealth of Australia; British American Tobacco Australasia Ltd v Commonwealth of Australia* (2012) 250 CLR 1, 63 [151] (Gummow J), 130 [365] (Kiefel J).

<sup>56</sup> *Ibid*, 34–5 [44] (French CJ), 47 [101] (Gummow J).

<sup>57</sup> *Ibid*, 34–5 [44] (French CJ).

<sup>58</sup> *Ibid*, 66 [164] (Hayne and Bell JJ).

<sup>59</sup> *Ibid*, 34 [42] (French CJ), 53 [118] (Gummow J), 67–8 [169] (Hayne and Bell JJ), 99 [278] (Crennan J), 130–1 [365] (Kiefel J).

*TPP Act* did not give the Commonwealth or any other person an interest or benefit that was proprietary in character.<sup>60</sup>

The main argument raised by the plaintiffs was that the Commonwealth acquired the benefit of ‘control’ over tobacco packaging and removed the plaintiffs’ ability to use its intellectual property, including trade marks and designs, on tobacco packaging — which resulted an ‘acquisition’ on unjust terms.<sup>61</sup> However, this claim was rejected by the majority, including Hayne and Bell JJ who stated that the requirements of the *TPP Act* were no different to legislation requiring label warnings against the misuse of a product, or telling the consumer what to do if a product has been used incorrectly.<sup>62</sup> Further, French CJ conceded that although the *TPP Act* controls the way in which tobacco products can be marketed, imposing this control does not result in the receipt of a benefit of a proprietary character by the Commonwealth or any other person.<sup>63</sup> Similarly, Crennan J explained that legislative provisions requiring manufacturers to place warnings on product packaging are ‘commonplace’ and the fact that the plaintiffs were required by law to sell their products with more stringent packaging does not equate to any ‘diminution in or extinguishment of any property’.<sup>64</sup> This was supported by Hayne and Bell JJ, who stated that no-one other than the tobacco companies obtain any use of or control over the packaging through the *TPP Act*, as the companies still own the packaging, can sell their products using the packaging and decide what it packaging will look like.<sup>65</sup>

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<sup>60</sup> Ibid.

<sup>61</sup> Ibid, 71 [181] (Hayne and Bell JJ).

<sup>62</sup> Ibid.

<sup>63</sup> Ibid, 34–5 [44] (French CJ).

<sup>64</sup> Ibid, 71 [182] (Hayne and Bell JJ), 108 [301] (Crennan J).

<sup>65</sup> Ibid, 71 [182] (Hayne and Bell JJ).

The plaintiffs also raised a number of ‘creative’ arguments in order to try and articulate relevant ‘benefits’ which were conferred on the Commonwealth and others by the restrictions contained in the *TPP Act*.<sup>66</sup> These claims were all dismissed on the basis that the benefit derived was not of a proprietary nature. The purported benefits included:

- the Commonwealth obtaining an expected reduction in public expenditure on health care.<sup>67</sup>
- that ‘Quitline’ would obtain the benefit of enhanced goodwill and increased prominence of advertising on tobacco packaging due the restrictions on the plaintiffs’ intellectual property from appearing on this packaging.<sup>68</sup>
- the Commonwealth attaining the right to require the printing of its messages and those of others to appear on tobacco packaging, such as graphic health warnings and the ‘Quitline’ phone number, ‘without any obligation to pay’.<sup>69</sup>
- the pursuit of the legislative purposes of the TPP Act by the Commonwealth.<sup>70</sup>
- the discharge of an obligation under the Convention on Tobacco Control.<sup>71</sup>

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<sup>66</sup> Liberman, above n 5, 371.

<sup>67</sup> *JT International SA v Commonwealth of Australia; British American Tobacco Australasia Ltd v Commonwealth of Australia* (2012) 250 CLR 1, 62 [148] (Gummow J).

<sup>68</sup> *Ibid*, 8, 62 [148] (Gummow J), 110 [306] (Crennan J), 132 [370] (Kiefel J).

<sup>69</sup> *Ibid*, 108 [302] (Crennan J).

<sup>70</sup> *Ibid*, 33–4 [42] (French CJ), 62 [147] (Gummow J), 68–70 [172] – [177] (Hayne and Bell JJ), 109 [303] (Crennan J), 132 [372] (Kiefel J).

<sup>71</sup> *Ibid*, 62 [148] (Gummow J); *Tasmania v Commonwealth* (1983) 158 CLR 1, 145–6.

## VII CONCLUSION

The ruling of the High Court of Australia in this case is undoubtedly a landmark decision. As Australia was the first jurisdiction in the world to enact mandatory plain cigarette packaging laws, a constitutional challenge to these laws was unprecedented. In addition, Australia was considered as a global leader in international control, and consequently many jurisdictions globally sought to emanate Australia's plain packaging regime.<sup>72</sup> As a result, this challenge attracted worldwide attention. After the clear majority of the High Court held in favour of the Commonwealth and upheld the validity of the *TPP Act*, the decision was praised by New Zealand's associate Health Minister as a 'global victory' against tobacco manufacturers and promoters.<sup>73</sup> In the aftermath of the decision, both France and the United Kingdom have already introduced mandatory plain cigarette packaging, which came into effect in both jurisdictions in May 2016.<sup>74</sup> In addition, several other jurisdictions including New Zealand, Belgium, Norway, Ireland, Canada and Singapore are all in the process of considering, or implementing, mandatory plain cigarette packaging.<sup>75</sup>

In the context of constitutional law, this case was significant as it affirmed the principle that an acquisition for the purposes of

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<sup>72</sup> Liberman, above n 5, 362.

<sup>73</sup> Dominique Schwartz, 'NZ Says Plain Packaging Verdict a Global Victory', *ABC News* (online), 15 August 2012 <<http://www.abc.net.au/news/2012-08-15/nz-hails-plain-packaging-verdict-a-global-victory/4200600>>.

<sup>74</sup> James Gallagher, 'Cigarette Plain Packs to "Go Global"', *BBC News* (online), 31 May 2016 <<http://www.bbc.com/news/health-36396666>>.

<sup>75</sup> *Ibid.*

s 51(xxxi) of the *Constitution* requires the receipt of a benefit or advantage that is proprietary in character.<sup>76</sup>

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<sup>76</sup> *JT International SA v Commonwealth of Australia; British American Tobacco Australasia Ltd v Commonwealth of Australia* (2012) 250 CLR 1, 33–4 [42] (Mason J), 53 [118] (Gummow J), 67–8 [169] (Hayne and Bell JJ), 99 [279] (Crennan J), 130–1 [365] (Kiefel J); *Tasmania v Commonwealth* (1983) 158 CLR 1, 145.



# ***DALLAS BUYERS CLUB LLC v IINET LTD***

## ***[2015] FCA 317***

SARAH GRESHAM\*

### I INTRODUCTION

The internet has become a double-edged sword for the film industry. Whilst it drives the industry forward, it also creates difficulties that impede its progress. Since the digital revolution, one of the biggest continual threats to the movie industry is piracy and copyright infringements, which have exacerbated over the past decade.

*Dallas Buyers Club LLC v iinet Ltd*<sup>1</sup> is a landmark case for online piracy in Australia. This case set precedent for the rule of preliminary discovery that entailed the handing over of customer details to right holders. This decision has profound implications for Australian internet users, in particular those who illicitly download, as it has made it increasingly difficult to download internet content in secret. This decision has opened debate concerning the legality of downloading content without purchasing it. It can be said that this decision is the starting point for Australia's online piracy issue, with many other factors needing to be considered in Australia's continually changing digital environment.

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<sup>1</sup> [2015] FCA 317.

## II BACKGROUND

### *A Factual Background*

The complainant, Dallas Buyers Club LLC and Voltage Pictures (‘Dallas Buyers Club’), used German software known as Maverick Monitor 1.47 to trace the internet protocol (‘IP’addresses<sup>2</sup> of devices, which illegally downloaded the film, Dallas Buyers Club over the BitTorrent system.<sup>3</sup> The Maverick software identified that 4726 IP addresses had unlawfully downloaded or distributed the film via the BitTorrent network.<sup>4</sup> Dallas Buyers Club alleged that such actions indicated copyright infringements outlined under the *Copyright Act 1968* (Cth) (‘Copyright Act’).<sup>5</sup>

Dallas Buyers Club could not personally identify the infringers, however it believed that the evidence received from the Maverick Software indicated that the respondents, the Internet Service Providers, could help detect the culprits.<sup>6</sup> The respondents in this case were six Australian Internet Service Providers (‘the providers’) including iinet, Intermode, Amnet Broadband, Dodo, Adam Internet and Wideband Network.<sup>7</sup> In May 2014, the company started sending

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<sup>2</sup> Internet Protocol address is a unique numerical label that identifies each computer or device using the internet or local network.

<sup>3</sup> BitTorrent is a communications protocol of peer-to-peer file sharing. BitTorrent is efficient software to distribute large files, such as entire movies and televisions shows, by allowing users to serve as network redistribution points.

<sup>4</sup> *Dallas Buyers Club LLC* [2015] FCA 317 [1].

<sup>5</sup> *Copyright Act 1968* (Cth).

<sup>6</sup> *Dallas Buyers Club LLC* [2015] FCA 317.

<sup>7</sup> *Ibid.*

notices to the providers requesting that they provide the customer details.<sup>8</sup>

The providers refused to comply with these requests and in October 2014 Dallas Buyers Club commenced proceedings in the Federal Court seeking disclosure.<sup>9</sup> An application for preliminary discovery was brought about under r 7.22; the Federal Courts power enables a party to seek the court's assistance in identifying individuals they wish to sue.<sup>10</sup> Dallas Buyers Club aimed to exercise the courts power in order for the providers to supply them with their customers' account information in order to identify the culprits.<sup>11</sup>

### *B Preliminary Discovery Rule*

The 'Preliminary Discovery Rule' becomes relevant in situations where a party feels that another has committed an offence against them, but they have insufficient evidence to make a claim.<sup>12</sup> In situations like this, the party is able to apply for preliminary discovery pursuant to r 7.22 of *Federal Court Rules 2011* (Cth).<sup>13</sup> This application is made prior to legal proceedings, and involves a request made to the prospective defendant requiring them to present documents, in order for the applicant to determine who to impeach, or whether there is enough reason for a cause of action at all.<sup>14</sup>

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<sup>8</sup> Ibid.

<sup>9</sup> Ibid.

<sup>10</sup> *Federal Court Rules 2011* (Cth) r 7.22.

<sup>11</sup> [2015] FCA 317.

<sup>12</sup> Ibid.

<sup>13</sup> Ibid.

<sup>14</sup> Ibid.

To make an order the prospective applicant needs to prove that they:  
<sup>15</sup>

1. Reasonably believe that they have the right to obtain relief in the Court from a prospective defendant whose identity is unknown to them.<sup>16</sup>
2. Upon making reasonable enquiries, the applicant has been unable to ascertain the identity and location of the prospective defendant in order to determine whether they have a case to commence proceedings.<sup>17</sup>
3. The prospective applicant must reasonably believe that:
  - a. The prospective defendant has, or is likely to have, or has had in its possession, information that directly relates to the issue of whether the prospective applicant may have a cause of action;<sup>18</sup>
  - b. If the prospective applicant reviews the documents it will assist them in determining their cause of action.<sup>19</sup>

### III ISSUES

The Federal Court defined three major questions to answer in this case. The first was whether Dallas Buyers Club's application for preliminary discovery met the formal requirements of r 7.22. If this rule was successfully met, the court would then exercise its discretion and decide whether to order the providers to deliver the information of their customers' contact details to Dallas Buyers Club. The third major question was whether the court would impose conditions upon its mandate.

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<sup>15</sup> Ibid.

<sup>16</sup> Ibid 1(a).

<sup>17</sup> Ibid 1(b).

<sup>18</sup> Ibid (ii).

<sup>19</sup> Ibid 2(b).

## IV DECISION

Justice Perram of the Federal Court of Australia ordered the Preliminary Discovery on 6 May 2015.<sup>20</sup> This meant that the Australian providers had to hand over the account holders' names and addresses of their Australian customers who were accused of illegally downloading the film.<sup>21</sup> However, this order was subject to specific conditions; the main condition stating that any letters that were to be sent by the complainants to the contravening account holders needed to be submitted to the courts first in draft form.

## V REASONING

*A Requirements for Preliminary Discovery*

To successfully fulfil the requirements of Preliminary Discovery, the court identified that there were three main elements, which needed to be satisfied.<sup>22</sup> First, the complainant must have the right to seek relief from the respondents.<sup>23</sup> Second, the complainant must not have been able to identify the potential respondents associated with the IP addresses.<sup>24</sup> Third, the providers must know or must be likely to know the identity of the accused.<sup>25</sup>

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<sup>20</sup> *Dallas Buyers Club LLC v iiNet Ltd (No 3)* [2015] FCA 422.

<sup>21</sup> *Ibid.*

<sup>22</sup> *Ibid* [52].

<sup>23</sup> *Ibid.*

<sup>24</sup> *Ibid.*

<sup>25</sup> *Ibid.*

*Complainant must have the right to seek relief*

In relation to the first element, the respondents contested that the complainants did not have the right to seek relief on the basis that there was insubstantial proof of a copyright infringement.<sup>26</sup> This argument was based off a report submitted by Dallas Buyers Club,<sup>27</sup> which outlined the procedure of downloading files from the BitTorrent system.<sup>28</sup>

This report revealed that each IP address had only uploaded a small sized file of the film via the website.<sup>29</sup> The respondents argued that because these files, which were uploaded, were so small, they were insufficient evidence to prove that a copyright infringement occurred.<sup>30</sup> When files are uploaded to the BitTorrent, they are broken down into many different ‘pieces’ so that they can easily be distributed between users. The respondents argued that because only ‘small slivers’ of the film were distributed it did not ‘communicate the film to the public’ as required by s 86 of the *Copyright Act*.<sup>31</sup>

Perram J dismissed this argument. He referred to the definition of the term ‘communicate’ in s 10 of the *Copyright Act*, which defines it as making the film ‘available online’.<sup>32</sup> The court accepted the fact that the accused users only made small slivers of the film available online, but deemed that this proved to be ‘strong circumstantial evidence’ that those users had infringed the copyright of Dallas

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<sup>26</sup> Ibid [28].

<sup>27</sup> Ibid [25]–[32]; Expert report of Dr Simone Richter.

<sup>28</sup> Ibid [27].

<sup>29</sup> Ibid.

<sup>30</sup> Ibid.

<sup>31</sup> Ibid [28],[29]; *Copyright Act* 1968 (Cth) s 86.

<sup>32</sup> *Dallas Buyers Club v iiNet Ltd* [2015] FCA 317 [29].

Buyers Club.<sup>33</sup> He contended that in order for a case under Preliminary Discovery to be brought about, it only needs show that the case has ‘some prospect of succeeding’ and therefore this was sufficiently satisfied in that regard.<sup>34</sup>

*Potential respondents must be unidentifiable to the complainant*

The respondents argued that complainants were able to access their information. They made this assumption on the fact that the monitored chat rooms could be used as a way of collecting this information. The courts believed it was highly unlikely that this information would be disclosed in such an open environment and therefore rejected this argument.<sup>35</sup>

*It’s probable that the respondents have access to information about the accused*

In regards to the third element, the respondents argued that there was no evidence indicating they held or could acquire information, which identified the accused parties.<sup>36</sup> This was argued on the basis that there was no assurance that the account holders were the parties who were responsible for sharing the film on BitTorrent.<sup>37</sup>

The respondents believed that the wording of r 7.22 for preliminary discovery did not constitute revealing a party who may potentially know the identity of an infringing party. They argued the wording of

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<sup>33</sup> Ibid [30].

<sup>34</sup> Ibid.

<sup>35</sup> Ibid [55].

<sup>36</sup> Ibid [1].

<sup>37</sup> Ibid.

the rule only allowed for direct identification of a prospective respondent.<sup>38</sup>

The courts rejected this argument, as this factor had already been unsuccessfully raised in prior cases.<sup>39</sup> Perram J expressed that preliminary discovery should not be limited to only direct identification, but also include documents that would help identify potential respondents.<sup>40</sup> He also questioned why such a rule, which acts as a way of justice to assist individuals, should be so narrowly defined in identifying wrongdoers, and therefore satisfied this element on this basis.<sup>41</sup>

### B *The Exercise of Discretion*

Perram J dealt with eight objections of this order brought forward by the providers<sup>42</sup> after being satisfied that the court had the power to order a preliminary discovery. These objections are as follows:

The first objection centred on the issue that only a sliver of the film was shared from each IP address and therefore the respondents did not believe this was enough to constitute a copyright infringement.<sup>43</sup> As previously discussed, the court rejected this on the basis that

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<sup>38</sup> Ibid [56]; *Federal Court Rules 2011* (Cth) 7.22.

<sup>39</sup> Ibid [58]; refer to decision of *Roads Traffic Authority (NSW) v Australian National Car Parks Pty Ltd* [2007] NSWCA 114 and *Roads Traffic Authority (NSW) v Care Park Pty Ltd* [2012] NSWCA 35, Perram J stated he was still bound by the precedent of these cases.

<sup>40</sup> Ibid [49]–[72].

<sup>41</sup> Ibid [66].

<sup>42</sup> *Dallas Buyers Club v iiNet Ltd* [2015] FCA 317 [73].

<sup>43</sup> Ibid [30].



despite the fact that they were small sized files, it was still ‘strong circumstantial evidence’ that an infringement had occurred.<sup>44</sup>

The second objection centred on the respondents’ argument that it would be unlikely that any case would be brought against the infringing parties because of the low cost of buying a copy of the movie.<sup>45</sup> They considered it a ‘trivial’ matter because the value copy of each film was less than \$10 and they did not believe it was conceivable that the complainants would seek to recover such a small reimbursement.<sup>46</sup> The court rejected this by stating that the purpose of proceeding under preliminary discovery r 7.22 was to identify prospective offenders irrespective of how ‘how good those claims are’.<sup>47</sup>

The third objection was the respondents’ statement in relation to attaining an injunctive relief in order to deter this from happening again.<sup>48</sup> The respondents believed this would not be sustainable because only a small sized file of the film was uploaded and there was no evidence that could prove there would be a repetition.<sup>49</sup> The court reasoned similarly with the last problem, stating that they do not believe an action for injunctive relief would be successful, however this matter was not being considered at this time and therefore it was an irrelevant factor to the application at hand.<sup>50</sup>

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<sup>44</sup> Ibid [30]–[31].

<sup>45</sup> Ibid [73].

<sup>46</sup> Ibid.

<sup>47</sup> Ibid [76].

<sup>48</sup> Ibid [73].

<sup>49</sup> Ibid [73 (iii)]; [79].

<sup>50</sup> Ibid [79].

The fourth objection brought forward by the respondents was the fact that the complainants failed to only pursue serious offenders who had committed multiple copyright offences through downloading other films.<sup>51</sup> The court stated this was irrelevant in the current matter.<sup>52</sup>

The fifth objection brought forward was the fact that there was evidence which suggested the complainants would engage in the practice of speculative invoicing<sup>53</sup> if they were given the information they were seeking.<sup>54</sup> Perram J recognised that the complainants had been involved in speculative invoicing practices in the United States.<sup>55</sup> The court referred to such actions as being deceptive conduct under s 18 of the *Australian Consumer Law*,<sup>56</sup> and by representing the parties as having higher liability is considered unconscionable conduct under s 21 of *Australian Consumer Law*.<sup>57</sup> The court followed the analysis provided in *Golden Eye (International) Ltd v Telefonica Uk Ltd*,<sup>58</sup> where preliminary discovery against an Internet Service Provider was

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<sup>51</sup> Ibid [73 (iv)].

<sup>52</sup> Ibid [80].

<sup>53</sup> Speculative invoicing is a practice where copyright owners send letters to internet users demanding large sums of money for allegedly infringing in there copyright by downloading films without permission. The letters threaten expensive lawsuits if consumers fail to pay up, but in actual fact they will settle for much lower sums. Speculative invoices are not a court order; a person who receives the letter is under no obligation to pay.

<sup>54</sup> Ibid [73 (v)].

<sup>55</sup> Ibid [81].

<sup>56</sup> *Competition and Consumer Act 2010* (Cth) Sch 2 [18].

<sup>57</sup> *Dallas Buyers Club v iiNet Ltd* [2015] FCA 317 [82]; *Competition and Consumer Act 2010* (Cth) Sch 2[18], [21].

<sup>58</sup> [2012] EWHC 723 (Cth).

granted on the basis that the complainant submitted their letters to the court for approval prior to them being sent to infringing parties.<sup>59</sup> Perram J deemed these actions necessary in order to protect the potential respondents.<sup>60</sup>

The respondents argued that they had a duty to respect the privacy and identity of their clients.<sup>61</sup> The court stated this factor is a very relevant consideration, particularly under Federal Law in pt 13 of the *Telecommunications Act 1997* (Cth),<sup>62</sup> which is designed to protect individuals' privacy.<sup>63</sup> However, s 280 of this Act also states that disclosure by law is not prohibited.<sup>64</sup> The court therefore dismissed this argument.<sup>65</sup>

The respondents stated that the future release of a new Internet Privacy Code that would outline industry standards of dealing with providers and illegal downloading.<sup>66</sup> They argued that the court should wait whilst this code was being developed before they finalised the relief they sought, as new avenues may come in to existence on the issue.<sup>67</sup> The court dismissed this argument as the code was merely in draft form and there was no certainty it would come into existence soon.<sup>68</sup>

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<sup>59</sup> Ibid.

<sup>60</sup> *Dallas Buyers Club v iiNet Ltd* [2015] FCA 317 [83].

<sup>61</sup> Ibid [73 (vi)]

<sup>62</sup> Ibid 84; *Telecommunications Act 1997* (Cth) pt 13.

<sup>63</sup> Ibid.

<sup>64</sup> Ibid s 280.

<sup>65</sup> Ibid.

<sup>66</sup> Ibid [73 (vii)]; [88].

<sup>67</sup> Ibid [89]–[90].

<sup>68</sup> Ibid [90].

The final argument made by the respondents was that the process for preliminary discovery under r 7.22 was being used as a process of investigation rather than identification.<sup>69</sup> The court rejected this argument because the case at hand required an element of investigation to reach the final outcome of identification.<sup>70</sup>

## VI CONCLUSION

Perram J's judgement was based on well-defined and established legal principles, which has resulted in a very coherent decision. The message of this case is clear: illegal downloaders can be traced, and their personal information can be handed over to right holders and their lawyers for the purposes of preliminary discovery.

This landmark decision for online piracy in Australia represents a major cultural shift in our society's attitude towards online violations that will now allow filmmakers to reap the rewards from their work. Since the Dallas Buyers Club's verdict, legislative modifications are progressively being made in order to create more rigid laws around illegal downloading practices.<sup>71</sup>

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<sup>69</sup> Ibid [72 (viii)].

<sup>70</sup> Ibid [91].

<sup>71</sup> The Copyright Amendment (Online Infringement) Bill 2015 was introduced to Parliament in March 2015. It was introduced to try and eradicate online piracy of film and television shows. The Bill was passed in parliament with the support of Coalition and Labor's 37-13. The Bill was designed to prevent Australian's accessing overseas websites like Pirate Bay a popular BitTorrent network site. Effectively under this Bill nothing changes until a right holder has success in the Federal Court to order an ISP to block these website. The ISP will then need to take steps to filter the website so the customer no longer have access to it.

There is no easy solution to internet piracy, as there is no set of methods to eradicate online copyright infractions. With technology rapidly advancing, this issue may remain a legally grey area for decades. Although this case has not instantaneously answered filmmaker's prayers, it has at least provided a stern warning for Australian internet users. This decision does however leave room for illegal downloaders who do not use BitTorrent to continue to obtain pirated content, but the government's regulatory changes to online and monitoring systems should reduce illegal downloading practices within Australia across the board.

# ***ZABURONI v THE QUEEN [2016] HCA 12***

SARAH GRESHAM\*

## I INTRODUCTION

*Zaburoni v The Queen*<sup>1</sup> is a pivotal High Court of Australia decision relating to the application of criminal law in regards to the human immunodeficiency virus ('HIV'). This case is leading the way to a clearer understanding of how the Australian criminal law procedures should function in relation to issues of HIV transmission, in particular reducing the risk of complainants being overcharged with unnecessary offences. The legal procedures in this area of law remain undefined so this case will perhaps be the turning point for future development and clarification of prosecutorial procedures. The criminal transmission of HIV involves intentionally or recklessly infecting a person with HIV.

The High Court of Australia highlighted the significance of differentiating between reckless behaviour and behaviour involving intention to transmit the HIV disease. This case established that if a HIV positive person has sexual intercourse with someone without protection, it should not be presumed that they intended to transmit HIV to that person.

All Australian States and Territories have distinctive criminal laws relating to situations when someone can be charged for negligent transmission of HIV to another person, or for exposing another person to HIV. In some states, HIV positive people may be charged

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<sup>1</sup> [2016] HCA 12.

with offences such as grievous bodily harm for malicious behaviour, whilst some other States have exclusive offences relating to the transmission of the disease.

Criminal cases involving HIV transmission or exposure in Australia are very rare, particularly where malicious behaviour is involved, as most people living with HIV who are aware of their status take reasonable steps to prevent transmitting HIV to others. In Australia there have been less than fifty prosecutions for criminal transmissions of HIV since 1991. It is estimated that more than 30 500 people within Australian suffer from HIV.<sup>2</sup>

## II BACKGROUND

### *A Factual Background*

The appellant, Mr Godfrey Zaburoni, was found guilty of intentionally transmitting HIV to another person with intent to do so under s 317(b) of the *Criminal Code 1899* (Qld).<sup>3</sup> The appellant was sentenced to a term of imprisonment of nine years and six months.<sup>4</sup>

The appellant was diagnosed with HIV in 1998 and was aware that the disease could be transmitted through unprotected sexual intercourse.<sup>5</sup> Mr Zaburoni met the complainant in 2006 and they

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<sup>2</sup> Australian Federation of AIDS Organisations, *HIV Statistics in Australia* (31 December 2014) <<https://www.afao.org.au/about-hiv/the-hiv-epidemic/hiv-statistics-australia#.V66rkxSEclI>>

<sup>3</sup> [2016] HCA 12.

<sup>4</sup> Ibid [3].

<sup>5</sup> Ibid [21]–[22], [30].

begun a relationship in 2007.<sup>6</sup> Mr Zaburoni failed to disclose to the complainant that he was HIV positive.<sup>7</sup>

The appellant and the complainant had repeated unprotected sexual intercourse during their relationship, which continued until September 2008.<sup>8</sup> The complainant was diagnosed as HIV positive a year later.<sup>9</sup> At no point throughout the relationship did Mr Zaburoni notify the complainant that he was HIV positive. Instead, to the contrary, the applicant made encouraging proclamations that he did not have any sexually transmitted diseases.<sup>10</sup>

### *B Procedural History*

The appellant pleaded guilty to the charge of unlawful grievous bodily harm in the District Court.<sup>11</sup> He was sentenced on 18 April 2013 to nine years and six months' imprisonment.<sup>12</sup> This conviction was then appealed in the Queensland Court of Appeal with the appellant arguing that the decision was unreasonable. He argued that the evidence obtained did not ascertain that he intended to transmit HIV to the complainant.<sup>13</sup> The appeal was denied and therefore he sought permission to appeal to the High Court of Australia.<sup>14</sup> The High Court permitted the appeal and handed its decision down on 6 April 2016.<sup>15</sup>

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<sup>6</sup> Ibid [24]–[26].

<sup>7</sup> Ibid [28].

<sup>8</sup> Ibid [26]–[27].

<sup>9</sup> Ibid [28]–[29].

<sup>10</sup> Ibid [28], [30].

<sup>11</sup> Ibid [3].

<sup>12</sup> Ibid.

<sup>13</sup> Ibid [4].

<sup>14</sup> Ibid [5].

<sup>15</sup> Ibid.



### III ISSUES

The issue before the High Court of Australia in this case was whether Mr Zaburoni's conduct was enough to prove that he had the intention to transmit HIV to the complainant. Keane J stated:

Where proof of the intention to produce a particular result is made an element of liability for an offence under the Code, the prosecution is required to establish that the accused meant to produce that result by his or her conduct...knowledge or foresight of result, whether possible, probable or certain, is not a substitute in law for proof of a specific intent under the code.<sup>16</sup>

In order to satisfy the offence under the criminal code in s 317(b), the prosecution needed to establish beyond reasonable doubt that at the time when the appellant was engaging in unprotected sexual intercourse with the complainant, he was aiming to transmit the HIV disease to her.<sup>17</sup>

### IV DECISION

The High Court held that whilst evidence indicated that the appellant was involved in recurrent unprotected sexual intercourse with the complainant, there was no evidence that indicated that the appellant had the intention to transmit HIV to her.<sup>18</sup> Hence, the decision of the Queensland Court of Appeal was quashed, and the proceedings were remitted for resentencing by the Queensland District Court for the lesser charge of reckless infliction of grievous bodily harm.<sup>19</sup>

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<sup>16</sup> Ibid [14].

<sup>17</sup> Ibid [19].

<sup>18</sup> Ibid [63]–[64], [65]–[66], [50]–[51].

<sup>19</sup> Ibid [51].

## V REASONING

The main issue of intention in this case surrounded the fact that just because Mr Zaburoni intended to have sexual intercourse with the complainant and knew that he was HIV positive, does not mean he intended to transmit the disease to the complainant.<sup>20</sup>

The plurality judges Kiefel, Bell and Keane JJ brought attention to the fact that the Queensland Court of Appeal's decision relied heavily on the regularity of unprotected sex over the many months of the couple's relationship to infer intention to transmit HIV.<sup>21</sup> However, they stated that this verification was not enough to ascertain intention that would lead to a criminal conviction.<sup>22</sup> Their Honour stated:

To the extent that the inference of intent depends upon foresight of the risk of the sexual transmission of HIV, it is the appellant's understanding, whether informed or otherwise, that is material. There was ample evidence from which to find that the appellant was aware of the risk of transmitting HIV to the complainant through unprotected sexual intercourse. Apart from the medical advice that the appellant was given by several doctors in 1998 after he learned of his HIV positive status, his lies to the complainant about that status before their sexual relationship commenced, and during the course of it, point to his awareness of the risk of sexual transmission. So, too, do his lies to the police about the number of times they engaged in unprotected sexual intercourse.<sup>23</sup>

There was evidence that indicated because the relationship lasted for 21 months, the risk of the complainant contracting HIV were

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<sup>20</sup> Ibid [6].

<sup>21</sup> Ibid [35], [40], [42].

<sup>22</sup> Ibid [50]–[51].

<sup>23</sup> Ibid [41].

14 percent.<sup>24</sup> However, there was no evidence that the appellant knew the likelihood of transmitting HIV from unprotected heterosexual sex.<sup>25</sup>

The plurality judges concluded that:

[a] rational inference open on the evidence [was] that the appellant engaged in regular unprotected intercourse with the complainant because it enhanced his sexual pleasure and he was reckless of the risk of transmitting HIV to her. The existence of that inference lessens the force of reasoning to a conclusion that the appellant intended to transmit the disease from the fact of frequent unprotected sexual intercourse. Apart from frequent unprotected sexual intercourse, there is no evidence to support the inference that the appellant had that intention. And the evidence fell well short of proving that the appellant believed that it was virtually certain that he would pass on HIV by regular unprotected sexual intercourse.<sup>26</sup>

They also firmly stated that the appellant's lies do not prove that he had sufficient intention to infect the complainant with HIV if he had unprotected sex with her.<sup>27</sup>

Gageler J agreed with the decision laid out by the plurality judges.<sup>28</sup> His Honour stated that the jury was right to consider the possibility that the appellant engaged in sexual intercourse with the complainant not with the intention to infect her with HIV, but merely for his own indulgence. Gageler J argued this was reckless

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<sup>24</sup> Ibid [31]–[32].

<sup>25</sup> Ibid.

<sup>26</sup> Ibid [44].

<sup>27</sup> Ibid [57]–[58].

<sup>28</sup> Ibid [64].

conduct, because there was no consideration as to whether the complainant might become infected with the disease.<sup>29</sup>

Nettle J similarly agreed with the orders conveyed by the plurality judges.<sup>30</sup> His Honour added some comments in relation to his observations surrounding the issue of intention:<sup>31</sup>

An accused may not be presumed to have intended the probable consequences of his or her act. But where it is proved that an accused foresaw that his or her actions would have an inevitable or certain consequence, it logically follows that the accused intended to bring about that consequence; and that is so whether or not the accused desired to bring it about. Hence, if an accused puts a loaded gun to the head of a victim and pulls the trigger while foreseeing that it is a certain or inevitable consequence that the victim will be killed or suffer really serious injury, and the victim is killed, it follows that the accused intended to kill or inflict really serious injury upon the victim and so may be convicted of intentional murder; and that is so notwithstanding that the accused may not have borne the victim any personal ill will as such and was motivated solely by a desire to experience the sensation of putting a loaded gun to the head of another human being and pulling the trigger.<sup>32</sup>

His Honour continued to say that this situation is not dissimilar from intentionally transmitting a serious disease, stating that:<sup>33</sup>

if an accused who is suffering from a serious disease has unprotected sexual intercourse with a victim while foreseeing that it is an inevitable or certain consequence of doing so that he or she will thereby transmit the disease to the victim, it

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<sup>29</sup> Ibid [62]–[64].

<sup>30</sup> Ibid [65].

<sup>31</sup> Ibid.

<sup>32</sup> Ibid [66].

<sup>33</sup> Ibid [67].

logically follows that the accused intendeds to transmit the disease to the victim despite that he or she may not wish to do so and despite being motivated solely by the pleasure of having unprotected sexual intercourse with the victim.<sup>34</sup>

Although Nettle J firmly stated that the evidence in the present case was insufficient to prove that the appellant foresaw the probability of transmitting HIV to the complainant,<sup>35</sup> he did state that whilst the lies told by the appellant show an intention to have unprotected sexual intercourse with the complainant, it does not in anyway prove that the appellant believed the possibility of transmitting the disease was so great that it was foreseeable.<sup>36</sup>

## VI CONCLUSION

This decision refutes the media perception that it is a crime for a HIV positive person to have unprotected sexual intercourse with another person. Whilst Zaburoni's actions were malicious and deceitful, it could not be equated to actual intention to transmit the HIV disease.

This case has blurred the boundary between what is morally right and legally acceptable. One would believe the right thing to do would be to disclose potentially infectious diseases to potential sexual partners, however this case instead suggests that as long as you do not intend to transmit the disease, then there is no need to disclose your situation to current or potential partners.

Reform in this area may be necessary in order to clarify this issue of intention. Due to the varied criminal law procedures, which vary

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<sup>34</sup> Ibid.

<sup>35</sup> Ibid [69].

<sup>36</sup> Ibid [69]–[70].

state to state, the difference between the processes in codified law and common law should be more clearly defined in this area. This clarification could resolve inconsistencies between jurisdictions in sentencing on the same issue. In certain circumstances where an act is clearly careless it may result in more severe liability in one state compared to another.

Overall for Australian law, it is important to clarify the criminal law position in matters involving HIV transmission and exposure. As these issues in legal proceedings are a fairly rare occurrence, it is important for the legislature to intervene to clarify the law so that people suffering from HIV know exactly what is legally wrong or right and in what jurisdiction.

**LEGALITY VS MORALITY**  
**PLAINTIFF M68/2015 V MINISTER FOR**  
**IMMIGRATION AND BORDER PROTECTION**  
**[2016] HCA 1**

AMELIA MCDERMOTT<sup>\*</sup>

I INTRODUCTION

Plaintiff M68 is a Bangladesh woman who arrived in Australia by boat — an ‘unauthorised maritime arrival’ (‘UMA’) as defined by s 5AA of the *Migration Act 1958* (Cth) (‘the Act’).<sup>1</sup> She was detained by officers of the second defendant, the Commonwealth of Australia (‘the Commonwealth’), and sent to Nauru as per s 198AD of the Act — a country elected by the first defendant, the Minister for Immigration and Border Protection (‘The Minister’), as a ‘regional processing country’ under s 198AB(1) of the Act.<sup>2</sup> The third defendant is Transfield Services (Australia) Pty Ltd who, since March 2014, has been the service provider at the Processing Centre on Nauru whereby the Plaintiff was detained — pursuant to a contract with the Commonwealth to provide ‘garrison and welfare services’ (‘The Transfield Contract’).<sup>3</sup> The central issue raised in this case is whether the Commonwealth of Australia has the legitimate executive power to take persons who, despite non-

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<sup>1</sup> *Plaintiff M68/2015 v Minister for Immigration and Border Protection* [2016] HCA 1 [1].

<sup>2</sup> *Ibid* [2].

<sup>3</sup> *Ibid* [12].

citizenship, are present in Australia and are afforded full protections of the Australian Constitution, to a foreign country and subject them to extra-judicial, extraterritorial detention which is funded and secured by the Commonwealth, but which lacks those constitutional protections. This case and its outcome has been highly contentious — shedding light on Australia’s legally dubious offshore processing regime and its significance as a symbol of the ever-present dichotomy between legality and morality.

## II FACTS

The Commonwealth and the Republic of Nauru entered a Memorandum of Understanding (‘The Second MOU’) on 3 August 2013<sup>4</sup> — solidifying Australia’s offshore detention regime in Nauru and ensuring the detainment in Nauru of certain persons arriving by boat to Australia.<sup>5</sup>

Plaintiff M68 was one such person who arrived as an UMA. Her vessel was intercepted at sea by Commonwealth Officers on 19 October 2013. From here she was detained and then sent to a detention facility in Nauru on 22 January 2014 — pursuant to s 198AD(2) of the Act.<sup>6</sup> These same officers applied for a Regional Processing Centre visa on her behalf (without her consent) and paid the required visa fees. This was granted to her on 23 January 2014.<sup>7</sup> Plaintiff M68 thereby became a ‘protected person’ under the *Asylum Seekers (Regional Processing Centre) Act 2012* (Nauru), which meant any attempt to leave the detention facility without approval

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<sup>4</sup> Ibid [201]–[206].

<sup>5</sup> Ibid [3].

<sup>6</sup> Ibid [79].

<sup>7</sup> Ibid [191].



from an authorised person would be punishable by Nauruan law.<sup>8</sup> In the period covered by the plaintiff's claim, from 24 March 2014 until 2 August 2014, the plaintiff resided in Nauru's Regional Processing Centre Compound 3, surrounded by a high metal fence with entry and exit only possible through a checkpoint permanently manned by security officers.<sup>9</sup> The Commonwealth funded the setup and operations of the centre through its contractual relationships with both Transfield and Wilson Security Australia Pty Ltd.<sup>10</sup>

On 2 August 2014, the plaintiff was taken to Australia for medical review. On 16 December 2014, she gave birth to her daughter.<sup>11</sup> Since the plaintiff came from Nauru she was to be transferred back to this regional processing country after her treatment, pursuant to ministerial direction made under s 198AD(5) of the Migration Act.<sup>12</sup> The plaintiff commenced proceedings in this court pursuant to s 75 of the *Constitution*, seeking to prohibit her and her daughter's return to Nauru.<sup>13</sup>

### III SECTION 198AHA

The enactment of the Migration Amendment (Regional Processing Arrangements) Bill 2015 on 30 June 2015 was central to the outcome of this case. This amendment inserted s 198AHA into the

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<sup>8</sup> *Asylum Seekers (Regional Processing Centre) Act 2012* (Nauru) s 18C(2).

<sup>9</sup> *Plaintiff M68/2015 v Minister for Immigration and Border Protection* [2016] HCA 1 [8].

<sup>10</sup> *Ibid* [87], [93].

<sup>11</sup> *Ibid* [193].

<sup>12</sup> *Ibid* [194].

<sup>13</sup> *Ibid* [195].

Act with notable retrospective effect to 18 August 2012.<sup>14</sup> This law provides the Commonwealth with the power to take any action and make payments in relation to the arrangement of the regional processing functions of the country, with ‘action’ defined as including ‘exercising restraint over the liberty of a person’ as per subs 5(a).<sup>15</sup> This was the principal statutory authority relied upon by the Commonwealth to lawfully justify its participation in the plaintiff’s detention on Nauru.<sup>16</sup> Prior to this legislation, the Government had essentially unlawfully detained persons on Nauru without relevant statutory authority.<sup>17</sup> This retrospective law quintessentially won the case for the defendants.

#### IV THE CHALLENGE

The Plaintiff M68 argued that the Commonwealth’s actions in Nauru amounted to substantial and unlawful participation in her detention. She argued that but for the Commonwealth’s involvement in Nauru’s regional processing functions, ie, entering a MOU with Nauru, making a visa application on her behalf, paying the visa fee and taking her to Nauru (as well as funding the very operation and maintenance of the processing facility), the plaintiff would not have been detained and Nauru would have had no reason nor ability to detain her.<sup>18</sup>

The plaintiff further argues that the legislation purporting to grant legal authority for this participation, s 198AHA of the Act, is not a valid law as it transgresses limits on executive power as outlined in

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<sup>14</sup> Ibid [110].

<sup>15</sup> Ibid [71].

<sup>16</sup> Ibid [15].

<sup>17</sup> Ibid [188].

<sup>18</sup> Ibid [222].

*Lim v Minister for Immigration, Local Government and Ethnic Affairs* ('*Lim*').<sup>19</sup> This case held that detention by the State is generally punitive in its character and can only be granted by a court following a finding of criminal guilt.<sup>20</sup> An exception to that rule is that the executive can detain aliens as per s 51(xix) of the Constitution for particular purposes, these being — removal from Australia, receiving and determining an application for a visa for entry into Australia, or determining whether to permit such an application to be made.<sup>21</sup> The plaintiff argues that the purpose of s 198AHA is not for the removal of persons such as the plaintiff because s 198AHA enables the ongoing control of a person's detention in Nauru. Nor is its purpose to allow the Commonwealth to determine a persons visa application, or to 'receive, investigate or determine the outcome of that application', as these determinations in Nauru are for the possible grant of a visa to remain in Nauru and not Australia.<sup>22</sup>

The Commonwealth argued in response that its involvement in offshore processing in Nauru does not account to imposing detention. They argued that it is the laws of Nauru, not the Commonwealth, which enforce the detention requirement.<sup>23</sup> They argued that the Plaintiff lacks standing as her past detention in Nauru was not authorised under Australian law and could thus not be compensated under its jurisdiction.<sup>24</sup> Nonetheless, they argued that their involvement in the plaintiff's detention in Nauru was

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<sup>19</sup> (1992) 176 CLR 1.

<sup>20</sup> *Chu Kheng Lim v Minister for Immigration, Local Government and Ethnic Affairs* (1992) 176 CLR 1, 27.

<sup>21</sup> *Plaintiff M68/2015 v Minister for Immigration and Border Protection* [2016] HCA 1 [227].

<sup>22</sup> *Ibid* [228].

<sup>23</sup> *Ibid* [230]–[233].

<sup>24</sup> *Ibid* [230].

justified under s 198AHA of the Migration Act, which is supported by the Aliens power in s 51 (xix), the external affairs power in s 51(xxix) and the Pacific Islands power in s 51(xxx).<sup>25</sup>

## V JUDGMENT

The Court dismissed the Plaintiff's challenge by a majority of 6:1.

The joint judgment of French CJ, Kiefel and Nettle JJ upheld the defendant's claim that the plaintiff was not detained by Australia but by the law of the Republic of Nauru.<sup>26</sup> They held that the restrictions placed on her liberty were imposed by Nauru in an 'independent exercise of sovereign legislative and executive power'<sup>27</sup> and it was neither appropriate nor necessary for the High Court to question or scrutinise Nauruan laws.<sup>28</sup> The group also held that s 198AHA provided statutory authority for the Commonwealth's involvement in Nauru and that it was a valid law, dismissing the plaintiff's argument re *Lim* and asserting that this case 'has nothing to say about the validity of actions of the Commonwealth and its officers in participating in the detention of an alien by another state'.<sup>29</sup>

Justice Keane similarly found that the plaintiff was detained under Nauruan law and not by the Commonwealth<sup>30</sup> and that it was not necessary to examine the Nauruan laws and their constitutional validity.<sup>31</sup> His Honour also held that the *Lim* case did not apply<sup>32</sup>

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<sup>25</sup> Ibid [234].

<sup>26</sup> Ibid [32], [49].

<sup>27</sup> Ibid [34].

<sup>28</sup> Ibid [38]–[52].

<sup>29</sup> Ibid [41].

<sup>30</sup> Ibid [199], [239].

<sup>31</sup> Ibid [248]–[258].

and that the Commonwealth's participation in the plaintiff's detention was lawfully provided by s 198AHA.<sup>33</sup>

Justice Bell differed in her judgment in that her Honour held that, on the facts, the Commonwealth's participation in the plaintiff's detention was in fact sufficient enough to constitute detaining the plaintiff.<sup>34</sup> However, her Honour found that the authority provided by s 198AHA was sufficient enough to justify this detainment — asserting that this law meant that the Commonwealth could lawfully assist in detention but only to the extent necessary for processing an asylum claim.<sup>35</sup> In her Honour's learned opinion, the plaintiff's invocation of the *Lim* principle 'fails, not because that principle has no application but because her detention in Nauru did not infringe the principle'<sup>36</sup> — the Commonwealth's involvement in Plaintiff M68's detention found reasonably necessary for processing her refugee application.

Justice Gageler's judgment almost mirrored Justice Bell's conclusions, however His Honour discussed in obiter the framework of executive power within the Constitution and its definite limits.<sup>37</sup> Gageler J held, in regards to *Lim*, detention would only be punitive and unlawful were it not 'reasonably necessary to effectuate a purpose which is ... capable of fulfilment or capable of objective determination' and 'capable of objective determination by a court at

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<sup>32</sup> Ibid [238].

<sup>33</sup> Ibid [242].

<sup>34</sup> Ibid [83], [93].

<sup>35</sup> Ibid [101].

<sup>36</sup> Ibid [99].

<sup>37</sup> Ibid [115]–[166].

any time and from time to time’.<sup>38</sup> His Honour was satisfied that s 198AHA met these conditions.<sup>39</sup>

## VI DISSENTING JUDGMENT

Justice Gordon dissented. She upheld the plaintiff’s argument that the Commonwealth’s actions in Nauru amounted to substantial and unlawful detainment — setting out a summary of this involvement from [353] onwards which closely resembles the one argued by the plaintiff as above. Her Honour found that the Plaintiff’s detention was unlawful as it did not fall within any of the recognised exceptions in *Lim*<sup>40</sup> — s 19AHA an attempt to authorise activities beyond those necessary for the removal of the plaintiff from Australia, or for the determination of an application for a visa in Australia.<sup>41</sup> In fact, as her Honour argues, the plaintiff was detained after leaving Australia — clearly rejecting the executive limits so prescribed in *Lim*. Her Honour held that the aliens power of the constitution does not authorise a law which permits or requires detention once a person is removed from Australia<sup>42</sup> — rejecting the lawfulness of s 19AHA.

## VII CONCLUSION

This case is an alarming solidification of Australia’s offshore detention regime in Nauru — granting the Commonwealth the legal authority to exile persons seeking refuge in Australia to a life of detention in limbo. This case has had significant impact on the lives

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<sup>38</sup> Ibid [184].

<sup>39</sup> Ibid [185].

<sup>40</sup> Ibid [389], [400].

<sup>41</sup> Ibid [391].

<sup>42</sup> Ibid [393].

of those already detained in offshore processing countries like Nauru and Manus Island, as well as the lives of many persons who may arrive by boat into the future; allowing for the return of 250 detainees, including 37 babies, to Nauru after the judgment was passed.

Justice Gageler stated in her judgment that:

It will be apparent from what I have written ... that I consider the plaintiff's central claim (that the Commonwealth and the Minister acted beyond the executive power of the Commonwealth by procuring and enforcing her detention at the Regional Processing Centre between 24 March 2014 and 2 August 2014) to have been well-founded until 30 June 2015, when s 198AHA was inserted with retrospective effect.<sup>43</sup>

The retrospective authorisation, from our highest court, of three years worth of otherwise unlawful detention is disconcerting — shedding light on the remarkably incontestable power of the Australian executive.

*Plaintiff M68* has affirmed that there is little legal recourse for asylum seekers stuck in offshore limbo whose fates are beyond Australian concern. The case is highly significant as it has opened an otherwise tactically avoided discussion on the morality of our asylum seeker law; the dissenting judgment of Justice Gordon, whilst not legally binding, providing hope as to the future of this discussion and the direction we can take in an ever-developing legal sphere.

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<sup>43</sup> Ibid [188].