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**“Challenging the validity of an assessment on the  
basis of conscious maladministration by the ATO”**

**(with 2016 postscript on the Full Federal Court decision in  
*Donoghue*)**

**v2**

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## Background

The Australian Taxation Office (ATO) has a proud record of service to the Australian community. Nevertheless, over the years, a number of taxpayers have felt that they have been unfairly treated and have taken action to attack the ATO's alleged lack of bona fides (good faith) in making assessments, or otherwise dealing with taxpayer's affairs.<sup>2</sup>

However, until 2015 taxpayers in Australia had invariably failed in actions alleging misconduct by ATO officers.<sup>3</sup>

The tort of conscious (or 'deliberate')<sup>4</sup> maladministration<sup>5</sup> was developed by courts many years ago to deal with abuses of public office (i.e. the absence of an honest attempt to perform the functions of the office<sup>6</sup>, involving a deliberate and dishonest abuse of power).

The tort has traditionally been difficult to prove, largely because of the requirement to prove "malice" by the decision-maker,<sup>7</sup> and there was an impressive line of cases in which taxpayers had failed to successfully establish claims against the ATO. Indeed, in *Hii v Commissioner of Taxation*<sup>8</sup>, Collier J observed that there did not seem to have been a reported case prior to *Donoghue v Commissioner of Taxation* ('*Donoghue*')<sup>9</sup> in 2015 where a taxpayer was able to successfully establish conscious maladministration by the ATO or its officers.<sup>10</sup>

No doubt this general lack of success reflects in part the fact that '[t]he courts have traditionally operated on the assumption that ATO staff will act honestly in their work and hence the hurdle for

<sup>2</sup> The broader potential problem of increased non-compliance which can result from taxpayer perceptions of unfairness or procedural injustice in ATO actions has been highlighted by studies including K Murphy, 'Procedural justice and tax compliance' Working Paper 56 (Feb 2004) Centre for Tax System Integrity, ANU; M Wenzel, 'Motivation or rationalisation? Causal relationships between ethics, norms and tax compliance', Working Paper 63 (May 2005) Centre for Tax System Integrity, ANU; Simon James, Kristina Murphy and Monika Reinhart, 'Taxpayer Beliefs and Views: Two New Surveys' (2005) *Australian Tax Forum* 157; and, more recently (by analogy), Julie M Barkworth and Kristina Murphy, 'Procedural justice, policing and citizen compliance behaviour: The importance of emotion' (2015) 21(3) *Psychology, Crime and Law* 254.

<sup>3</sup> See for example *Marijancevic v DCF of T* 2008 ATC ¶20-046, 8627 (Ryan, Kenny and Stone JJ). The terminology of such claims in Australia prior to the 2008 decision in *Futuris Corporation Ltd v FC of T* 2008 ATC ¶20-039 tended to be in terms of lack of good faith

<sup>4</sup> *FCT v Futuris Corporation Ltd* 2008 ATC ¶20-039 [55], [66] (Gummow, Hayne, Heydon and Crennan JJ). The tort involves a deliberate failure to comply with e.g. the provisions of an Act (i.e. knowingly or with deliberate disregard acting in excess of their powers).

<sup>5</sup> N Cox, 'Justice, fairness and the common law: The tort of misfeasance in public office' (May 26, 2015) <http://ssrn.com/abstract=2610837>, 2;

<sup>6</sup> In *NT v Mengel* [1995] HCA 65 [10], Brennan J stated that 'it is the absence of an honest attempt to perform the functions of the office that constitutes the abuse of office'; see also J Bevacqua, *Taxpayer Rights to Compensation for Tax Office Mistakes* CCH & ATTA Doctoral Series No 3.

<sup>7</sup> As defined in the case-law to include knowledge and (perhaps) reckless indifference: see Bevacqua, above n 8, 44, 49 and A Freeman and B May, 'Taking on the government: what is misfeasance in public office?' <http://www.lexology.com/library/detail.aspx?g=98d56500-b3d6-49a-a463-5414580372ad>, 26 January 2015, discussing inter alia *Brett Cattle Company Pty Ltd v Minister for Agriculture, Fisheries & Forestry & Anor* (the live cattle export ban case): Federal Court (NSW Registry) NSD 1102 of 2014. Bevacqua notes, at 43, that traditionally, liability for conscious maladministration is personal to the offending public officer, and suggests that the Crown is not vicariously liable — though "the employer would normally be expected to stand behind the relevant officer accused of the misfeasance, even where no vicarious liability exists" — as apparently happened in *Re Young v Commr of Taxation* [2008] AATA 155, where the Commissioner agreed in to indemnify the employee involved.

<sup>8</sup> [2015] FCA 375 [98].

<sup>9</sup> [2015] FCA 235.

<sup>10</sup> *Hii v Commr of Taxation* [2015] FCA 375; 2015 ATC ¶20-501, [98] (Collier J).

proving that the ATO has acted improperly is generally fairly high<sup>11</sup>, as well as the courts' view that an allegation of bad faith in assessing a taxpayer is 'a serious allegation and one not lightly to be made. It is, thus, not particularly surprising that allegations directed at setting aside assessments on the basis of [ATO] absence of good faith have generally been unsuccessful... one would hope that this was and would continue to be the case'.<sup>12</sup>

However, there is a delicate balancing act involved. In policy terms, imposing too heavy a liability on public officers 'may deter officials from exercising powers conferred on them when their exercise would be for the public good'. On the other hand, defining liability too narrowly may mean that innocent persons affected by an abuse of public power are left without a remedy. Courts considering the tort of conscious maladministration must try to balance these competing considerations.<sup>13</sup>

While the tort of conscious maladministration by a public officer is 'well-established' in general law<sup>14</sup>, it had lain fallow in Australian *tax* jurisprudence until it was brought to the attention of the tax profession by the 2008 High Court decision in *Futuris*, where it was identified as one of the two possible foundations for an attack under s 39B of the *Judiciary Act 1903* (Cth) on the validity (rather than the accuracy) of a tax assessment.<sup>15</sup> Since then, a number of taxpayers have brought actions alleging conscious maladministration by the ATO,<sup>16</sup> although as noted it was 2015 before a taxpayer succeeded in such a claim.

Similar issues have arisen in other jurisdictions. For example, there have been concerns raised in Canada in relation to the actions of their revenue authorities<sup>17</sup>, and while the context may be different, the underlying issues are analogous.<sup>18</sup>

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<sup>11</sup> Peter Haggstrom, 'A Critical Review of Tax Administration in Australia From An Ombudsman's Office Perspective' in Abe Greenbaum and Chris Evans (eds), *Tax Administration — Facing the Challenge of the Future* (1998) 263, 267; see also Bevacqua above n 8, 48–9. However, this 'trust' of ATO officers is 'not unqualified': *Donoghue*, above [142] (Logan J) — quoting the joint judgment in *Futuris*, above, at [23]–[25], [55]–[57].

<sup>12</sup> *Kordan Pty Ltd v FC of T* 2000 ATC 4812 [60] (Hill, Dowsett and Hely JJ); quoted with approval in the joint judgment in *Futuris*, above [60].

<sup>13</sup> *Sanders v Snell* [1998] HCA 64 [37] (Gleeson CJ, Gaudron, Kirby and Hayne JJ).

<sup>14</sup> *NT v Mengel* [1995] HCA 65, joint judgment [65] (Mason CJ, Dawson, Toohey, Gaudron and McHugh JJ); Brennan J [4]; *Sanders v Snell*, above [42] (Gleeson CJ, Gaudron, Kirby and Hayne JJ) — though they noted that the tort was of 'imprecise scope'. In *Mengel*, Mason CJ, Dawson, Toohey, Gaudron and McHugh JJ stated at [57] that it 'was recognised as recently as 1973 that the precise limits of the tort ... were then undefined ... In important respects, that it still true'.

<sup>15</sup> *FCT v Futuris Corporation Ltd* 2008 ATC ¶20-039.

<sup>16</sup> A recent (unsuccessful) attempt being *Pratten v FC of T* [2015] FCA 1357, [24]–[46] (Robertson J); see also A Freeman and B May (above); *Hii v C of T* [2015] FCA 375 [83], [84], [97] (Collier J) citing *Gashi v C of T* [2013] FCAFC 30 [43] (Bennett, Edmonds and Gordon JJ) and *C of T v AAT* [2011] FCAFC 37.

<sup>17</sup> Indeed, Du Pont and Lubetsky go so far as to assert that in Canada, the result of jurisdictional gaps between the relevant courts has been that 'CRA auditors largely have licence to act with near impunity' —above n 1, 105, 108.

<sup>18</sup> See for example J Bevacqua, 'Suing Canadian Tax Officials for Negligence: An Assessment of Recent Developments', *Canadian Tax Journal*, Vol 61 No 4 (2013), 893; M J Hewitt, 'Can You Sue the Canada Revenue Agency for Investigating You?'

<[http://www.singleton.com/en/Publications/Can\\_You\\_Sue\\_the\\_Canada\\_Revenue\\_Agency\\_for\\_Investigating\\_You.aspx](http://www.singleton.com/en/Publications/Can_You_Sue_the_Canada_Revenue_Agency_for_Investigating_You.aspx)>.

Reviewing the Canadian cases, Du Pont and Lubetsky<sup>19</sup> suggested in 2013 that:

Even though the majority of [Canadian] tax officials are conscientious and play a vital role in the administration of the tax system, abusive audits can and do occur for a variety of reasons. Some cases have involved personally motivated malevolence toward a taxpayer,<sup>20</sup> some ... [involved] administrative blunders within the tax department (such as lost records or inaccurate record keeping),<sup>21</sup> while others simply result from inadequate training or supervision of the auditor.

A range of cases reported<sup>22</sup> in Canada illustrate these points. Thus in:

- *Leroux v Canada Revenue Authority*<sup>23</sup>, Canada Revenue Authority (CRA) auditors shredded the taxpayer's original documents, then disallowed deductions on the basis that the taxpayer did not have adequate supporting documentation
- *McCreight*, the CRA officer investigating the taxpayer's use of R&D tax credits swore an information alleging fraud and conspiracy by certain parties, primarily (as the Court found) in order to enable the investigator to retain possession of documents they had previously seized<sup>24</sup>
- *Archambault*, Justice Reimnitz found that Revenu Québec had acted in bad faith by intentionally and maliciously withholding the taxpayer's R&D tax credits, seizing their bank account improperly in order to put financial pressure on the taxpayer, and keeping the taxpayer uninformed about proceedings, thus making it difficult for them to prepare a defence.<sup>25</sup>
- *Chhabra v The Queen*, the state was ordered to pay exemplary damages for their agents' use of tainted documents and improper action in maliciously garnisheeing 75% of the taxpayer's gross professional income;<sup>26</sup>
- *Longley v MNR*, punitive damages were awarded where the CRA improperly refused to recognise the validity of the taxpayer's arrangement and intentionally misled the taxpayer by falsely denying that it had received legal advice supporting the legality of the taxpayer's arrangement<sup>27</sup>;

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<sup>19</sup> G Du Pont and M H Lubetsky, 'The Power To Audit Is the Power To Destroy: Judicial Supervision of the Exercise of Audit Powers', *Canadian Tax Journal* (2013) 61 (Supp), 103; cf the similar comments by Purse (above), 1.

<sup>20</sup> Citing *Main Rehabilitation Co, v Canada*, 2004 FCA 403 and *Chhabra v The Queen* 89 DTC 5310 (FCTD).

<sup>21</sup> Cf *Gallant v The Queen* 2012 TCC 119 where the CRA's form contained errors which led a taxpayer to claim an excessive deduction.

<sup>22</sup> By way of background, see D Jacyk, 'The Dividing Line Between the Jurisdictions of the Tax Court of Canada and Other Superior Courts' (2008) 56(3) *Canadian Tax Journal* 661, 692-6, 704-7; Du Pont and Lubetsky, above n 1, 103; Collins Barlow, 'Oh! Taxman, what big teeth you have' <<http://www.collinsbarrow.com/en/cbn/publications/oh-taxman-what-big-teeth-you-have>>. See also D Roffleisch, 'Rulings on CRA general duty of care — a positive development' *Law Times, Speakers Corner*, 26 January 2015; G Purse, 'How To Sue The CRA' <[http://www.mondaq.com/article.asp?articleid=402130&email\\_access=on](http://www.mondaq.com/article.asp?articleid=402130&email_access=on)>; Hewitt, above n 101; and cf Bevacqua above n 101, 893.

<sup>23</sup> 2012 BCCA 63

<sup>24</sup> *McCreight v AG* 2012 ONSC 1983; Purse above n 102, 3.

<sup>25</sup> *Archambault v Revenu Quebec* 2013 QCCS 5189 [699]; Purse, above, 5, 89 DTC 5310 (FCTD).

<sup>26</sup> (1992) 66 B.C.L.R. (2d) 238 (CA).

- *Joncas v Agence du Revenu Quebec*<sup>28</sup>, damages were awarded where a Revenue Quebec auditor made assertions which they knew were false, and ignored obvious points in issuing assessments; and
- *Groupe Enico Inc v Agence du Revenu du Quebec*<sup>29</sup>, compensation of some \$4 million plus interest was awarded where the court found that CRA created falsely inflated assessments, planted evidence and took a range of other inappropriate actions including unwarranted garnishee action.

Such cases (and *Donoghue* in Australia) underline the point made by Du Pont and Lubetsky above — large bureaucracies, no matter how committed institutionally to public service, must be assiduous in training and monitoring staff to ensure that the organisational ideals are upheld and applied in practice despite human frailties and organisational pressures<sup>30</sup>.

## The Elements of “Conscious Maladministration”

The tort of conscious maladministration was considered by the High Court of Australia in non-tax contexts in *Northern Territory v Mengel*<sup>31</sup> and subsequently in *Sanders v Snell*<sup>32</sup>.

In *Mengel*, a station owner failed to establish that unauthorised<sup>33</sup> actions taken by Northern Territory cattle inspectors which prevented the plaintiff from selling their cattle at a particular time (thus causing significant financial loss to the plaintiff) constituted conscious maladministration, even though the inspectors were aware of the problems their decision would cause for the complainant. In the course of his judgment, Deane J set out<sup>34</sup> the elements which the taxpayer was required to prove in order to establish conscious maladministration as being:

1. an invalid or unauthorised act<sup>35</sup>
2. done maliciously
3. by a public officer<sup>36</sup>

<sup>28</sup> 2012 QCCQ 5096.

<sup>29</sup> 2013 QCCS 5189.

<sup>30</sup> For example, Collins Barlow (above), queried whether CRA pressure to generate financial returns from audits may have been a factor in the excesses by CRA officers in various cases, while Logan J noted in *Donoghue* above, [101],[113] that the auditor in that case had been operating under time pressures to complete the audit.

<sup>31</sup> [1995] HCA 65 (Mason CJ, Brennan, Deane, Dawson, Toohey, Gordon, McHugh JJ).

<sup>32</sup> *Sanders v Snell* [1998] HCA 64.

<sup>33</sup> I.e., there was no statutory or other authority for their actions: *Mengel*, above, [2], even though the actions were taken for the purpose of furthering a government-sponsored campaign to eradicate disease in cattle.

<sup>34</sup> *NT v Mengel* [1995] HCA 65 [23].

<sup>35</sup> *Mengel*, Deane J at [8].

<sup>36</sup> Bevacqua, above n 8, 44, notes that there is ‘no single clear test’ to identify a public officer, and that it has been suggested that employees occupying positions lower on the public service ladder might not be held to be occupying a public office — thus creating difficulties for plaintiffs. In *Mengel*, above n 21, Brennan J stated at [5] that a ‘public officer’ is anyone who is appointed to discharge a public duty, and receives a compensation in whatever shape, whether from the Crown or otherwise’. In *Donoghue* (below) Logan J avoided this problem by identifying the Commissioner of Taxation as the ‘public officer’ by virtue of their statutory duty to issue the assessments in question — raising in turn the possibility of the Commissioner being personally liable for damages, unless there is de facto authority and the State is vicariously liable for the acts of its servants within the scope of their duty: *Mengel*, above, the above, the joint judgment at [13] ~~noted~~ that “... the [Northern] Territory accepts that if there is any liability on the part of the Inspectors, it is vicariously liable to the Mengels” – cf the joint

4. in the purported discharge of his or her public duties
5. which causes loss or harm to the plaintiff.

In relation to the second element of “malice”:

- The case-law has stressed that conscious maladministration involves an act done in bad faith<sup>37</sup> - it is a “deliberate tort in the sense that there is no liability unless either there is an intention to cause harm or the officer concerned knowingly acts in excess of his or her power”.<sup>38</sup> That is, the tort is triggered by a state of mind in the public officer that is inconsistent with an honest attempt to properly perform the functions of their public office<sup>39</sup>.
- The Full Federal Court in *Denlay v FCT* stressed that conscious maladministration requires actual bad faith, and ‘does not include constructive bad faith established by unwitting involvement in [an] offence’. The focus is on the state of mind of the officers involved in making the assessment; and the concept relates to the integrity of the process and the competence and honesty of those officers.<sup>40</sup> Accordingly, proof that the defendant acted in good faith will generally negate liability for conscious maladministration.
- The critical concept of ‘malice’ is usually the most difficult element to prove, though it has been broadened in more recent case-law – see below<sup>41</sup>;  
In *Mengel*, Deane J stated that for the purposes of conscious maladministration, ‘malice’ would exist if the act was done (i) with actual intent to cause such injury; (ii) with knowledge of invalidity or lack of power and the act would be likely to cause such injury; or (iii) with reckless indifference<sup>42</sup> or deliberate blindness to that invalidity or lack of power and that likely injury.<sup>43</sup>

Brennan J took a similar view, suggesting that:

Misfeasance in public office consists of a purported exercise of some power or authority by public officer otherwise than in an honest attempt to perform the functions of his or her office whereby

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judgment at [60] – but see 6 above; see also *Young & Commissioner of Taxation* (above) [22] (Hack and McPherson DP).

<sup>37</sup> *Applicant WAFV of 2002 v Refugee Review Tribunal* [2003] FCA 16, [51]-[52] (French J)

<sup>38</sup> *Mengel*, above, joint judgment [57].

<sup>39</sup> *Mengel*, Brennan J at [9],[10]. His Honour observed at [9] that in ‘more recent times, the scope of the tort has not been limited to cases in which a public officer has acted maliciously ... but [extends to situations where] a public officer engages in conduct in purported exercise of a power but with actual knowledge that there is no power to engage in that conduct’.

<sup>40</sup> [2011] FCAFC 63 [76]-[80] — cited in *Roberts v DCT* [2013] FCA 1108 [25] (Besanko J).

<sup>41</sup> *NT v Mengel* [1995] HCA 65, [23] (Deane J).

<sup>42</sup> ‘Recklessness’ is usually defined via an objective test as conduct beyond mere inadvertence or carelessness, involving disregard or indifference to consequences that are reasonably foreseeable as being a likely result of actions taken — running what a reasonable person would regard as ‘an unjustifiable risk’ or ‘a conscious disregard of an unjustified risk’ amounting to ‘gross carelessness’: *BRK (Bris) Pty Ltd v FC of T* 2001 ATC 4111 [77]-[80] (Cooper J); *Yazbek v FC of T* 2014 ATC ¶10-369 [93]-[103] (Bennett J) and other cases cited in Woellner et al, *Australian Taxation Law*, (25<sup>th</sup> edn) 2015, 1,870-1 nn 23-5. ‘Recklessness’ therefore involves an intermediate state between lack of reasonable care (mere carelessness) and intentional conduct: see Woellner et al (above) at 1,863-4 and 1,871-2 respectively.

<sup>43</sup> *NT v Mengel* [1995] HCA 65, Deane J [24].

loss is caused to a plaintiff. Malice, knowledge and reckless indifference are states of mind that stamp on a purported but invalid exercise of power the character of abuse of or misfeasance in public office. If the impugned conduct then causes injury, the cause of action is complete.<sup>44</sup>

The judges delivering the joint judgment in *Mengel*<sup>45</sup> were less definite in relation to whether recklessness would found an action in conscious maladministration. After earlier stating that principle suggested that misfeasance in public office was a counterpart to torts involving intentional infliction of harm and should be confined in the same way,<sup>46</sup> their Honours stated merely that if misfeasance in public office was to be viewed as a counterpart to the torts imposing liability on private individuals for the intentional infliction of harm, there was 'much to be said for the view that' misfeasance would include reckless disregard of the means of ascertaining the extent of the officer's power.<sup>47</sup>

Similarly, in *Sanders v Snell*, Sanders failed to prove conscious maladministration in relation to his dismissal from his position as Executive Officer of the Norfolk Island Government Tourist Bureau. The High Court quoted from the judgment in *Mengel* (above) and noted that

For the purposes of deciding *Mengel*, the majority considered it sufficient to proceed on the basis that the tort requires an act which the public official knows is beyond power and which involves a foreseeable risk of harm, but noted also that there seems much to be said for the view that misfeasance extends to the situation of a public official recklessly disregarding the means of ascertaining the extent of his or her power.<sup>48</sup>

Accordingly, while *Mengel* is usually cited as holding that reckless indifference is sufficient to found the tort,<sup>49</sup> this may not be technically correct. It will be interesting to see how the current High Court approaches the issue, should it have another opportunity to consider the point if the appeals in *Donoghue proceeds* that far.

## **The decision in *Futuris* – Conscious Maladministration enters tax jurisprudence**

In *Futuris*<sup>50</sup>, the company had lodged tax returns showing a taxable income of some \$86 million flowing from a complex series of intra-group transactions. The ATO subsequently issued two separate amended assessments to Futuris, including in each the same amount of \$19.95 million in relation to a capital gain (in the case of the second amended assessment, the \$19.95 million was included in a larger sum assessed under Part IVA of the *Income Tax Assessment Act 1936* (Cth) (*ITAA36*)). Futuris claimed that by doing so, the ATO had knowingly 'double counted' the \$19.95 million capital gain and had therefore issued the second amended assessment in bad faith, knowing it to be wrong, which (Futuris argued) constituted an abuse of a public office and therefore conscious maladministration. The ATO relied upon the 'compensating adjustment' provision in s 177F(3) *ITAA36* to enable it to

<sup>44</sup> *NT v Mengel* [1995] HCA 65, Brennan J [10]

<sup>45</sup> Mason CJ, Dawson, Toohey, Gaudron and McHugh JJ.

<sup>46</sup> *NT v Mengel* [1995] HCA 65, joint judgment at [60] - note at [48].

<sup>47</sup> *NT v Mengel* [1995] HCA 65 (Mason CJ, Dawson Toohey, Gaudron and McHugh JJ) [62] (though they noted at [62] that this was not what was put to the Court in *Mengel*). This was the interpretation also adopted by the High Court subsequently in *Sanders v Snell* [1998] HCA 64 [38].

<sup>48</sup> Citing *Mengel* (1995) 185 CLR 307 at 347. Similarly, in *Roberts v DFCT* [2013] FCA 238, Besanko J at first instance indicated at [42] merely that he accepted 'as arguable for the purpose of this application that that form of recklessness which bears a close affinity with deliberate conduct ... may be sufficient'.

<sup>49</sup> See for example the observations by the various Law Lords in *Three Rivers (No 3)* [2003] 2 AC 1.

<sup>50</sup> *FCT v Futuris Corporation Ltd* 2008 ATC ¶20-039.

exclude the amount of \$19.95 million from the Part IVA assessment if this was necessary to avoid any 'double counting'.

In a joint judgment, Gummow, Hayne, Heydon and Crennan JJ in the High Court rejected *Futuris*' argument and held that the ATO had not committed misfeasance in public office, because its actions did not involve a deliberate failure either to comply with the provisions of the Act or to administer a law according to its terms,<sup>51</sup> nor was it an act by ATO staff which was knowingly in excess of their powers,<sup>52</sup> or the exercise of statutory powers corruptly or with deliberate disregard for the proper scope of those powers.<sup>53</sup>

The decision in *Futuris* highlighted two interesting questions:

1. Are there only two grounds on which the validity of an assessment can be challenged? and
2. The role of 'recklessness' in relation to conscious maladministration.

### **1. Are There Only Two Bases for Challenging the Validity of an Assessment?**

The joint judgment in *Futuris* referred to only two bases for attacking the validity of an assessment, namely that the assessment was tentative/provisional, or that there was a conscious maladministration of the Act.<sup>54</sup>

Kirby J disagreed with the other Justices on this point and observed that while tax lawyers had typically focussed on these two issues, this did not justify treating these two grounds as the only bases for 'jurisdictional error' for the purposes of s 39B of the *Judiciary Act 1903* (Cth). He commented that:

As the two nominated categories of invalidity have arisen in taxation cases for at least 80 years, there is a risk that specialists in taxation law will overlook, or ignore, the considerable subsequent advances in administrative law ... Specialist disciplines, including in law, can occasionally be myopic and inward-looking ... The recognised 'jurisdictional error' categories in Australia are not closed. Least of all are they confined to the two classifications beloved by tax lawyers. According to a leading Australian academic authority on the subject, [eight] categories have been recognised<sup>55</sup> ... [which] go well beyond the two that have engaged virtually the entire attention of the Federal Court and of this Court in these proceedings and other cases like it. There is a risk that the broader categories will be overlooked in such taxation matters if reference is made only to past authority and tax appeals. Once disqualifying invalidity ('jurisdictional error') is propounded, these other categories are necessarily enlivened. When a suggestion of invalidation is made, it is not sufficient for the courts, or the parties, simply to cite taxation cases.<sup>56</sup>

Despite His Honour's strong exhortation, subsequent decisions have tended to favour the 'myopic' interpretation of conscious maladministration.

<sup>51</sup> *FCT v Futuris Corporation Ltd* 2008 ATC ¶20-039 [55] (Gummow, Hayne, Heydon and Crennan JJ).

<sup>52</sup> *FCT v Futuris Corporation Ltd* 2008 ATC ¶20-039 [11] (Gummow, Hayne, Heydon and Crennan JJ).

<sup>53</sup> *FCT v Futuris Corporation Ltd* 2008 ATC ¶20-039 [59]. (Gummow, Hayne, Heydon and Crennan JJ)

<sup>54</sup> *FCT v Futuris Corporation Ltd* 2008 ATC ¶20-039 [51]–[52]. (Gummow, Hayne, Heydon and Crennan JJ).

<sup>55</sup> In truncated and summary form (see Kirby J at [134], quoting Aronson, 'Jurisdictional error without the tears' in Groves and Lee (eds) *Australian Administrative Law — Fundamentals, Principles and Doctrines*, 2007 330 at 335–6), these are: a mistaken denial of jurisdiction; a misapprehension of the limits of the decision-maker's powers; acting outside the general area of the decision-maker's jurisdiction; acting on a mistaken assumption about the existence of an essential requirement; disregarding a required consideration or paying regard to an irrelevant one; misconceiving the function being performed or the extent of the decision-maker's powers; acting in bad faith; or breaching natural justice.

<sup>56</sup> *FCT v Futuris Corporation Ltd* 2008 ATC ¶20-039 [133]–[135] (Kirby J) — see also [136],-140], [151]–[152].



Thus in *Roberts v Deputy Commissioner of Taxation*,<sup>57</sup> in the context of an application by the Deputy Commissioner of Taxation for summary judgement based on Notices of Amended Assessments, Besanko J at first instance referred to several passages in the joint judgement in *Futuris*<sup>58</sup> and concluded:<sup>59</sup>

In my opinion there are only two categories of error which are not protected by s 175 of the ITAA 1936. The other forms of what constitutes jurisdictional error in other areas of administrative law are not sufficient, nor is recklessness in an expanded sense or carelessness in the administrative process ...<sup>60</sup>

In the subsequent hearing seeking leave to appeal from Besanko J's decision,<sup>61</sup> Mansfield J seemed to endorse the view that there were only two grounds for challenging an assessment.<sup>62</sup>

Subsequently, in *Hii v FCT*,<sup>63</sup> Collier J referred<sup>64</sup> to the decisions in *Roberts*,<sup>65</sup> *Marijancevic v DFCT*,<sup>66</sup> *Denlay v FCT*,<sup>67</sup> *DCT v Hua Wang Bank Berhad (No 2)*,<sup>68</sup> *Commissioner of Taxation v AAT*<sup>69</sup> and *Gashi v FCT*,<sup>70</sup> and concluded that these decisions of the Federal Court had 'narrowed the categories where the Court has power to intervene' in challenges to assessments pursuant to s 39B of the *Judiciary Act 1903* (Cth) to the two traditional bases.<sup>71</sup>

However, there are occasional exceptions. Thus, in *Woods v DFC of T*,<sup>72</sup> a case involving an appeal against a summary judgement and refusal to stay enforcement proceedings, Porter J in the Supreme Court of Tasmania suggested that a 'fair reading' of the joint judgment in *Futuris* did not disclose that their Honours had definitively limited the categories of jurisdictional error to only two, and pointed out that it was 'at least arguable, being the view adopted by Kirby J, that there was no intention to limit the categories to these two instances'.<sup>73</sup>

While the prevailing view appears to be that there are only the two bases for conscious maladministration, there is considerable force in the observations by Kirby J in *Futuris*<sup>74</sup>, and it is hard to see any overwhelming rationale in principle for the narrower view. There is some merit in the view that tax law should apply all administrative law concepts of jurisdictional error as they develop, rather than privileging two and excluding others.

<sup>57</sup> [2013] FCA 238 (Besanko J).

<sup>58</sup> See the judgment of Besanko J at [36]–[40]. His Honour stated at [41] that his conclusion was consistent with the observations of the Full Federal Courts in *Marijancevic* and *Denlay*, and with the observations of Kenny J in *DCT v Hua Wang Bank Berhad (No 2)* (above).

<sup>59</sup> *Roberts v DCT* [2013] FCA 1108 [19],[36]–[41], citing *Futuris* (above) joint judgment at [25]

<sup>60</sup> *Roberts v DCT* [2013] FCA 1108 [19 – point 2],[42] (Besanko J). In *Pratten* (above) [4]–[5], [25]–[26], Robertson quoted these comments by Besanko J with apparent approval and reached the same conclusion in "~~broad terms~~broad terms".

<sup>61</sup> *Roberts v DCT* [2015] FCA 238 (Mansfield J).

<sup>62</sup> *Roberts v DCT* [2015] FCA 238 [32], [35]–[36], but see [30] (Mansfield J); see also *Gashi v FCT* 2013 ATC ¶20-377 [42]–[43].

<sup>63</sup> 2015 ATC ¶20-501 (Collier J)

<sup>64</sup> 2015 ATC ¶20-501 [81]–[84] (Collier J).

<sup>65</sup> *Roberts v DCT* [2013] FCA 1108 (Besanko J at first instance — referred to by Collier J in *Hii v CT* [2015] FCA 375 at [81], and at [82] to the (unsuccessful) application for leave to appeal — *Roberts v DCT* [2015] FCA 238.

<sup>66</sup> *Marijancevic v DFC of T* 2008 ATC ¶20-046.

<sup>67</sup> *Denlay v FCT* [2011] FCAFC 63; 2011 ATC ¶20-260

<sup>68</sup> *DCT v Hua Wang Bank Berhad (No 2)* (2010) 81 ATR 40 [48].

<sup>69</sup> *C of T v AAT* (2011) 191 FCR 400 [23].

<sup>70</sup> *Gashi v C of T* [2013] FCAFC 30

<sup>71</sup> 2015 ATC ¶20-501 [81].

<sup>72</sup> [2011] TASSC 68 – cf Mansfield J in *Roberts* (2015) at [30]

<sup>73</sup> [2011] TASSC 68, see [53]–[57].

<sup>74</sup> Cf Mansfield J in *Roberts* [2015] FCA 238, [30].

## B. The Role of Recklessness in Relation to Conscious Maladministration

As noted above, the conventional view is that the High Court in *Mengel* held that reckless indifference or deliberate blindness in relation to the invalidity of or lack of power for a public officer's acts<sup>75</sup> is sufficient to ground an action for conscious maladministration.<sup>76</sup>

However, as noted above, while Deane J and Brennan J were certainly of this view in *Mengel*, the joint judgment was more guarded, stating merely that 'there is much to be said for the view that misfeasance extends to the situation of a public official recklessly disregarding the means of ascertaining the extent of his or her power'.

Similarly, the High Court joint judgment in *Futuris* observed that the House of Lords had indicated that in English law 'recklessness may be a sufficient state of mind to found the tort',<sup>77</sup> though they did not indicate clearly whether they believed that the same development had occurred or should occur in Australian law.<sup>78</sup>

Subsequently, in *Roberts v DCT*, Besanko J in a guarded statement 'accepted as arguable' for the purposes of the application in that case that while 'recklessness in an expanded sense or carelessness in the administrative process' were not sufficient to found an action for conscious maladministration, the form of recklessness which 'bears a close affinity with deliberate conduct ... may be sufficient' (emphasis added).<sup>79</sup>

On the subsequent hearing seeking leave to appeal that judgment, Mansfield J endorsed the approach by Besanko J on this issue, holding that the facts did not demonstrate conscious maladministration, *whether or not this included reckless maladministration*. Thus His Honour left open the issue of whether recklessness could constitute conscious maladministration.

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<sup>75</sup> See the comments by Besanko J in *Roberts* (2013) [28],[42], quoted in turn with approval by Collier J in *Hii*, above, [99]; cf Mansfield J in *Roberts* (2015) above, [39].

<sup>76</sup> See for example, below, the observations by Logan J in *Donoghue* at [144]–[145], discussing the decision of the House of Lords in *Three Rivers District Council v Bank of England [No 3]* [2003] 2 AC 1; see also Bevacqua, above n 8, 49–50. Compare, as to the position in Canada, Du Pont and Lubetsky (above n 1), 116.

<sup>77</sup> *FCT v Futuris Corporation Ltd* 2008 ATC ¶20-039 [11] (Gummow, Hayne, Heydon and Crennan JJ), citing *Three Rivers District Council v Governor and Company of the Bank of England (No 3)* [2003] 2 AC 1, 198, 228, 231.

<sup>78</sup> Logan J *Donoghue*, above at [144] cited the quotation "with apparent approval" by the joint judgment in *Futuris* at [11] of the statements by their Lordships in *Three Rivers [No 3]* as support for his interpretation. However, as noted, their Honours in *Futuris* had not clearly endorsed this result, instead stating obliquely that 'The House of Lords has since indicated that in English law recklessness *may* be a sufficient state of mind to found the tort. The affinity between tort law and public law has been remarked upon in this Court ... [reflecting] the precept that in a legal system such as that maintained by the *Constitution*, executive or administrative power is not to be exercised for ulterior or improper purposes'.

<sup>79</sup> *Roberts v DCT* [2013] FCA 1108 [42] — Besanko J had stated earlier in his judgment that 'Recklessness is very close to conscious maladministration in that it is proceeding with a course of conduct well knowing that it is likely that it is not in accordance with the law and prescribed administrative processes, but careless or indifferent to that fact. It includes a serious departure from the law in prescribed administrative processes to the point that one can infer what blindness or a state of mind akin to that...' [28]. His Honour at [30]–[33] discounted comments made by French J in *DCT v Warrick (No 2)* [2004] FCA 918 [100] on the question of whether a lack of bona fides could be established by showing a lack of conscientious and diligent approach by the ATO to the decision-making process as being of doubtful weight, given that the observations in that case were qualified and made before the decision in *Futuris*.

Most recently, in *Hii v C of T*, Collier J noted that the observations by Besanko J on this point had been ‘carefully qualified’ and did not support a submission that recklessness (carelessness or indifference to the law) constituted bad faith.<sup>80</sup>

*Donoghue* seems to have been the first Australian taxation case which raised directly the issue of whether reckless indifference was a sufficient ground for an action in conscious maladministration. At first instance (the case is on appeal to the Full Federal Court) Logan J quoted with apparent approval the statements by the various Lords in the UK case of *Three Rivers District Council v Bank of England (No 3)*,<sup>81</sup> where their Lordships stated variously that:

[it is] settled law that an act performed in reckless indifference as to the outcome is sufficient to ground the tort ... (Lord Steyn at 192);

[it is sufficient that] the public officer ... is reckless as to [as to the probability that their action will injure another person] (Lord Hutton at 228); and

[it is sufficient if the] official does the act intentionally being aware that it risks directly causing loss ... and the official wilfully disregards that risk (Lord Hobhouse at 231<sup>82</sup>).

Logan J noted that their Lordships expressly adopted as correct the proposition which they drew from *Mengel* that ‘proof of recklessness was sufficient in relation to the tort of misfeasance in public office’<sup>83</sup> and suggested that the decision in *Futuris* supported this position’.<sup>84</sup>

Recognising recklessness as a trigger for conscious maladministration seems the better approach in policy terms,<sup>85</sup> and some other jurisdictions have taken this approach<sup>86</sup>. However, it is not clear that the High Court has actually held that reckless indifference was a sufficient ground in Australia.

*Donoghue* therefore appears to be the first Australian tax case which raised directly the issue of whether reckless indifference is a sufficient ground for an action in conscious maladministration –and where a taxpayer has actually succeeded in proving conscious maladministration by the ATO.<sup>87</sup> - It will be interesting to see the approach taken by the Full Federal Court on this issue when it delivers its judgment in the appeal from the decision by Logan J.

Against this background, it is useful to consider the decision in *Donoghue* more closely.

<sup>80</sup> [2015] FCA 375 [99] (Collier J).

<sup>81</sup> [2003] 2 AC 1, 193 (Lord Steyn), 228 (Lord Hutton) and 231 (Lord Hobhouse of Woodborough); Cox (above), 4(n 27) cites subsequent cases applying the *Three Rivers (No.3)* decision.

<sup>82</sup> His Lordship at [144] suggested that the “requirement of foresight of probable harm to the plaintiff, or recklessness as to such harm, is sufficient to ensure that the tort is confined within reasonable bounds ...”

<sup>83</sup> 2015 ATC ¶20-494 [144] (Logan J).

<sup>84</sup> 2015 ATC ¶20-494 [145] (Logan J) — but see the discussion in the text around n 75 above; cf Pratten (above).

<sup>85</sup> Bevacqua, above n 8, 50, comments that including recklessness as a sufficient element of the tort ‘gives rise to the only practical hope of the tort being available in all but the rarest cases of ATO operational mistake causing taxpayer loss’.

<sup>86</sup> Du Pont and Lubetsky, above, p116, fn 51.

<sup>87</sup> In *Donoghue* (above) [130], the Commissioner of Taxation was held to be the ‘public officer’ because ultimately he was responsible under the Act for the issue of the tax assessments in question. This avoided the problem identified by Bevacqua at 44–5 that junior public servants such as Mr Main (the auditor in question) might not be held to be ‘public officers’, but raises the issue of a potential order for damages being made against the Commissioner personally (see above), and whether the State would be vicariously liable for the acts of the Commissioner (and possibly others) acting within the scope of their employment (see e.g. n6 above, but cf C Sappideen, P O’Grady, J Riley, G Warburton and B Smith, *Macken’s Law of Employment* (7<sup>th</sup> edn) Law Book Co 2011, Chap 13.), or would indemnify them – as apparently occurred in *Re Young v Commr of Taxation* [2008] AATA 155.

## Problems in Paradise: *Donoghue v Commissioner of Taxation*

The facts of *Donoghue* were startling, to say the least.

In that case, Mr Donoghue had retained a firm of solicitors (Moore & Associates) to act for him in relation to a range of legal matters. A large part of the relevant work was done by Simeon Moore, the son of Peter Moore, a partner in that legal firm. Simeon was at the time a student in the Law School of an Australian university, but was not then admitted to practice.

The judge found that Simeon performed most of the work for Donoghue in relation to various litigious matters, operating as an agent or employee of Moore & Associates<sup>88</sup> – though styled as a ‘lay associate’ or ‘consultant’. In the course of that work, Simeon created a considerable amount of advice, documentation and other materials prepared in relation to anticipated litigation, which the judge held was protected by legal professional privilege<sup>89</sup>.

Simeon subsequently rendered a bill to Mr Donoghue for some \$750,000 for work allegedly done. Logan J found that:

The number of hours stated on this invoice to have been worked ... over the period mentioned is truly fantastic both in total and with reference to individual days. If the entries on the invoice are to be believed, for the period between 20 April and 5 June 2010 (each inclusive) and between 13 and 15 June 2010 (each inclusive), Simeon Moore performed services each and every hour of each and every day that fell in these periods. Again if the entries on the invoice are to be believed, the latter period was worked after working 17 hours on 10 June, 18 hours 11 June and 22 hours on 12 June. In total, including GST and what was said to be ‘ancillary costs’, the total amount said to be owing is \$753,174.62. And this for the services of an as yet not admitted law graduate undertaking post-graduate studies in law ...

The sum sought is outrageously extortionate ... I regard this tax invoice as a fantasy document ...<sup>90</sup>

Perhaps not surprisingly, Donoghue refused to pay the bill. Following this refusal, Simeon had a conversation with Donoghue to the effect that if the bill was not paid, Simeon would ‘have no hesitation giving the ATO everything I have on you. You should be very worried. A family friend is an Assistant Commissioner and I’ve reported people to him before and he has taken them down ...’<sup>91</sup>

By October 2010, the ATO had already commenced an audit into Donoghue as a result of information received from an unrelated third-party source and by the end of October 2011, the auditor in charge of the case (Main<sup>92</sup>) had prepared a draft report — before receiving any information from Simeon. .

Subsequently, in November 2011, Simeon sent a large amount of information and documentation about Donoghue’s affairs by email at various times to Mr Wabek of the ATO, including material which Logan J held was protected by legal professional privilege. Simeon provided this information to the ATO without Donoghue’s consent.

<sup>88</sup> Except for some preliminary research work which the judge found that Simeon had provided on an independent basis.

<sup>89</sup> On the alternative basis that either Simeon was (i) working to Moore & Associates in the provision of legal advice and the conduct of existing or anticipated litigation, or (ii) was operating as a conduit between Donoghue and Moore & Associates who were acting as Donoghue’s lawyers: [58]-[62]. Logan J noted that the question of whether the materials were privileged was “highly controversial”, and this will no doubt be one of the key issues (with waiver and other matters) canvassed in the ATO’s appeal to the Full Federal Court.

<sup>90</sup> *Donoghue v C of T* [2015] FCA 235 [71]-[72] (Logan J).

<sup>91</sup> *Donoghue* [2015] FCA 235 [73] (Logan J). The judge found ([67],[78]) that Simeon Moore held a complete set of files in relation to Donoghue’s matters solely for the purpose of pursuing Donoghue’s existing or anticipated litigation.

<sup>92</sup> Main was a junior ATO auditor, and this was the first audit for which he had primary responsibility

The material supplied by Simeon to the ATO was passed by Wabeck on to another ATO officer (Clark) who in turn passed it on to Main. The information provided significant new insights and information, and as a result, Main abandoned his original report and prepared a new one using the information provided by Simeon. This new report was used as the basis for preparation of default assessments which were later served on Donoghue, together with imposition of penalties and a Departure Prohibition Order ('DPO').

The whole process had been conducted in secret within the ATO, to avoid Donoghue learning of its plans<sup>93</sup>. The ATO apparently feared that if Donoghue became aware of the proposed assessments and DPO, he might either leave Australia (or not return) in order to avoid payment of the significant amount of tax owing. Main was therefore reluctant to ask either Peter Moore or Donoghue about the status of the documents obtained, in case this alerted Donoghue to the ATO's interest in his affairs. Similarly, neither Wabeck nor Clark sought to explore with Simeon or anyone else the question of whether any of the materials might be privileged,<sup>94</sup> even though Main had alerted them to his apprehension about the possibility of legal professional privilege applying to at least some of the documents.

Main knew that he should not use for assessment purposes any material covered by legal professional privilege. He gave evidence that when he first received the information, he considered whether the documents received were likely to be covered by the privilege, and concluded that this was 'unlikely' because it was not apparent on the face of the documents that they recorded the provision of legal advice to Donoghue.<sup>95</sup> Logan J noted that this conclusion was a 'convenient one' for Main, as he was at the time under 'a degree of time pressure to complete the audit',<sup>96</sup> and held that Main's 'conclusion as to what was necessary to make these extracted documents privileged was mistaken and reckless'.<sup>97</sup>

When Donoghue received the default assessments, he rightly surmised, in light of the threats made by Simeon, that some of his privileged communications may have been given to the ATO. Donoghue accordingly retained new solicitors to challenge the validity of the assessments, Departure Prohibition Order and penalties under *s 39B* of the *Judiciary Act 1903* (Cth), on the basis - among other things - of 'conscious maladministration' by the Commissioner<sup>98</sup> through the ATO staff's improper use of the privileged materials in the assessment process.

Logan J held that Donoghue had established conscious maladministration, finding so far as relevant that:

1. Main did not deliberately use material knowing it definitely to be privileged. However, he did 'deliberately not pursue or cause to be pursued inquiries which would have quelled an apprehension, always present, which he had that the documents and information provided by Simeon Moore (or some indeterminable part thereof) were subject to legal professional privilege'.<sup>99</sup>

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<sup>93</sup> *Donoghue*, (above), [107] (Logan J).

<sup>94</sup> *Donoghue* [107] (Logan J).

<sup>95</sup> *Donoghue* [100] (Logan J).

<sup>96</sup> *Donoghue* [101] (Logan J).

<sup>97</sup> *Donoghue* [102] (Logan J).

<sup>98</sup> *Donoghue* [123]-[131] (Logan J).

<sup>99</sup> *Donoghue* [112] (Logan J).

2. Main knew that he could not use privileged material for the purpose of the audit and assessments, that the privilege could not be waived by third parties or a solicitor, and that in any case there was no evidence of waiver in the materials.<sup>100</sup>
3. Main was always apprehensive that some of the material might be privileged, but ‘chose to take his own counsel’ on this issue, ‘closed his eyes to the obvious’ and (wrongly) concluded that the risk of the documents being protected by privilege was low:

Mr Main deliberately chose not to make or cause to be made inquiries [about the possible application of the privilege]. He chose to take a risk ... that the material might indeed be privileged and its use in the process of assessment forbidden by law. He made these choices under the pressure of a limited time within which to complete his audit ... [and] acted in reckless disregard of a right which Mr Donoghue had at least to claim an important common law privilege.<sup>101</sup>

[Moreover, Main] ... ‘chose, deliberately, not to put in place a regime which would protect any claimed privilege before use was made of that material for assessing purposes’.<sup>102</sup>

Accordingly, Logan J held that the Commissioner of Taxation<sup>103</sup> had, through Main’s actions, committed conscious maladministration in the assessment process<sup>104</sup>. The assessments were therefore quashed, as were the penalties and DPO.<sup>105</sup> The materials provided by Simeon were to be either returned to Donoghue or destroyed.

## **Contributing factors - the impact of inadequate supervision and guidance within the ATO**

In *Donoghue*, Logan J noted that Main struck him as

an intelligent, serious-minded young man, dedicated to his auditing duties within the Australian Taxation Office ... This was the first audit for which he had primary responsibility... I do not consider that the weakness in the process of assessment revealed by this case was one of character on Mr Main’s part but rather ... of inexperience and zeal, coupled with a lack of relevant supervision and guidance.<sup>106</sup>

<sup>100</sup> *Donoghue* [112] (Logan J).

<sup>101</sup> *Donoghue* [107] [112], [113] (Logan J).

<sup>102</sup> *Donoghue* [138] (Logan J).

<sup>103</sup> Logan J observed at [130] that the Commissioner had rightly been joined as respondent to the action because under the deeming provision in s 8(2) of the *Taxation Administration Act*, the assessments and notices issued by delegates of the Commissioner were deemed to have been given by the Commissioner of Taxation.

<sup>104</sup> Logan J did not directly address the issue of whether personal liability could attach to the Commissioner (or Main), and it is not clear from the case report whether indemnities have been offered to the Commissioner or other parties if they are ultimately found to have been involved in/directly in conscious maladministration.

See Bevacqua above n 8, 43; Robert Evans, ‘Damages for Unlawful Administrative Action: The Remedy for Misfeasance in Public Office’ (1982) 31 *International and Comparative Law Quarterly*, 640, 644–5, Traditionally, Crown vicarious liability has not applied to conscious maladministration: Bevacqua, above n 8, 43.

<sup>105</sup> *Donoghue* [145]–[148]. Logan J at [145] noted that it was — in the first instance — for the Commissioner to decide whether, having regard to the information still available to the ATO and ‘in the circumstances now prevailing’ it was ‘possible in fact and in law’ to issue fresh assessments.

<sup>106</sup> *Donoghue* [99], (Logan J).

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Logan J observed that Main would have benefited from advice and guidance from ‘an engaged, experienced supervisor’ and perhaps also external legal advice to advise him on the implications of the proposed use of the questionable material supplied by Simeon Moore in preparing assessments.<sup>107</sup>

On the latter point, Logan J observed that Main’s supervisors and colleagues within the ATO had also failed in their responsibilities and contributed to the problem.<sup>108</sup> Main had advised Clark and Wabeck (the colleagues who had been involved in the transmission of the Simeon materials to Main) of his apprehension that at least some of the materials might be covered by legal professional privilege, but despite this, neither colleague tried to persuade him not to use the material, nor did they alert Main’s supervisors to his concerns or explore with Simeon Moore or anyone else the question of whether any of the material Simeon was offering to the Australian Taxation Office might be privileged.<sup>109</sup>

Similarly, although Main did not actually alert his ATO supervisors to his concerns about the possibility of legal professional privilege applying, Logan J was critical of the fact that neither of Main’s supervisors within the ATO detected his apprehension in relation to this issue, or offered him any guidance as to the possible implications of using the material provided by Simeon Moore to create assessments. His Honour observed that

The defect in the process of assessment revealed by this case is not one for which Mr Main is solely responsible. It is to be remembered that while rank has its privileges, it also has its responsibilities.<sup>110</sup>

This warning highlights the need for systemic reform in these areas – regardless of the legal outcome in the case - if the ATO is to avoid a recurrence of such problems.

## Other issues

There were a number of other issues canvassed by Logan J in the course of his judgment:

### Obfuscation:

Logan J was critical of the ATO’s response to the queries raised by Donoghue’s new lawyers as to whether the ATO had received privileged material and their attempt to claim privilege in relation to that material on behalf of Donoghue.

The ATO’s initial response required Donoghue to provide details of the specific documents he claimed were subject to privilege. Logan J suggested that this response ‘might accurately be described as obfuscation by the Australian Taxation Office’, since it posed an almost impossible task for Donoghue and his lawyers, who did not know which documents had been given to the ATO.<sup>111</sup>

At the very least, this would seem an inappropriate response from a federal government department, and certainly not one expected of a ‘model litigant’.<sup>112</sup>

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<sup>107</sup> *Donoghue* [99] (Logan J).

<sup>108</sup> *Donoghue* [99] (Logan J).

<sup>109</sup> *Donoghue* [107], [114] (Logan J).

<sup>110</sup> *Donoghue* [107] (Logan J).

<sup>111</sup> *Donoghue* [115], Logan J.

<sup>112</sup> *Donoghue* [132]–[140] ([Logan J](#)). This is not the first time that the ATO has been criticised for inappropriate conduct: see Woellner et al, *Australian Taxation Law* (25<sup>th</sup> edn) CCH Aust Ltd ¶31-505.

### Other ATO arguments based on ss 166, 263 ITAA 36, *Denlay*, and waiver of privilege

1. **Different assessing officer**: Logan J gave short shrift to an argument by the ATO that it did not matter whether or not the Simeon material was privileged, or whether Main had been wilfully blind 'or worse', because a different ATO officer (who was not aware of the privileged nature of the materials relied on) had actually made the assessment decision.<sup>113</sup>

As Logan J pointed out, under s 8(2) *TAA 1953*, the Commissioner of Taxation was ultimately responsible for the decision to issue the assessment, so that the fact that a different ATO officer (rather than Main) had actually issued the assessments as a delegate under s 8(2) was irrelevant – the decision remained in law that of the Commissioner.

This seems to be correct.

2. **Sec 166 ITAA 36**: Logan J indicated that he understood that the ATO had been “disposed” at one stage to submit that the words “any other information in [the Commissioner’s] possession” in s 166 *ITAA 36* impliedly authorised the use for assessment purposes of information covered by legal professional privilege.

His Honour indicated that this submission was not pressed, and that it would have failed in any event as it “would have run counter to over-whelming authority”<sup>114</sup>.

This also seems clearly correct.

3. ***Denlay***: His Honour also dismissed an argument by the ATO that the decision in *Denlay*<sup>115</sup> justified the ATO actions<sup>116</sup>. In *Denlay*, the ATO had been given stolen bank records by a third party (but had not been a party to the theft of those records) and used them to assess taxpayers.

The Full Federal Court there had said that the Commissioner was not prevented from carrying out his statutory duty under ss 166 to assess the taxpayer merely because the Commissioner might suspect that ATO officers may have committed some illegality in the course of gathering information. Logan J commented that:

The passage ... from *Denlay* is not ... an endorsement of the proposition that s 166 gives the Commissioner *carte blanche* consciously to maladminister the ITAA36 in the process of making an assessment.

Significantly, *Denlay* did not (seem) involve potentially privileged materials<sup>117</sup> and may therefore be distinguishable. However, this issue will no doubt be argued vigorously before the Full Court, and it will again be interesting to see the approach taken by that Court. Without access to the documentation and argument before the Full Court, it is difficult to be definite, but on balance, there seems to be merit in Logan J’s approach.

4. **Reasonableness and s 263**: Logan J referred to an “overarching” requirement of reasonableness governing the operation of s 263<sup>118</sup> and observed that this would require the ATO to put in place a regime to protect material for which legal professional privilege had been claimed (including potentially privileged material given to the ATO without the privilege holder’s consent). The ATO had not put such a regime in place in *Donoghue*.

<sup>113</sup> *Donoghue* [117]–[132], [133]–[134],[136]–[137]. (Logan J).

<sup>114</sup> *Donoghue*, (above) [113]–[134]. (Logan J).

<sup>115</sup> (2011) FCAFC 63– see *Donoghue*, (above), [135] (Logan J).

<sup>116</sup> *Donoghue*, (above) [135] (Logan J).

<sup>117</sup> *Donoghue*, (above) [135] (Logan J).

<sup>118</sup> *Donoghue*, above, [138] (Logan J)



5. Finally, Logan J rejected arguments that :

- a. **s 263 ITAA 36 impliedly overrode the privilege** – Logan J noted that authorities such as *Citibank*<sup>119</sup> and *JMA*<sup>120</sup> had established that the wording of s 263 was too general to override a fundamental principle such as legal professional privilege.<sup>121</sup>

Logan J also held that the privilege also applied to materials sent to the ATO by Simeon, observing that:

... It would be an incongruous construction of these two generally worded provisions [ss 166 and 263] to conclude that while the Commissioner could not demand access under s 263 to privileged material [but] that he could nevertheless access it if happenstance (or worse) brought that same privileged within his possession”.<sup>122</sup>

This first point seems clearly correct- indeed, it is perhaps surprising that the ATO ran the s 263 argument, given the weight of authority developed over an extended period that legal professional privilege applies to constrain s 263.<sup>123</sup>

The second point (in relation to privileged materials sent to the ATO without the consent of the privilege holder) also seems logical, though perhaps less clearly established. It can at least be said that a finding that privilege had been removed by the unauthorised actions of a person acting *mala fides* against the privilege-holder’s wishes, would have significant implications for the scope and integrity of the privilege.  
and

- b. **any privilege had been waived** by Donoghue<sup>124</sup> when the materials were attached to an affidavit read in support of the original application for an injunction to prevent the ATO making use of the materials.<sup>125</sup>

In Logan J’s view, there had been no waiver of privilege because the only purpose for disclosing the material was to identify the material for which privilege was being claimed, so that it fell within the exception in *ACCC v Cathay Pacific Airways Ltd*<sup>126</sup>

The application of the doctrine of implied waiver is notoriously difficult and fickle, and this issue will no doubt be argued vigorously on both sides before the Full Court. .  
Again, without having access to all the evidence and argument, it is difficult to predict the outcome on this point. However, the test for implied waiver is whether, in the circumstances of the case, the taxpayer or their agent takes some action which is

<sup>119</sup> *FC of T v Citibank Ltd* (1989) 20 FCR 403.

<sup>120</sup> *JMA Accounting Pty Ltd v FC of T* (2004) 139 FCR 537.

<sup>121</sup> *Donoghue* [136]–[139] (Logan J).

<sup>122</sup> *Donoghue* (above) [136] (Logan J).

<sup>123</sup> See for example *FC of T & Ors v Citibank Ltd* 89 ATC 4268, 4274-77 (Bowen CJ and Fisher J; *Allen Allen and Hemsley v DFC of T* 89 ATC 4294; *FC of T v Coombes (No 2)* 99 ATC 4634, [32]–[34] (Sundberg, Merkel and Kenny JJ); *JMA Accounting Pty Ltd & Entrepreneur Services Pty Ltd v Carmody* 2004 ATC 4916, 4919-4920 (Spender, Madgwick and Finkelstein JJ).

<sup>124</sup> *Donoghue*, [137] (Logan J).

<sup>125</sup> *Donoghue*, [140] (Logan J).

<sup>126</sup> Logan J indicated that he “did not regard the test for waiver ... as being met by the mere availability for inspection, or the acquisition of knowledge of, a privileged communication. If that was sufficient, any inadvertent disclosure would suffice. Appropriate regard must be paid to the quality of the conduct of the party entitled to claim privilege as well as to the practical significance of the disclosure ...” [2012] FCA 1101, [25]. see also Woellner et al, (above) at ¶29-275 (pp.1679-80).

inconsistent with maintenance of the confidentiality underpinning the privilege, with considerations of fairness being a factor<sup>127</sup>, and disclosure of the gist of privileged communication does not necessarily constitute waiver<sup>128</sup>.

The issue is finely balanced, but given the points above, it is arguable that fairness may influence a conclusion that the acts of the taxpayer have not waived the privilege

Once again, it will be interesting to see what conclusion the Full Court reaches on this point and the reasoning supporting its conclusion.

### **The implications from *Donoghue* at first instance**

As well as (hopefully) clarifying the elements of the tort of conscious maladministration, the Full Court decision in *Donoghue* may well provide important insights into the operation of legal professional privilege in this context and the doctrine of implied waiver. Further down the track, there may well be an application to the High Court for special leave to appeal by whichever party loses in the Full Federal Court, giving the High Court an opportunity to provide definitive guidelines on these significant issues.

In the meantime, it is important to recognise that in a large bureaucracy such as the ATO, operating in such a sensitive field, some mishaps are bound to occur from time to time. The key is to learn from them and avoid repetitions.

In that light, pending the Full Court decision, the following legal and non-legal points can be drawn from *Donoghue*:

1. The decision by Logan J in *Donoghue* clearly holds that reckless indifference is a sufficient basis for a finding of conscious maladministration. That is, it is not necessary that an ATO officer 'deliberately use material which he *knew definitely* to be privileged' (emphasis added). It is sufficient if the officer acts with reckless indifference in that they 'deliberately [did] not pursue or cause to be pursued inquiries which would have quelled an apprehension ... that the documents and information ... (or some indeterminable part thereof) were subject to legal professional privilege'.<sup>129</sup>

It will be interesting to see what approach the Full Federal Court takes to the issue — and in light of the High Court's earlier comments in *Mengel* and *Sanders* — perhaps even more interesting to see the High Court's approach, should the matter proceed that far.

2. The prevailing view is that there are only two bases on which the validity of an assessment can be challenged under s 39B of the *Judiciary Act 1903*: i.e., where there is (i) a provisional/tentative assessment or (ii) conscious maladministration. This point would also benefit from clarification by the Full Federal and perhaps High Court.
3. It was surprising to see the ATO argue that s 263 overrode legal professional privilege, given the weight of authority to the contrary and the ATO's acknowledgment over many years that the privilege does apply to constrain ATO access powers. There may have been a nuance in the argument which is not apparent from the judgment.

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<sup>127</sup> *Mann v Carnell* (1999) 168 ALR 86.

<sup>128</sup> *Kirby v Centro Properties Ltd (No 2)* [2012] FCA 70.

<sup>129</sup> *Donoghue* (above) [112] (Logan J).

4. Regardless of the legal outcome on appeal, the case underlines the need for systemic improvements in the education and training of ATO staff on key aspects of their work, particularly junior staff in the early stages of their career. It also points to the need to monitor case-work closely to ensure that the pressure of unrealistic or looming deadlines (or other factors) does not cause procedural aberrations.
5. Similarly - again regardless of the legal outcome on appeal - there is a clear need for systemic improvements within the ATO in supervision processes and the ongoing training and education of potential supervisors<sup>130</sup>.
6. Logan J's criticism of the ATO's apparent 'obfuscation' in response to the attempt by Donoghue's lawyers to claim privilege signals a potentially serious issue that needs to be addressed urgently by the ATO - particularly in light of earlier criticisms of ATO practices<sup>131</sup>.
7. The case raises the interesting question of whether, in accordance with the underlying nature of an action for conscious maladministration, the Commissioner — as the relevant public officer<sup>132</sup> — could be held personally liable<sup>133</sup> for any damages caused to Donoghue by the actions of ATO staff for whom the Commissioner is ultimately responsible, and whether the State would be vicariously liable for the Commissioner's actions<sup>134</sup> or would indemnify the Commissioner or other affected officers<sup>135</sup>.

## Conclusion

The tort of Conscious Maladministration represents an important check on conscious abuse of public office

The tort has existed for many years, but was largely ignored by the tax profession in Australia<sup>136</sup> until 2008, when it was highlighted by the High Court of Australia decision in *Futuris*. Since then, the tort has become almost a staple pleading in cases challenging ATO assessments, though it appears that until the 2015 decision in *Donoghue*, no taxpayer had succeeded in such claims.

Understandably, the courts have been concerned to keep the tort within reasonable bounds. However, the facts in *Donoghue* — allied to the examples of abuse overseas — demonstrate that the courts need to balance this constraint against the need to ensure that people who suffer damage as a result of conscious maladministration by government departments are not denied a remedy on technical grounds.

The decision in *Donoghue* also underlines the need for the ATO (and other government departments) to ensure that staff — particularly those in key areas — are well trained and supervised, to avoid excess zeal, inexperience (or organisational and other pressures) creating the sort of problems that arose in that case.

A key point to emerge from *Donoghue* at first instance was the express endorsement by Logan J of recklessness as a foundation for the action in conscious maladministration. If the point is upheld

<sup>130</sup> See S Grieve and K Bertram, "The Commissioner of Taxation's duty of administration of the tax laws under the microscope" (above).

<sup>131</sup> See for example R Woellner, 'Is the ATO a law unto itself?' paper presented at ALTA 2007 (Perth).

<sup>132</sup> See s 8 *ITAA 1936*, and related provisions which confer a general power of administration on the Commissioner in relation to a wide range of direct and indirect tax Acts.

<sup>133</sup> See *Mengel*, (above), [60] (joint judgment).

<sup>134</sup> See Young, (above) [22] (Hack and Mc Pherson DP).

<sup>135</sup> See n 6 above.

<sup>136</sup> Though taxpayers had made numerous claims for 'bad faith' in various ATO decisions, as noted above.

by the Full Federal Court on appeal, this would make it (somewhat) easier for future claimants to succeed in actions against the ATO (and other government departments/officials).

The ATO's appeal to the Full Federal Court<sup>137</sup> has been heard, with judgment reserved. The decision will no doubt have a significant impact on the future development of this area of the law, and will certainly be examined closely by the ATO and tax advisers alike.

Prof Robin Woellner  
December 2015

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## 2016 Postscript: the decision on appeal of the Full Federal Court in *Donoghue*

On 17 December, 2015, the Full Federal Court (Kenny and Perram JJ; Davies J agreeing) published its judgement on the ATO's appeal from the judgement of Logan J at first instance.

The Full Court reversed the decision of Logan J and took a very different approach to the issues in the case, holding that legal professional privilege and conscious maladministration did not apply, and that the key issues were the equitable action for breach of confidence and – particularly - the over-riding role of s 166 *ITAA36* which imposed an obligation on the ATO to assess taxpayers.

In brief, the key issues in the Full Court's decision were:

1. The element which takes an assessment outside the protection of ss 175 and 177 *ITAA36* is the absence of good faith<sup>138</sup>, conscious maladministration being one example of this, "... though there may well be others".<sup>139</sup>

Accordingly, a finding that the officer had not acted in bad faith ~~would~~ precluded any finding of conscious maladministration.<sup>140</sup>

2. Logan J's reliance on Legal Professional Privilege was misconceived, because that privilege is not a general barrier to inspection of confidential communications; it only applies to enable

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<sup>137</sup> Kenny, Perram and Davies JJ (judgment reserved).

<sup>138</sup> French J discussed the concept of "good faith" in *Applicant WAFV of 2002 v Refugee Review Tribunal* [2003] FCA 16 at [38]-[53].

<sup>139</sup> Kenny and Perram JJ at [111], citing *Futuris* (above); (Davies J agreeing – His Honour indicated at [111] that he agreed with the "reasons and conclusions" of Kenny and Perram JJ that the appeals be allowed, but wished to add some further observations.

<sup>140</sup> Davies J at [114]-[115]; cf Kenny and Perram JJ at [96].

a person to resist compulsory disclosure of privileged communications<sup>141</sup>. In *Donoghue*, the ATO had not used its powers of compulsory disclosure under e.g. ss 263 or 264 ITAA 36<sup>142</sup> to access the documents – the documents had been provided voluntarily by Simeon Moore<sup>143</sup>

Accordingly, legal professional privilege could not apply in *Donoghue*, and was therefore irrelevant to the question of whether or not the ATO could use the information to assess Donoghue<sup>144</sup>.

3. The only basis on which Donoghue could have prevented the ATO from using the information would have been through an action in equity for breach of confidence<sup>145</sup>, before the ATO used the information to create an assessment of Donoghue's tax liability<sup>146</sup>.

The Full Court held that Donoghue had abandoned any claim for a breach of confidence action at the first instance hearing, and the Full Court refused Donoghue's application to argue breach of confidence before it<sup>147</sup>.

On the facts in *Donoghue*, it ~~might have~~<sup>might have</sup> been possible" for Donoghue to take action for breach of confidence before the ATO used the information to assess him<sup>148</sup>, because Simeon Moore had warned Donoghue that he intended to send materials to the ATO. In many cases, however, ~~the, the~~ taxpayer will have no warning of the "dob-in"<sup>149</sup>, and if the ATO keeps the fact that information has been supplied secret (as it did in *Donoghue*), the taxpayer will have no practical opportunity to protect their information.

4. A key element in the Full Court's reasoning was the central role ~~of s~~<sup>s</sup> 166 ITAA36. At the time the issues in *Donoghue* arose, s166 stated that:

"From the returns, and from any other information in the Commissioner's possession, the Commissioner shall make an assessment of" the taxpayer's liability to tax".<sup>150</sup>

The Full Court, applying the decisions in *Awad* and *Denlay*, held that s166 imposed a *duty* on (rather than merely permitting) the Commissioner to make an assessment of a taxpayer's

<sup>141</sup> Kenny and Perram JJ at [76], citing *Propend and Pape*.

<sup>142</sup> Subsequently replaced by ss 353-10 and 353-15 *Tax Administration Act 1953* (Cth).

<sup>143</sup> In breach of the duty of confidentiality owed to Donoghue.

<sup>144</sup> Kenny and Perram JJ in *Donoghue* at [58]

<sup>145</sup> The three elements which a complainant is required to prove in an equitable action for ~~breach of~~<sup>breach of</sup> confidence were specified in *Coco v AN ClarkeClarke (Engineers) Ltd* [1969] RPC 41 at 47, ~~cite,~~<sup>cite</sup> with approval by Kenny and Perram JJ in *Donoghue* at [54].

<sup>146</sup> Kenny and Perram JJ in *Donoghue* at [59].

<sup>147</sup> *Donoghue*, [61]-[65], (Kenny and Perram JJ).

<sup>148</sup> Kenny and Perram JJ speculated at [59] that "it may perhaps have been possible [for Donoghue to bring an action for breach of confidence] under the principle in *Lord Ashburton v Pape* even after the documents were delivered to the ATO, at least before the information in them was assimilated via the assessment process" – though they expressed "no concluded view" on this point.

<sup>149</sup> As also occurred in *Donoghue* when an independent 3<sup>rd</sup> party had earlier provided information about Donoghue to the ATO (which had caused the ATO to undertake the initial audit of Donoghue) without warning *Donoghue*: Kenny and Perram JJ at [27].

<sup>150</sup> The wording of s 166 was subsequently amended to read that the Commissioner "must" make an assessment from the returns, and any other information in the Commissioner's possession".

liability to tax based on information then in his possession, regardless of how the ATO had obtained that information:

“[*Awad* and *Denlay*... require] the conclusion that s166 not only permits but requires the Commissioner to act upon the information which he has his possession regardless of how we came to have it. *Section 166 exhibits a policy which explicitly privileges the need to have accurate assessments made on the information available over other private law rights. It did not matter in Denlay that the information might have been unlawfully obtained by the Commissioner’s officers* [though this was not the finding in that case]. ... *All that mattered was that it had come into the Commissioner’s possession. The combined effect of Denlay and Awad is that the Commissioner is not only entitled, but obliged, to use information which is in his possession even if he knows is subject to a claim for breach of confidence and even if he knows it is privileged*” (emphasis added)<sup>151</sup>.

The Full Court’s approach of prioritising the need for accuracy of assessments over the lawfulness of the conduct of ATO officers (on the basis that ATO officers would be restrained by the fact that they would be subject to the normal law of the land if they committed unlawful acts<sup>152</sup>) is a policy choice that may prove controversial<sup>153</sup>. It raises issues such as how far is society prepared to go in allowing information obtained by unlawful means to be used in assessing taxpayers? Is the Full Court’s “Chinese Walls” between ATO investigators (acting unlawfully) and ATO assessors (carrying out their proper assessing functions under s 166<sup>154</sup>) – perhaps with knowledge of the prior unlawful conduct) – sound either in law or policy terms?

5. The Full Court concluded that, given the over-riding role of s 166, it could not be maladministration for an ATO assessor to make an assessment based on information which had been privileged in the hands of the taxpayer or their legal advisors.
6. The Full Court also canvassed a number of other issues, including:
  - a. The ATO assessor had acted properly, and indeed had acted “precisely as s166 required to do. There were no defaults his conduct as a public servant. There was no maladministration, still less conscious maladministration...”<sup>155</sup>

However, it should be recalled that when making the assessments, the ATO assessor had believed (wrongly, as it turned out), that he was not permitted to use privileged materials in making the assessments – so that he had acted against what he (wrongly)

<sup>151</sup> Kenny and Perram JJ in *Donoghue* at [74]. Davies J at [115] stated that the circumstances in which the information on which Main based his assessments “could not and did not, alter the liability to tax which the law imposed on the taxpayer on the facts known to the Commissioner and the Commissioner’s reliance on that information to raise the assessments could not, and did not, constitute the exercise of power in bad faith nor a deliberate disregard of his duty to assess in accordance with the law”.

<sup>152</sup> ) Kenny and Perram JJ in *Donoghue* at [73], quoting with approval the Full Court in *Denlay* (above) at [81]-[82].

<sup>153</sup> Though it has been applied in several cases: see e.g. *Awad v Commissioner of Taxation* [2000] FCA 1288; (2000) 104 FCR 106.

<sup>154</sup> Kenny and Perram JJ at [74].

<sup>155</sup> Kenny and Perram JJ in *Donoghue* at [96].

believed the law to be. . Similarly, Logan J’s criticism of the failure of the supervisors and colleagues to communicate with or advise the assessor on key issues suggests that the ATO needs to adjust its training programmes for staff at all levels.

- b. The Full Court in obiter doubted whether the documents provided by Simeon Moore would have supported a claim for breach of confidence or legal professional privilege<sup>156</sup>; and
- c. While s 166 did not apply to protect an assessment of penalties under Division 284 TAA 1953, that Division provided its own criteria for liability, and did not require the ATO to examine the documents provided by Simeon in order to impose the penalty<sup>157</sup>. Accordingly, the penalties were properly imposed<sup>158</sup>.

It will be interesting to see whether Donoghue seeks special leave to appeal to the High Court, and if so what approach that Court takes to the application and (if it proceeds that far), the issues .

### **Some comments on the Full Court decision in *Donoghue*:**

The Full Court decision took a very different approach to that of Logan J at first instance, and raises a number of significant issues, including:

1. The Full Court’s decision that legal professional privilege (and breach of confidence) did not apply once the ATO obtained possession of the relevant information – by whatever means – and used it to make assessments, significantly strengthens the ATO’s powers.
2. Prioritising the need for accurate assessments over both other private rights and the obligation of ATO officers to act lawfully in gathering tax information has support in case law, but reflects a policy choice which may prove controversial.

What are the limits to “acceptable” unlawful behaviour by ATO officers, beyond which the actions will “taint” subsequent assessments? If reliance is to be placed on “conscious maladministration”, will that relatively narrow doctrine (particularly if “reckless indifference is excluded) be adequate to provide appropriate protection for taxpayers?

3. Is society prepared to allow the ATO to ensure (hopefully) the accuracy of assessments by means of unlawful actions? Would repeated resort to unlawful means of obtaining information damage society’s perception of the ATO, and perhaps ultimately affect the level of voluntary compliance?
4. The Full Court did not address directly the questions ~~of whether of whether~~ “reckless indifference” was ~~an~~ adequate basis for an action in conscious maladministration, nor

<sup>156</sup> Kenny and Perram JJ in *Donoghue* at [68], [98]-[102].

<sup>157</sup> Davies J took a somewhat different view, stating that “It cannot be a misuse of the provisions which impose the liability to penalties for the Commissioner to make a penalty assessment in reliance on the same information that he relied on for the exercise of his assessment power under s 166 ... where that same information shows that the taxpayer has a liability to an administrative penalty under Div 284.

<sup>158</sup> Kenny and Perram JJ in *Donoghue* at [106]; cf Davies J at [115],[118].

whether there are only two grounds on which to challenge the validity of an assessment (conscious maladministration or a tentative/provisional assessment)<sup>159</sup>.

These issues must therefore await future cases in which they are raised directly.

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February 2016

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<sup>159</sup> Though there was an indication that conscious maladministration was only one example of “good faith”, and “there may well be others” - see above.