CASE NOTES

Tortious Liability of Directors: Body Corporate 202254 v Taylor

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In what is now a familiar scenario, purchasers of units in a residential development discovered that construction had been defective and the units leaked. With most of the possible corporate defendants either struck off the register of companies or insolvent, a number of these purchasers brought a claim against the director of the development company, alleging both negligence and breach of the Fair Trading Act 1986. The question for the Court on appeal was whether it should strike out either or both of these claims.

I HISTORY

Mr Taylor was the sole director and shareholder of a number of companies incorporated for the purpose of the development. The units were sold through a real estate agency, which produced a promotional brochure that made a number of claims upon which the Body Corporate relied:[1]

> As is vital in all good decisions, you must be comfortable with the **strength and experience** of the person you are dealing with. ... We are certain that you will be delighted with the **standard of workmanship** of your apartment and the **professionalism** of the developer.

Within two years of completion, however, defects in the development's building-work began to show. The owners, accordingly, commenced proceedings seeking damages for the loss associated with making repairs and the stigma that would attach to the development.

In the High Court, Keane J struck out the claim in negligence, but not the claim under the Fair Trading Act.[2] Both sides appealed. The Court of Appeal, therefore, found itself forced to deal with the difficult issues

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1 *Body Corporate 202254 v Taylor* [2009] 2 NZLR 17, 20–21 (CA) (emphasis in judgment) ["*Taylor*"].

2 *Body Corporate No 202254 v Approved Building Certifiers Ltd (in liq)* (29 August 2006) unreported, High Court, Auckland Registry, CIV-2003-404-3116.

that arise when a plaintiff attempts to lay personal liability at the feet of a company director. This case note only discusses the negligence claim.[3]

II THE CLAIM IN NEGLIGENCE

The claim against Mr Taylor was that he was "negligent in his conduct and management of the Siena Villas development".[4] This put in issue the circumstances in which a company director will owe a client of that company a duty of care — a question of some controversy. Indeed, this point split the Court. While all the Justices agreed that the negligence claim should not have been struck out, the Court split 4:1 over the appropriate path to take before liability, on these facts, could be found.

The Majority

William Young P delivered a joint judgment with Arnold J, with which Glazebrook and Ellen France JJ, in their Honours' own joint judgment, concurred. Their Honours' starting point was the case of *Trevor Ivory v Anderson*.[5] The case is well known and its facts can be briefly stated. A raspberry grower contracted with Trevor Ivory Ltd, the major shareholder and managing director of which was Mr Trevor Ivory, to advise on the removal of the couch grass that grew among his raspberries. Mr Ivory himself recommended that the growers use Roundup, a powerful herbicide, which they did. While the herbicide successfully removed the offending grass, it also killed the raspberries. With Trevor Ivory Ltd in liquidation, the growers alleged that Mr Ivory was personally liable for giving the negligent advice. The Court of Appeal held unanimously that this was not the case.

Cooke P (as he then was) and Hardie Boys J rested their judgments on the idea of "disattribution" — that if the director's act can be attributed to the company, then, necessarily, it is not the act of the director. Tort could not be used to avoid the principles of limited liability. As Cooke P opined, and the majority in *Taylor* quoted, "when he formed his company, Mr Ivory made it plain to all the world that limited liability was intended".[6] For the Court to reach the conclusion that Mr Ivory was personally liable, clear evidence would be required that he was not acting as the company at the relevant time.

One way to displace the presumption that the director was not acting

3 For a discussion of the Fair Trading Act element of the case, see Wilson and Trotman, "Personal Liability under s 9 FTA" [2008] NZLJ 441.

4 *Taylor*, supra note 1, 21.

5 [1992] 2 NZLR 517 (CA) ["*Trevor Ivory*"].

6 *Taylor*, supra note 1, 25, quoting *Trevor Ivory*, supra note 5, 524.

as the company, in the eyes of both Cooke P and Hardie Boys J, would be to show an "assumption of responsibility, actual or imputed" on Mr Ivory's behalf.[7] As a result of this dictum, this test has been treated, by some, to be a prerequisite if an agent is to be responsible for any civil wrong. Yet, while McGechan J, the third Justice in *Trevor Ivory*, also found that Mr Ivory had not assumed responsibility, as the majority in *Taylor* noted, for his Honour assumption of responsibility was only relevant because this was a necessary part of the tort — negligent misstatement — at issue.[8] As the majority also observed, it was this judgment that was treated as the ratio of the case when the House of Lords came upon similar facts in *Williams v Natural Life Foods*.[9] In fact, it was the only judgment to which their Lordships referred. In the *Williams* case, the House of Lords held a director not to be liable under the principle in *Hedley Byrne*,[10] finding that he had not assumed personal responsibility and created a special relationship between himself and the plaintiff. A special relationship with the company would not be a sufficient foundation for the director's liability.[11]

The *Taylor* majority saw four "overlapping rationales" to the reasoning in *Trevor Ivory* and *Williams*. The first was the idea of disattribution; the second, the concern that allowing a claim would be erosive of the concept of limited liability; the third, that allowing a claim in tort may be inconsistent with the contract relationship between the parties. The final rationale was what their Honours termed the "elements of the tort" approach and encapsulated, essentially, McGechan J's reasoning in *Trevor Ivory*.[12]

The disattribution ground was dismissed swiftly as unconvincing. As a number of commentators have argued, this idea is based on a misunderstanding of the identification principle, a principle that was developed to make companies liable for the acts of their directors in circumstances where the usual means of attribution — generally agency or vicarious liability — were not applicable.[13] The misunderstanding occurs when it is suggested that because the agent's actions can be imputed to the principal, this serves to absolve the agent of liability. No case until *Trevor Ivory* reached this conclusion.[14] While attribution can be used to impose liability on a company, it does not work the other way to confer immunity upon an individual. Further, the approach leads to the "perverse" situation where the law immunizes senior employees against liability for their torts, but not their junior colleagues.[15] And, as the majority noted, not only was

7 *Taylor*, supra note 1, 26, quoting *Trevor Ivory*, supra note 5, 527.

8 *Taylor*, supra note 1, 29–30.

9 [1998] 1 WLR 830 (HL) ["*Williams*"].

10 *Hedley Byrne & Co Ltd v Heller & Partners Ltd* [1964] AC 465 (HL).

11 *Williams*, supra note 9, 835.

12 *Taylor*, supra note 1, 28.

13 See Campbell, "Claims against Directors and Agents" [2003] NZLJ 109, 109–110.

14 Ibid 110. See also Watts, "*Trevor Ivory v Anderson*: Reasoning from Outer Space" [2007] NZLJ 25.

15 *Taylor*, supra note 1, 29.

this academic criticism persuasive, but also, the House of Lords had already firmly laid the disattribution theory to rest.[16]

While protecting the principle of limited liability was a relevant consideration for their Honours, it was not a decisive one. Limited liability limits the risks of shareholders; it cannot offer a blanket protection to directors against their torts.[17] Similarly, that a tort was committed in the course of performing contractual duties would not mean that the tortfeasor did not owe a duty of care. However, the tortfeasor would be able to take advantage of any contractual limitation of liability agreed with the potential plaintiff.[18]

Addressing the fourth identified rationale, their Honours stated that *Trevor Ivory* and *Williams* have "no application at all" to cases in which assumption of responsibility is not an element of the tort at issue. Yet whether this was meant as a general finding or rather as merely a necessary principle of the "elements of the tort" approach is unclear. While the statement by itself appears to imply the former, this is contradicted by the fact that the majority goes on to discuss the ways in which Mr Taylor might have assumed responsibility for the ultimately negligent building-work (for which, as Chambers J noted, assumption of responsibility is not a necessary element). Regardless of this, it seems clear that the best approach is that of McGechan J, and Lord Steyn in *Williams*.[19]

The majority finally set out the most plausible bases on which the appellants could bring a negligence claim at trial: Mr Taylor's promotion of himself in the relevant brochure implied an assumption of responsibility to supervise the project, and the errors in this supervision were evidence of negligence.[20] After discussing the second, but connected, ground of appeal in this case, and concluding that directors and employees could face direct liability for deceptive conduct in trade under the Fair Trading Act 1986, their Honours formed the view that the negligence claim should not be struck out. Acknowledging the limitations of analysis on a strike out application, and bemoaning the "frustratingly abstract context" within which the case had to be dealt, the Court explicitly left it to future courts to determine the extent to which *Trevor Ivory* would be the guiding authority in this area.[21]

The Minority

For Chambers J, it was unnecessary to confront *Trevor Ivory* to decide this case. In his Honour's view, the "long and the short of it" was that if

16 In *Standard Chartered Bank v Pakistan National Shipping Corporation (No 2)* [2003] 1 AC 959 (HL). See *Taylor*, supra note 1, 29.

17 Ibid.

18 Ibid.

19 Campbell, supra note 13, 110; Watts, supra note 14, 26.

20 *Taylor*, supra note 1, 33.

21 Ibid.

a builder carelessly constructed a residential building, and thereby caused damage, he or she would be liable in negligence. The only relevance of the fact that the builder was employed at this time would be that it could render others vicariously liable for the tortious act.[22] As Chambers J noted, *Morton v Douglas Homes Ltd*[23] stated this principle clearly. In that case, Hardie Boys J held that, if company directors had actual personal control over the construction, they would be held personally liable. Indeed, regardless of one's status as a director, manager, or humble employee, liability to clients would still be determined based on whether the acts performed for the company were subject to his or her control.[24] Noting further that the pertinent conduct need not be the main cause of loss, but merely a contributory cause, the fact that Mr Taylor did not build the villas on his own did not convince his Honour that the claim should not be allowed to proceed.[25]

His Honour attributed the confusion in this area of law from a failure to appreciate the different functions of contract and tort.[26] When an individual contracts with a company, only the company will be liable for a breach of the contract, as, plainly, only the company will be a contracting party. If the individual wants the director of that company also to be liable, then either the individual can contract with the director, or the director can be asked to furnish a guarantee for the company's promise.

Tort, however, focuses on the natural person who caused the plaintiff's loss. The reason for the confusion is that often the elementary principles of tortious liability are obscured because a plaintiff will frequently sue only the employer of the tortfeasor, in the search for the most profitable defendant. Yet, as his Honour made clear, it will always be the employee's tort on which the plaintiff will sue.[27] Given this, the question at issue was not whether responsibility could be shifted from Mr Taylor's company to him, but whether Mr Taylor could absolve himself of responsibility for his own tortious acts, and leave only his company liable.

The plaintiffs here were not suing because of the contractual promise; rather, they claimed relief because Mr Taylor had been a negligent builder. Thus, this case was not at all similar to *Trevor Ivory*. While there had been a contractual relationship between some of the plaintiffs and Mr Taylor (and it was these plaintiffs who also brought the Fair Trading Act claim), his Honour still distinguished this case on the basis that the acts of negligence claimed were not performed pursuant to the contract for sale and purchase. While perhaps this finding is debatable, as his Honour further noted, in any case Mr Taylor had not highlighted any contractual provision that limited his liability for negligence.

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22 Ibid 51.

23 [1984] 2 NZLR 548 (HC).

24 Ibid 595, cited in *Taylor*, supra note 1, 52.

25 *Taylor*, supra note 1, 52.

26 Ibid.

27 Ibid 53–54.

Finally, Chambers J held that the idea of assumption of responsibility was relevant only to claims for negligent misstatement — a tort subject to a number of special rules to contain liability. As the present case was a claim for defective building work, the concept had no proper role to play in coming to a conclusion of liability. Instead, for his Honour, the appropriate foundation for liability rested, "as Todd states, 'on ordinary principles of negligence for physical damage to property caused by faulty work of construction...'".[28]

III DISCUSSION

Chambers J is right to place the muddling of tort and contract at the heart of the difficulty these cases pose. In recent defective building cases, most often the complaint is made by purchasers who are disappointed with the quality of the product for which they have contracted.[29] That is to say, these are essentially contract claims — for expectation losses — made by those who, not being the original purchasers, cannot frame their claims in contract. It should be no surprise, therefore, that the idea of assumption of responsibility, which is predicated, like contract, on consent, should appeal. Lord Steyn identified as much in *Williams*, when his Lordship noted how assumption of responsibility could play an "essential gap filling role" in the face of the "restricted conception of contract in English law, resulting from the combined effect of the principles of consideration and privity of contract".[30] This was expressly restricted, however, to cases of negligent misstatement — a tort that, in itself, can be understood to be quasi-contractual.[31]

Nevertheless, this, at least, can explain the approach here of the majority. Their Honours come very close to treating this case as one of negligent misstatement, on the basis that Mr Taylor stated in the brochure that he and the standard of his workmanship could be trusted and the plaintiffs reasonably relied on this, suffering loss as a result. In any event, the idea of assumption of responsibility is used to sheet home a contractual liability in the absence of consideration, as the brochure is treated as an informal guarantee, given by Mr Taylor on behalf of his company. Whether guarantees should be implied in this way is questionable, especially given the strict formal requirement that a guarantee be both in writing and signed. It is also to go beyond even the use of assumption of responsibility to mitigate the effects of privity, as Mr Taylor personally contracted with no one as to the standard of his company's construction — a point to which

28 Ibid 55 (reference omitted).

29 Watts, "Editorial: Companies, their Managers, and Obligations in Tort" [2008] CSLB 111.

30 *Williams*, supra note 9, 837.

31 Grantham and Rickett, "Directors' 'Tortious' Liability: Contract, Tort or Company Law?" (1999) 62 Mod L Rev 133, 136.

Chambers J alludes in his Honour's dissent. And while it is strongly arguable that contractual doctrines do prove limiting in contexts such as these, it is submitted that broadly resorting to voluntary assumption of responsibility to fill these gaps is undesirable as the term, as we have seen, lacks a clearly understood meaning and could lend itself to manipulation to suit any desired result. It does not help us to understand the real reason that, in any given case, the courts will impose liability.

Chamber J's *Morton* (actual control) test, while perhaps less contestable than the majority's approach, is not itself free from difficulty. Apportioning liability based on the actual control a person may have had over certain aspects of the construction is a good incentive for directors to stay far away from the building sites on which their companies are engaged, a luxury that directors of one-man companies, like Mr Taylor and Mr Ivory, may not be able to afford.[32] Further, to accept his Honour's argument, one must also accept that these are bona fide claims for damage to the structure of a building, not damage to its value, and that the general rules of negligence — those found in *Donoghue v Stevenson*[33] — can still be easily applied.

These cases are difficult but frequent ones for courts, and it is clear that we are still some way from developing a clear set of principles on which they may be decided. What should not be lost sight of, however, is the overriding finding of this case. A person cannot escape liability for tort simply because he or she is a director; the personality of a company and its senior management, in these circumstances, is distinct. Therefore, while future courts will be left to determine the legacy of, particularly, *Trevor Ivory*, it would seem, at least, we have one fixed point on which further clarity in the law can be built.

32 Carpenter, "Directors' Liability and Leaky Buildings" [2006] NZLJ 117, 120.

33 [1932] AC 562 (HL).

Tax Avoidance: Two Cases of the Supreme Court of New Zealand

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I BACKGROUND

Glenharrow Holdings Ltd v Commissioner of Inland Revenue[1] and *Ben Nevis Forestry Ventures Ltd v Commissioner of Inland Revenue*[2] are two recent yet long-awaited decisions of the Supreme Court of New Zealand, being the first cases decided by this Court on the issue of tax avoidance. The two cases involved taxpayers that followed the black letter of the law in arranging their business affairs. Nevertheless, the Justices of the Supreme Court deemed that the arrangements were tax avoidance after considering the tax advantages obtained by the taxpayers.

These two cases send a strong message to taxpayers: business contracts that do not meet the criteria of being genuine commercial arrangements will be considered arrangements that have the effect of tax avoidance, and therefore subject to the Commissioner's extensive power of reconstruction.

The *Glenharrow* Case

Glenharrow Holdings Ltd ("Glenharrow") was a shelf company with share capital of $100. In 1997, Glenharrow purchased a three-year mining licence from a Mr Meates for $45 million. The Crown's expert assessed the value of the mining licence at $4,207,000, while the trial judge arrived at a figure of $9,757,000.

Glenharrow paid a deposit of $80,000 for the mining licence, using money obtained by Mr Fahey, its shareholder. The remainder of the purchase price was satisfied by way of cheque, drawn from the trust account of Glenharrow's solicitors. In return, Mr Meates (the vendor) gave Glenharrow a loan advance of $44,920,000, secured by a mortgage over Glenharrow's assets, the mining licence, and the shares executed by Mr Fahey. It was accepted by the Court that Mr Fahey had no personal liability in respect of the vendor financing. Three annual instalments of $15 million were payable under the mortgage of the licence, with the first of these three instalments due on 31 March 1999. The expiry date of the licence was 15 November 2000. At this date, mining of the land had barely begun as a result of delays in obtaining consents.

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1 [2009] 2 NZLR 359 (SC) ["*Glenharrow*"].

2 [2009] 2 NZLR 289 (SC) ["*Trinity*"].

Under the provisions of the Goods and Services Tax Act 1985, the mining licence qualified as a second-hand good. Aside from the issue of tax avoidance, Glenharrow was entitled to claim an input tax credit for the GST portion of the mining licence's purchase price, as it was registered for GST and was operating on an invoice basis. This meant that Glenharrow was entitled to a refund of one ninth of the purchase price, being $5 million. If Mr Meates had also been registered for GST, there would have been a requirement on him to pay GST output tax on the sale price. However, as Mr Meates was not registered for GST purposes, this neutrality was not achieved in the transaction.

While the legislature does not expressly require such neutrality in transactions, the Court nonetheless deemed that the transaction was tax avoidance, acknowledging that businesses would be disadvantaged if they purchased goods from non-registered parties and were not entitled to claim an input tax credit. The reasons for this are discussed in Part II of this case note.

The *Trinity* Case

This case involved an investment scheme in a Southland forest that was due to be harvested in 2048. The land was owned by Trinity Foundation (Services No 3) Ltd, a subsidiary of the Trinity Foundation Charitable Trust, which granted a licence over 484 plantable hectares to the taxpayers. The fee for the licence was $2,050,518 per plantable hectare, despite the fact that the land was valued at $700 per hectare. It was anticipated that the proceeds obtained from the sale of the trees in 2048 would cover the cost of the licence premium, and the risk that the proceeds from the harvest would not be enough to meet the premium was mitigated by the provision of insurance. The licence premium was due to be paid in 2048, while the insurance premium was due for payment in 2047. Promissory notes were issued to add comfort that payment would be made. The taxpayers sought to claim immediate deductions for the expenses. Furthermore, the Trinity scheme was structured using loss attributing qualifying companies, which meant that the taxpayers personally utilized the tax losses that would result from claiming the deductions. This structure also afforded limited liability protection to the participants.

This scheme was devised by Dr Garry Muir, an Auckland tax lawyer. If the scheme had been allowed to operate as envisioned by Dr Muir, the taxpayers would have been afforded the possibility of reducing their tax liability for many years. This reduction would have been achieved by allowing the taxpayers to claim deductions for expenses that they may never have needed to pay, while concurrently taking advantage of the fact that the trees would take 50 years to mature, meaning no income would be produced for 50 years. The Court took exception to the tax effect of the arrangement, deeming it to be tax avoidance.

II THE OPERATION OF GENERAL ANTI-AVOIDANCE PROVISIONS TO DEFEAT SPECIFIC PROVISIONS

In both *Glenharrow* and *Trinity*, the Court recognized that the respective taxpayers had followed the black letter of the law in utilizing specific provisions of the tax legislation for the arrangement of their business affairs. Despite this, in both cases the Court ruled that the arrangements were in breach of the applicable general anti-avoidance rule. In doing so, the Court strived to achieve an appropriate balance between allowing taxpayers the freedom to advantageously arrange their affairs in accordance with tax legislation, and ensuring that such arrangements fall within the legislature's intent.[3]

Tax Avoidance in *Glenharrow*

The general anti-avoidance provision under consideration in *Glenharrow* was section 76 of the Goods and Services Tax Act. This section was amended in 2000, with the amendment applying on and after 10 October 2000. The relevant version of section 76 was considered by the Court:[4]

> [W]here the Commissioner is satisfied that an arrangement has been entered into between persons to defeat the intent and application of this Act, or of any provision of this Act, the Commissioner shall treat the arrangement as void for the purposes of this Act....

The Supreme Court used a two-stage test under section 76. First, there must be an arrangement entered into between at least two persons. This was not an issue on the facts of *Glenharrow*. The second stage looks at whether the arrangement was entered into between the parties to defeat the intent and application of the Act or any provision of the Act.[5] Crucially, the Court confirmed that the second test is not concerned with the motive or purpose of the taxpayer. Rather, it is an objective test that focuses on the purpose of an arrangement.[6]

Distortions created between registered and unregistered persons, and between those registered on a payments basis and those on an invoice basis, were factors which the Court said suggested an arrangement that defeated the intention of the Act.[7] In applying the second stage of the test to the facts, the Court determined that the arrangement was artificial. The objective economic reality was that the debt owed by Glenharrow to Mr

3 *Trinity*, supra note 2, 332.

4 Goods and Services Tax Act 1985, s 76 (later amended by the Taxation (GST and Miscellaneous Provisions) Act 2000, s 116(1)).

5 *Glenharrow*, supra note 1, 375.

6 Ibid 375–376.

7 Ibid 380.

Meates would never be discharged. Considering the remaining three-year term of the licence, Glenharrow would not have been able to mine enough stone to make the sales that would be required to pay off the purchase price.[8]

Balancing factors such as the gross disparity between the price and the size of the purchaser, the shrinking value of the asset, the limited life of the licence, and the fact that Mr Fahey was not personally liable for the debt, the Court determined that the GST refund that Glenharrow was claiming was not proportionate to the burden undertaken. The Court also considered the fact that Mr Meates was unregistered; hence, there was no GST imposed on his side of the transaction.[9] The Court summed up the arrangement by stating that "[t]he end in view was a distortion which very plainly defeated the intent and application of the Act."[10]

Tax Avoidance in *Trinity*

If the anti-avoidance issue had been ignored in *Trinity*, the majority of the Supreme Court would have allowed the deductions that the taxpayers sought, as they complied with the specific sections of the Act relating to allowable deductions. In this vein, the taxpayer argued that the general anti-avoidance rule[11] should be interpreted as narrowly as possible, to give taxpayers certainty when tax planning. This argument was rejected by the Court, which clarified the test under section BG 1:[12]

> The taxpayer must satisfy the Court that the use made of the specific provision is within its intended scope. If that is shown, a further question arises based on the taxpayer's use of the specific provision viewed in light of the arrangement as a whole.

The Court has sent a message to taxpayers: if taxpayers utilize provisions in the way that Parliament intended, their affairs are likely not to breach the anti-avoidance rule. However, if an arrangement has a more than incidental purpose or effect of tax avoidance, the arrangement may be counteracted and subject to reconstruction by the Commissioner.[13] The Court provided further guidance:[14]

> A classic indicator of a use that is outside parliamentary contemplation is the structuring of an arrangement so that the taxpayer gains the benefit of the specific provision in an artificial or contrived way. It is not within Parliament's purpose for specific provisions to be used in that manner.

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8 Ibid 381.
9 Ibid 383.
10 Ibid.
11 Income Tax Act 1994, s BG 1.
12 *Trinity*, supra note 2, 331.
13 Ibid.
14 Ibid 331–332.

On weighing up the facts of the case, the Court concluded that the promissory notes were a "gratuitous mechanism" that did not realistically secure the payment of the licence premium in 2048.[15] Furthermore, there was a gross disparity between the licence fee payable by the taxpayers, and the actual value of the land. This meant that it was highly unlikely that there would be a realization of the profit required to cover the licence premium.[16] Aspects of the Trinity scheme were described by the Court as "both artificial and contrived".[17]

III THE COMMISSIONER'S POWER OF RECONSTRUCTION

In both cases, the Court considered the exercise of the Commissioner's power of reconstruction, and deemed that the Commissioner had acted appropriately in the reconstructions made. In *Glenharrow*, Blanchard J noted that "[t]he Commissioner has a discretion in this respect",[18] thus illustrating the relative freedom afforded to the Commissioner for this purpose.

Furthermore, the Court in *Trinity* stated that the Commissioner's power of reconstruction extended to "all those taxpayers who have benefited from it.... No question of mutuality or even awareness by a benefiting taxpayer is a necessary element."[19] This suggests that the Commissioner's power of reconstruction is wide-reaching and discretionary.

IV CONCLUSION

The two cases send a strong message to taxpayers that merely relying on specific provisions of tax legislation will not provide a sufficient defence to a claim of tax avoidance. The general anti-avoidance provisions operate to ensure that the specific provisions are not abused; the advantages obtained through their use must not fall outside of the scope that was intended by Parliament. Elements that introduce an artificial aspect to an arrangement will suggest that it had been contrived with the purpose of tax avoidance.

15 Ibid 334.
16 Ibid 335.
17 Ibid 340.
18 *Glenharrow*, supra note 1, 383.
19 *Trinity*, supra note 2, 343.

Functions of a Public Nature and Judicial Review: YL v Birmingham City Council

BRENDON ORR*

YL v Birmingham City Council[1] is a recent decision of the House of Lords on the obligation of a private person or company to observe human rights where they perform a 'public function'.[2] The decision has attracted considerable commentary and debate;[3] eventually proving so controversial that the outcome was subsequently overturned by specific legislation.[4]

The phrase "functions of a public nature", in section 6(3)(b) of the Human Rights Act 1998 (UK) ("UKHRA"), contains a whole host of ambiguities and definitional issues, so much so that the equivalent United States doctrine has been described as a "conceptual disaster area".[5] This case note examines the decisions of both the majority and the minority in *YL*, and offers some guidance to decision-makers and potential litigants on what factors are relevant to determining whether a person or body performs a public function.

A more general question is also considered; namely, whether the 'public function' test discussed in *YL* is the same as, or different to, the test for amenability to judicial review. In earlier decisions, these tests were assumed to be the same.[6] However, a number of judgments, including *YL* and others, have thrown doubt on this proposition.[7] In *YL*, the Law Lords placed heavy reliance on the Strasbourg 'state responsibility' jurisprudence,[8] and reasoned that "although domestic case law on judicial

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1 [2008] 1 AC 95 (HL) ["*YL*"].

2 Human Rights Act 1998 (UK), s 6(3)(b); New Zealand Bill of Rights Act 1990, s 3(b).

3 For further analysis of this case, see Palmer, "Public, Private and the Human Rights Act 1998: An Ideological Divide" (2007) 66 CLJ 559; Landau, "Functional Public Authorities after *YL*" [2007] PL 630; McGarry, "'Functions of a Public Nature' under the Human Rights Act 1998: The Decision of the House of Lords in *YL v Birmingham City Council*" [2007] 5 Web JCLI; Williams, "*YL v Birmingham City Council:* Contracting Out and 'Functions of a Public Nature'" (2008) 4 EHRLR 524; Woolf, Jowell, and Le Sueur, *De Smith's Judicial Review* (6 ed, 2007) 149–152.

4 Health and Social Care Act 2008 (UK), s 145(1): provision of certain social care is deemed to be a public function.

5 Black, "Foreword: 'State Action', Equal Protection and California's Proposition" (1967) 81 Harv L Rev 69, 95, referring to the US 'state action' doctrine.

6 See *R (Beer) v Hampshire Farmers' Markets Ltd* [2004] 1 WLR 233, 240 (CA) ["*R (Beer)*"].

7 See *YL*, supra note 1, 105, 125–126. See also *R (Quark Fishing Ltd) v Secretary of State for Foreign and Commonwealth Affairs* [2006] 1 AC 529, 545–546 (HL); *R (SB) v Governors of Denbigh High School* [2007] 1 AC 100, 115–116 (HL); *Aston Cantlow and Wilmcote with Billesley Parochial Church Council v Wallbank* [2004] 1 AC 546, 553–554, 598–599 ["*Aston Cantlow*"].

8 See generally Quane, "The Strasbourg Jurisprudence and the Meaning of 'Public Authority' under the Human Rights Act" [2006] PL 106.

review might be helpful, it could not be determinative of what is a core or hybrid public authority".[9]

The same question can be asked in the New Zealand context: is the 'public function' test in section 3(b) of the New Zealand Bill of Rights Act 1990 ("NZBORA") the same as the test for amenability to judicial review? If the answer is 'yes', then this may provide lawyers with another useful line of authority when arguing application issues in both judicial review and human rights proceedings. If, however, the answer is 'no', then the reasons for this divergence ought to be examined, particularly in the New Zealand context where, unlike in *YL*, there is no similar obligation to observe Strasbourg jurisprudence.

I FUNCTIONS OF A PUBLIC NATURE

The dividing line between those who are subject to the obligations imposed by human rights instruments, and those who are not, is often difficult to discern. In an ordinary case, the obligation to respect and affirm the rights of individuals falls upon the government and public entities, not private individuals.[10] "Wholly private conduct is left to be controlled by the general law of the land."[11] Section 6 of the UKHRA provides:

> (1) It is unlawful for a public authority to act in a way which is incompatible with a Convention right.
>
> ...
>
> (3) In this section "public authority" includes —
>
> (a) a court or tribunal, and
>
> (b) any person certain of whose functions are functions of a public nature....

The section creates a boundary between those who are required to observe the UKHRA, and those who are not.[12] These actors are further divided into two groups: the first group includes bodies that form part of the 'core government', and the second group includes those persons who exercise "functions of a public nature", whether or not they fall within any of the core branches of government.[13]

The effect of this functional classification is to capture individuals or organizations that fall between the public–private divide, and which ought

9 *YL*, supra note 1, 125–126, referring to *Aston Cantlow*, supra note 7, 566 per Lord Hope.

10 Joseph, *Constitutional and Administrative Law in New Zealand* (3 ed, 2007) 1145–1154.

11 *R v N* [1999] 1 NZLR 713, 718 (CA). This case held that "the exercise or purported exercise by the police of their powers comes within s 3(a) of the Bill of Rights".

12 For an excellent summary of the developing United Kingdom line of authority on s 6(3)(b), see Woolf, Jowell, and Le Sueur, supra note 3, 152–154.

13 Clayton and Tomlinson, *The Law of Human Rights* (2 ed, 2009) 232.

properly to be subject to constitutional restraint.[14] This distinction has become increasingly blurred as the government extends its use of private businesses and not-for-profit organizations, to provide ostensibly 'public' services. The "contractualization" of government is not new,[15] but it has not been until recently that courts have been required to confront these issues in the human rights context.[16] The effect of the tests in section 6(3)(b) of the UKHRA and section 3(b) of the NZBORA is to subject organizations who perform "functions of a public nature" to the full weight of obligations imposed by human rights statutes.

Potential claimants ought to have their rights protected in situations where the state contracts out its services to private providers. Private institutions or bodies which provide these services should not be afforded a shield that allows them to avoid respecting or upholding a person's basic human rights.[17]

II THE FACTS OF *YL*

The claimant, Mrs YL, was an elderly woman who suffered from Alzheimer's disease. She had been placed in a residential care home, which accommodated a mix of privately and publicly funded residents. The home was run by Southern Cross Health Care Ltd, a private provider. The claimant lived in the home under the terms of a contract between herself, Southern Cross, and the Birmingham City Council (the local authority).[18]

The local authority was under a duty to make arrangements for providing "resident accommodation for persons ... who by reason of age, illness, disability ... are in need of care and attention which is not otherwise available to them".[19] Under the Health and Social Care Act 2001, the local authority was also obliged to fund most of the claimant's living costs;[20] these payments were made directly to Southern Cross, as the operator of the care home.

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14 The most developed jurisprudence on the 'contractualization' of government can be found in the United States 'state action' doctrine. See eg the summary of general principles in *Edmonson v Leesville Concrete Co Ltd* 500 US 614 (1991) 621–622. See also *Marsh v State of Alabama* 326 US 501 (1946); *Shelley v Kraemer* 334 US 1 (1948); *Terry v Adams* 345 US 461 (1953); *Burton v Wilmington Parking Authority* 365 US 715 (1961); *Brentwood Academy v Tennessee Secondary School Athletic Association* 531 US 288 (2001).

15 See generally Hunt, "The Constitutionalism and the Contractualisation of Government in the United Kingdom" in Taggart (ed), *The Province of Administrative Law* (1997).

16 The leading authorities in this area are comparatively recent: see eg *Brentwood Academy v Tennessee Secondary School Athletic Association*, supra note 14; *RWDSU v Dolphin Delivery Ltd* [1986] 2 SCR 573; *Ransfield v Radio Network Ltd* [2005] 1 NZLR 233 (HC) ["*Ransfield*"]; *YL*, supra note 1.

17 See Landau, supra note 3, 639: "[The decision in *YL*] licences the washing away of human rights law through contracting out, thereby removing the protection of proportionality inherent in Convention law and often lacking in domestic private law."

18 *YL*, supra note 1, 121.

19 National Assistance Act 1948 (UK), s 21(1).

20 Health and Social Care Act 2001 (UK), s 54.

Following a dispute with the claimant's family over disruptive visits, Southern Cross exercised its contractual right to terminate the claimant's placement agreement for "good reason", giving her four weeks notice. Through the Official Solicitor, the claimant commenced proceedings in the High Court, arguing that the termination notice violated her rights under Articles 2, 3, and 8 of the UKHRA, which included the right to respect for the "home".

It could not be argued that the Council was responsible for the alleged breach of the claimant's right to a home, nor could it be said that the Council had, in any way, failed to carry out its statutory duties. The claimant's only recourse was to seek a declaration that the private care home provider was exercising functions of a public nature within section 6(3)(b). Only then could she pursue her substantive claim.[21]

III THE JUDGMENTS

The case resulted in a 3:2 split in the House of Lords. In the majority, Lords Scott, Mance, and Neuberger held that Southern Cross was *not* performing a public function. Lord Bingham and Baroness Hale dissented.

The Majority View

The majority held that the provision of care and accommodation by a care home provider such as Southern Cross was an inherently private function. Lord Scott summarized the reasoning of the majority by emphasizing that Southern Cross was a company carrying on a socially useful business for profit[22] — it entered into private law contracts with the residents in its care homes and with the local authorities with which it did business.[23] In addition, it received no public funding, enjoyed no special statutory powers, and was at liberty to accept or reject residents as it chose, at whatever price it thought suitable.[24]

The Law Lords affirmed the approach taken in *Aston Cantlow and Wilmcote with Billesley Parochial Church Council v Wallbank*, where Lord Nicholls had noted that, although there could be no test of universal application, the factors to be taken into account included the extent to which the body: (a) is publicly funded; (b) is exercising statutory powers; (c) is taking the place of central or local government; or (d) is providing a

21 The Strasbourg jurisprudence, along with United Kingdom authority, notes that Art 8 "does not ... give a right to be provided with a home and does not guarantee the right to have one's housing problem resolved by the authorities": *Kay v Lambeth London Borough Council* [2006] 2 AC 465, 510–511 per Lord Hope. At best, Mrs YL's claim could have been to enforce her right to due process, prior to her removal.

22 *YL*, supra note 1, 108.

23 Ibid.

24 Ibid 108–109.

public service.[25] The emphasis was on the *nature* of the function, not the person discharging it.[26]

The majority in *YL* held that there was a distinction between the functions of a local authority in "making arrangements for providing resident accommodation" pursuant to section 21 of the National Assistance Act 1948, and that of a private company providing this care pursuant to a contract with the public authority on an 'arm's length' commercial basis.[27]

The majority's reasoning was based on a strict view of the distinction between 'public' and 'private', and was strongly influenced by the fact that the care home was a private, profit-making company operating under contractual arrangements.[28]

The Minority View

The minority took the view that, "while there cannot be a single litmus test of what is a function of a public nature, the underlying rationale must be that it is a task for which the public, in the shape of the state, have assumed responsibility".[29] It was decisive that the claimant had been placed in a care home by a local authority, at the authority's own expense, pursuant to a statutory duty to arrange care.[30]

Lord Bingham and Baroness Hale considered that the legislators who framed the UKHRA could not have intended to leave vulnerable people, such as Mrs YL, without protection in circumstances where their rights have been infringed.[31] The minority considered that a more expansive interpretation of section 6(3)(b) was necessary, in order to provide greater protection to those claimants whose rights were being infringed in situations where they had historically benefited from the protection of the state.[32]

IV JUDICIAL REVIEW AND PUBLIC FUNCTIONS

The judgments in *YL* raise a question of general application — is the term "functions of a public nature" in section 6(3)(b) of the UKHRA the same as, or different to, the test for amenability to judicial review? Prior to the decision in *YL*, there had been no clear answer to this question, although

25 *Aston Cantlow*, supra note 7.

26 The House of Lords went on to find that parochial parish councils were not performing a function of a public nature under s 6(3)(b) when enforcing liabilities against lay rectors for chancel repairs (Lord Scott dissenting): *YL*, supra note 1, 108, 111.

27 Ibid 108–109 per Lord Mance.

28 Clayton and Tomlinson, supra note 13, 243.

29 *YL*, supra note 1, 119 per Baroness Hale.

30 Ibid 120–121.

31 Ibid 107.

32 Ibid.

a number of decisions suggested that the two tests were identical.[33] As a result of these past decisions, the test for whether a body was one that performed "public functions" could be answered by reference to factors that determined whether a decision-maker was amenable to judicial review.[34]

To examine their Lordships' finding in *YL* (that the two tests were not the same), it is first necessary to examine their similarities. In the context of judicial review of public powers, the courts have determined reviewability by reference to the type of *function* performed by the decision-maker.[35] In *R v Panel on Takeovers and Mergers, ex parte Datafin plc*, Donaldson MR suggested that "the only essential elements are what can be described as a public element, which can take many different forms".[36] Subsequent decisions have enumerated a series of factors, such as: (a) whether, "but for" the existence of the body, the government would have stepped in to regulate the activity in question;[37] (b) whether there is a statutory underpinning for the function or body in question;[38] (c) whether the body exercises extensive or monopolistic powers;[39] and (d) whether the body receives extensive public funding in carrying on a public function.

The Civil Procedure Rules 1998 (UK) now refer to judicial review as a claim to the lawfulness of "a decision ... in relation to the exercise of a public function".[40] These similarities were noted in *Poplar Housing & Regeneration Community Association Ltd v Donoghue*, where Lord Woolf CJ considered that section 6 of the UKHRA was "clearly inspired by the approach developed by the courts in identifying the bodies and activities subject to judicial review".[41]

In *YL*, however, the Law Lords were reluctant to rely on comparable judicial review cases for direct assistance.[42] It was argued that section 6 was designed to mirror the scope of state responsibility at Strasbourg, a matter which is not ordinarily relevant to the consideration of a public body in domestic administrative law.[43] Lord Mance, in particular, relied heavily upon the requirement that a private individual must exercise "state or governmental functions or powers" before being subject to the jurisdiction

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33 See *Poplar Housing & Regeneration Community Association Ltd v Donoghue* [2002] QB 48, 69 (CA) ["*Poplar Housing*"]. See also *R (Heather) v Leonard Cheshire Foundation* [2001] EWHC Admin 429, [65] (CA); *R (Beer)*, supra note 6, 240; *R v Servite Houses, ex parte Goldsmith* [2001] BLGR 55 (CA).

34 See *R (A) v Partnerships in Care Ltd* [2002] 1 WLR 2610 (CA); *R (Beer)*, supra note 6.

35 *R v Panel on Takeovers and Mergers, ex parte Datafin plc* [1987] 1 QB 815 (CA) ["*Datafin*"]. See also *R v Jockey Club, ex parte Aga Khan* [1993] 1 WLR 909 (CA) ["*Aga Khan*"]; *R v Football Association Ltd, ex parte Football League Ltd* [1993] 2 All ER 833 (CA); Pannick, "Who is Subject to Judicial Review and in Respect of What?" [1992] PL 1; Woolf, Jowell, and Le Sueur, supra note 3, 131–138.

36 *Datafin*, supra note 35, 838 per Donaldson MR.

37 *R v Advertising Standards Authority, ex parte Insurance Services plc* [1990] COD 42.

38 *R v Criminal Injuries Compensation Board, ex parte Lain* [1967] 2 QB 864, 884 (CA); *R (A) v Partnerships in Care Ltd*, supra note 34.

39 *Datafin*, supra note 35, 845. Compare *Aga Khan*, supra note 35, 932 per Hoffman LJ: "the mere fact of power, even of a substantial area of economic activity, is not enough".

40 Civil Procedure Rules 1998 (UK), Part 54, r 1(2)(a)(ii).

41 *Poplar Housing*, supra note 33, 69 per Lord Woolf CJ. Compare *YL*, supra note 1, 125–126.

42 *YL*, supra note 1, 125–126.

43 Parkhill and Murray, "A Difference of Opinion" (2007) 157 NLJ 1378. See also *YL*, supra note 1, 125–126.

of the European Court of Human Rights.[44] As noted elsewhere,[45] the test for state responsibility under Article 34 of the European Convention of Human Rights often involves a broader consideration of institutional and functional criteria, which extend well beyond the "function oriented" section 6(3)(b).[46]

Lord Bingham went further on the issue of judicial review, by noting that section 6(3)(b) places emphasis on the function performed, rather than the nature of the body performing it. Accordingly, it "will not ordinarily matter" that a body is amenable to judicial review.[47] With respect, this position is unconvincing. A number of the Law Lords in *YL* acknowledged that the reviewability or otherwise of a body will often be relevant to the test under section 6(3)(b).[48] This was expressly recognized in the subsequent case of *R (Weaver) v London & Quadrant Housing Trust*:[49]

> [A]lthough the question whether a body is a public authority for the purposes of the Human Rights Act is not to be equated with the question whether it is amenable to judicial review, since the rationale under the Human Rights Act is different, it may nonetheless be helpful to consider amenability to judicial review.

It seems, then, that, while the House of Lords say that the tests are different, susceptibility to judicial review provides, at least de facto, a very strong indication that the body or individual may also be subjected to scrutiny under section 6 of the UKHRA.[50]

V PUBLIC FUNCTIONS IN NEW ZEALAND

Section 3(b) of the NZBORA states that the NZBORA applies to acts done by persons or bodies in the performance of "a public function, power or duty conferred or imposed by or pursuant to law". The leading authority on this "public function" requirement is *Ransfield v Radio Networks Ltd*,[51] where the High Court provided a list of factors relevant to identifying public

44 *YL*, supra note 1, 125–126.

45 See Williams, supra note 3, 525–526.

46 See Quane, supra note 8, 115, 120. See generally *Costello-Roberts v UK* (1995) 19 EHRR 112; *Holy Monasteries v Greece* (1995) 20 EHRR 1 for the leading Strasbourg decisions in this area.

47 *YL*, supra note 1, 105.

48 Ibid 131–132.

49 [2009] 1 All ER 17, [60] (CA).

50 This approach is supported by the Strasbourg jurisprudence: see *Radio France v France* [2004] ECHR 53984/00. See also Clayton and Tomlinson, supra note 13, 245.

51 *Ransfield*, supra note 16.

functions.[52] The primary focus was on the function, power, or duty, rather than on characterizing the entity as either public or private.[53] This approach aligns with a functional, rather than institutional, analysis of the entity in question, and recognizes that there is no single test for determining what is a public function.[54] Similarly, in *Datafin*, the Court recognized that there was no single test for assessing amenability to judicial review.[55] There the Court held that, in determining whether a body or particular decision is susceptible to judicial review, courts can look not only at the source of the power, but also at the 'public function' exercised and its public consequences.[56]

In *Shortland v Northland Health Ltd*, the Court of Appeal noted in passing that a similar approach may be taken to determining 'public functions' under section 3(b) as in administrative law.[57] Likewise, in the judicial review decision of *TV3 Network v Eveready NZ Ltd*,[58] Cooke P suggested that the plaintiff might fall within section 3(b), but reached no final conclusion on the issue.

A comparable approach was adopted in *Dunne v Canwest TVWorks Ltd*,[59] a case in which the plaintiffs were the leaders of two minority parties in Parliament, who had sought judicial review of the defendant's decision to exclude them from a televised leaders' debate on the defendant's free-to-air (but privately owned) television channel. On the question of whether the defendant, a private company, was susceptible to judicial review, the Court held that the case involved a public function: namely, election coverage.[60] The case was argued, in part, on the footing that the defendant performed a public function under section 3(b) of the NZBORA.[61] Accordingly, it was said to owe a duty to "assist all voters to inform themselves of the leaders and the policies of the political parties contesting the election".[62] This was held to be a significant factor weighing in favour of reviewability.[63]

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52 These included, inter alia: (a) whether the entity is publicly owned or privately owned; (b) whether the source of the power is statutory; (c) whether, and to what extent the entity is subject to public control; (d) whether the entity is publicly funded; (e) whether the entity is the government's alter ego; and (f) whether the entity exercises functions, powers, or duties that affect the rights of any person: ibid 247–248.

53 Joseph, supra note 10, 1150.

54 Ibid 1149. Occasionally the approach is clear: see eg *M v Board of Trustees of Palmerston North Boys' High School* [1997] 2 NZLR 60, 70–71. The High Court distinguished between the provision of private boarding facilities for pupils, and the provision of free education. The latter was held to be a public function, but the former was not.

55 *Datafin*, supra note 35, 847.

56 Ibid. See *Electoral Commission v Cameron* [1997] 2 NZLR 421 (CA); *Webster v Auckland Harbour Board* [1987] 2 NZLR 129 (CA); *Royal Australasian College of Surgeons v Phipps* [1999] 3 NZLR 1 (CA). See also *Mercury Energy Ltd v Electricity Corp of New Zealand* [1994] 2 NZLR 385, in which it was held that a public body, making decisions in the public interest that might adversely affect the rights and liabilities of private individuals, is amenable to judicial review.

57 [1998] 1 NZLR 433, 444 (CA).

58 [1993] 3 NZLR 435, 441 (CA) ["*TV3 Network*"].

59 [2005] NZAR 577 (HC) ["*Dunne*"]. See Taggart, "Administrative Law" [2006] NZ L Rev 75, 91–96 for a more extensive analysis of this decision.

60 Ibid 585. See also ibid 582, referring to a decision on amenability to judicial review using the 'public impact' analysis: see *Royal Australasian College of Surgeons v Phipps*, supra note 56.

61 *Dunne*, supra note 59, 581, referring to the s 3(b) analysis in *TV3 Network*, supra note 58, 441 per Cooke P.

62 Ibid 584.

63 Here, the Court implicitly emphasized the s 14 NZBORA right to receive information.

The same considerations were relevant in *Mangu v Television New Zealand Ltd*,[64] a case in which an independent candidate in the Te Tai Tokerau electorate sought judicial review of the defendant's failure to mention her candidacy in a news item about the contest in that electorate. Lang J considered that Television New Zealand's decision operated at the "micro level of gathering and presenting the news",[65] and held that it had "a fundamental right to gather and present news in the way it sees fit".[66]

The interesting aspect of this decision, for present purposes, is that the question of reviewability was answered with reference to the 'public function' factors set out in *Ransfield*. Lang J noted that these factors "are also relevant in considering whether a body exercising a statutory power is susceptible to judicial review".[67]

The decisions in *Dunne* and *Mangu* demonstrate that there may be very little to distinguish, in the New Zealand context, between a functional section 3(b) rights-based analysis, and the functional test for amenability to judicial review in *Datafin*.

VI CONCLUSION

If a distinction can be drawn between the tests for amenability to judicial review and the test for applicability under section 6 of the UKHRA, the House of Lords consider that this arises only as a result of the requirement that the law be developed with reference to Strasbourg jurisprudence.[68] This distinction has been criticized as "fundamentally flawed" by academic commentators.[69] Yet the distinction is of little relevance in New Zealand. Under both section 3(b) of the NZBORA and the test for amenability to review, the 'public function' analysis appears to be the same.

It is not envisaged that this approach will have the effect of expanding the scope of rights protection under section 3(b). The key consideration must always be the identification of the particular function being performed;[70] the reality is that the factors enumerated in *Ransfield* and *Datafin* are merely signposts that serve to direct the courts in one way or the other.[71] The thesis of this case note is simply that, rather than being divergent pathways, the two approaches to reviewability are, in reality, co-extensive.

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64 [2006] NZAR 299 ["*Mangu*"].

65 Ibid 302.

66 Ibid 303.

67 Ibid 302. See also *Falun Dafa Association of New Zealand Inc v Auckland Children's Christmas Parade Trust Board* [2009] NZAR 122, [42].

68 See *YL*, supra note 1, 126.

69 Williams, supra note 3. See also Quane, supra note 8, 108.

70 See *Television New Zealand Ltd v Newsmonitor Services Ltd* [1994] 2 NZLR 91, 95 (HC).

71 This approach generally aligns with regarding the NZBORA as providing a set of "navigation lights". See Rishworth, "Common Law Rights and Navigation Lights: Judicial Review and the New Zealand Bill of Rights" (2004) 15 PLR 103.