New approaches to regulatory sanctions

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The Regulatory Enforcements and Sanctions Bill has now gone through the House of Lords and I think there could be Royal Assent by the end of the summer.[1] So the powers contained in it will be available to regulators. In many ways what is contained in the Act will be something of a revolution compared to the way we have traditionally designed regulatory sanctions in other areas.

It would be appropriate to start by describing some of the key features of the Act and it might also be helpful to explain some of my own thinking in the Macrory Review,[2] which formed the background to some of the clauses. First, here are two responses to the Act from the debates in the House of Lords:

> There is benefit to the public interest. There is also benefit to businesses, which are likely to be defendants in these cases, of a greater flexibility than the one and only procedure now available. (Lord Borrie)
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> The bill, as drafted by the government, potentially makes every regulator and every public official in every local authority, effectively not just the regulator but the investigator, prosecutor, judge, jury and sentencer in his or her own or her own cause, subject only to that ultimate right of appeal. (Lord Lyall)

Lord Lyall, a former Conservative Attorney General, was virulently against the way the Act was drafted. He kept saying to effect 'I think Macrory is excellent but I hate the Act'! In fact, when you read the two comments above, although they appear diametrically opposed, they both contain an element of truth.

The origin of my own report goes back a few years to the work of Phillip Hampton, who was asked by the Treasury in 2004/2005 to look generally at the relationship of regulators of all types with business.[3] By the end of the Review his real concern was that there were far too many regulators. He found 61 national regulators outside the financial sector, not counting local authorities, and thought they should be consolidated into a much smaller number. He was also concerned that too many regulators, particularly at local authority level, had rather a 'tick box' mentality to regulation and weren't actually thinking about why they were regulating.

I was on the board of the Environment Agency at the time. When Hampton arrived, the Agency was quite worried about what he would find – although in fact it came out of the Hampton Review very well. The Agency had already adopted the so-called risk-based approach to regulation and thinking about why they were pursuing the policies they were and Hampton urged that all regulators should adopt this approach. He also recognised that sanctions, which are – ideally – fast, effective and proportionate, do play an important role in the regulatory system. He was concerned that we tend to rely too much on the criminal law in this area, and he didn't think that was right. However, he recognised that to examine sanctions would be a major exercise beyond his remit, and therefore recommended there should be another review from the Cabinet Office. And that is how I became involved in what I sometimes call 'Son of Hampton'.

My remit was to review the penalty and sanctioning regimes of some 60 regulators in England and Wales, including the familiar Environment Agency and Health and Safety Executive, plus UK-wide and local authority regulators. I was not concerned with economic regulators, such as the competition and utility regulators, although I had a lot of contact with them because they tend to have a modern, up-to-date sanctioning system with a whole range of approaches available to them. The report was published in 2006, and gratifyingly all the recommendations were accepted by the government. The current Act takes some of them forward.

I had worked for DEFRA before, about five years ago, looking at why there are so few environmental civil penalties in this country. There are now civil penalties in one or two environmental areas, but in the States and Canada civil penalties are a very powerful tool for certain types of breaches. We wrote a report[4] and the intellectual question we kept asking was, if civil penalties are suitable for environmental law, why are they not suitable for health and safety law, why not for food standards law? What is different about environmental regulation compared with other regulatory systems? It is actually quite difficult to make the case for putting the environment on a different footing. The beauty of the Hampton Review, and then the Macrory Review, was to avoid becoming trapped by those

1 Now an Act, the Bill received Royal Assent on 21 July 2008. For the sake of clarity, references to the Bill in the original presentation of this paper have now been substituted in this published version by references to the Act.

2 R Macrory 'Regulatory Justice: Making Sanctions Effective' Cabinet Office November 2006.

3 P Hampton 'Reducing Administrative Burdens: Effective Inspection and Enforcement' HM Treasury March 2005 (The Hampton Review).

4 M Woods, R Macrory 'Environmental Civil Penalties' (2003) Centre for Law and the Environment, Faculty of Laws, University College London.

questions of demarcation and instead to stand back and look across nearly every area of regulation. The relationships and what the regulators are trying to do are very similar across the board. Although I studied food standards law and building law and other areas in which I was not a legal expert with some trepidation, when I started asking the basic questions, I received very similar answers.

Quite early on it became apparent to me that to avoid getting lost in a mass of detail it was necessary to stand back and ask, what is the purpose of penalties? Why are there penalties in a regulatory regime? I certainly start from the basic premise that legitimate business advice and incentivisation are the best approaches. Hampton says this and I support him in this respect. However, you still need sanctions of some sort. After reviewing the literature and talking to people I came up with a set of Penalties Principles that should underlie the approach and design of a modern sanctions regime.

In brief, sanctions should:

- aim to change behaviour
- aim to eliminate financial gain if applicable
- be responsive
- be proportionate
- restore the harm caused if applicable
- deter future non-compliance.

The most important are probably the first two. The aim of a sanction in this area is not to punish as such (although a punishment may be necessary in some circumstances), nor is it to create a stigma, but rather to change behaviour and to judge the best way to achieve this. Secondly, since we are dealing largely with businesses engaged in commercial activity and who can make money by non-compliance (rather than say the behaviour of individuals such as litter dropping or smoking in prohibited places), it is very important that the penalty system aims to eliminate any financial gains. This would be only fair to those industries which do comply and would send out the right signals.

When it comes to deciding that a formal sanction is required – something beyond a warning and indeed even a formal caution – the range of options is limited. The only course generally open is a criminal prosecution, where financial penalties are effectively the only options available to the courts where businesses are concerned. Nearly all regulators have various types of enforcement notices. Hampton supported enforcement notices because they give businesses a chance to return to compliance by telling them what they need to do and when they need to do it. However, if they don't comply with the enforcement notice, then the process reverts to the criminal law – non-compliance is a criminal offence. Where a regime includes a licensing requirement there may be power to revoke the licence, but this is rarely exercised against companies. Most criminal offences in nearly every area of regulation are drafted in strict terms – or sometimes semi-strict terms, because some of them, such as those in the area of health and safety, by their very nature incorporate a degree of reasonableness. Sometimes there may be a statutory defence of acting with all due care or something similar is provided in the legislation – but, typical of the way English law develops, there seems little consistency or principle in the availability of such defences.

Equally important, in every area the regulator is coping with an enormous range of potential offenders. At one extreme are the rogue traders – the 'white van man' for example – and businesses that consciously aim to avoid legal requirements. This does not just apply in environment but in food standards, in health and safety, in building controls and so on. At the other extreme are legitimate businesses which are trying their best. Many trade associations tend to present the situation as one where the regulator should just concentrate on the rogue traders since all the rest want to comply. However, it's not quite as simple as that. There is another species in the middle, not 'criminals' who consciously avoid the law, but businesses such as those which inadvertently or through carelessness breach the law. But such a breach may have serious consequences, for instance a water pollution incident which could cause an injury to somebody. It is not possible – public interest will say it is not possible – just to warn that business not to do it again, or even issue a formal caution. And it is circumstances like these that must be addressed.

As a matter of course I looked at the criminal processes and it is clear that criminal law will continue to play an important part in regulation. However, quite rightly, bringing a criminal prosecution is not an easy process. It is designed to cause stigma, ideally on the offender if fined. However, for legitimate businesses that fail to comply with the law, criminal prosecution can be an inappropriate and unwieldy response. Equally, the imposition of a fine may not be the best way to achieve changes in behaviour. One of the concerns is that if there is too much reliance upon the criminal process as a way of dealing with these regulatory offences, the criminal law tends to become devalued. Defence lawyers and even the courts sometimes describe regulatory offences as not criminal 'in the real sense'. In my view, somebody who fly-tips, who knows exactly what they are doing, is as much a criminal as a shop-lifter and should be treated in the same way. My concern is for the company which breaches regulatory requirements through oversight or carelessness, and, yes, makes some money out of it, but has done so by mistake. Does this deserve a criminal conviction? Should this company be subject to the same process? Lastly, and again this is very difficult to quantify, if the criminal process is relied upon too heavily, and because prosecuting somebody is such a major step, there may be what is known as a 'compliance deficit' – in other words it is not possible to deal with all the breaches that should be prosecuted, and breaches that should be sanctioned are not.

My report makes a number of recommendations for improving the criminal process. The first of these is better training of the magistrates' clerks and of the prosecutors. There was evidence from magistrates stating that one of the problems is that prosecutors frequently do not explain

the policy significance of a particular regulation. Magistrates want more guidance from the prosecutors. It may also be sensible to consider consolidating certain types of regulatory non-compliance cases in a particular geographic area where possible.[5]

My report suggests that there could be a wider range of sanctions. When dealing with businesses as opposed to individual criminals, the courts have very few sanctions other than a fine. Ninety-six per cent of our current outcomes in the criminal courts are fines. There are examples of very low fines compared with financial gains. However, it is not simply a matter of calling for higher fines. The courts are required to consider offenders' means, which often explains low fines, especially for small businesses. It seems to me that there is a role for corporate rehabilitation orders, which are more flexible and might be particularly suitable for small or medium-sized businesses – something equivalent to a community service order. One proposal is a profit order, where profits from non-compliance, such as failure to pay a licence fee, are clearly identifiable. Thirty years ago or so, the only options for ordinary individual criminals were fines or imprisonment. It was then recognised that a richer range of responses was needed in certain cases but this was never carried over into the regulatory area. There is a case for something like a publicity order, which could be handed down in combination with a fine. These ideas, although not part of the current Act, are being pursued and should be seen as part of the total package.

The recommendation that has attracted the most headlines is the idea of administrative penalties. These could apply in certain circumstances and would mean that the regulator initially calculates the penalty and the offender does not have to go through the court system. There are two types of administrative penalties: fixed and variable. Fixed penalties, which are defined in the legislation and are equivalent to parking tickets for example, may have a role for minor regulatory requirements. Variable penalties are more significant. These are equivalent to the penalties which the economic regulators can apply, as can many regulators in countries with similar legal traditions such as Canada, Australia and the USA. The purpose of a variable penalty is not simply to provide a mechanism for increasing fines. It is a tool for rapidly resolving an issue without imposing a criminal conviction on the business concerned.

The important thing is that these tools are not meant as a substitute for the criminal law. They are an added option. It is still up to the regulator and its enforcement policy to decide whether the circumstances merit a warning, a caution or a prosecution – or, in the future, an administrative penalty. I was fully aware of disturbing examples of the use of administrative penalties – for instance, the issuing of parking tickets, where the process sometimes seems to have been distorted by factors such as revenue generation or reaching output targets. It is very clear in my mind that any revenue should go into the general pot, not to the individual regulator.

The Regulatory Enforcement and Sanctions Act essentially consists of framework powers, which can be drawn down by ministerial order to individual regulators, including of course the Environment Agency. We are not forcing these powers on all regulators. It is up to them to decide whether they are going to be useful. However, if regulators don't take up these powers, I think the onus is very much on them to show why they don't want this more modern, flexible arrangement.

The point of the Act is to provide a common set of principles and safeguards dealing with existing offences. For future offences, it will be left to individual Acts of Parliament, but with the expectation that they will follow the principles in the Act. The Act provides for certain powers and procedures. First, and probably most importantly, the core offences that exist in the current law remain exactly the same. There is no redrafting of these, so if an offence is in strict liability terms, it continues as such; if it has a statutory defence, this remains for the administrative penalties. I could have recommended that we redraft all the offences, as some countries have done, and I did consider it. It could be made explicit, say, that intentionally and recklessly polluting water is a criminal offence, while polluting water without intention or recklessness is an offence leading to an administrative sanction only. We decided this would take too long but it may happen in the future when new regulatory controls are being designed. Offences could actually be defined as leading to a criminal offence or to an administrative penalty, and the wording could make it absolutely clear that these are very different. Essentially, the regulator will be able to choose which route to take.

Secondly, although administrative penalties are civil in nature, the Act provides that the regulator must be satisfied beyond all reasonable doubt that the offence has been committed, even where the decision to impose an administrative penalty has been made. I had no evidence that what was causing a problem for regulators was the fact that they couldn't prove these cases to criminal standards. The problem was the process and the time it took to get to the criminal courts, and that the criminal courts often did not treat the case as the regulator had hoped. So it seemed much simpler to me to have a system where the offence has to be proved beyond all reasonable doubt. That means that the investigation will be carried out to criminal standards, and all those procedural standards will apply. However, if there is a complete separation between the criminal process and administrative penalties with different evidential standards, problems can arise – and this sometimes happens with the Financial Services Authority – for instance, an investigation is started as for administrative penalties and

5 Macrory Review (n 1) para 3.15: 'Focusing offences in this way gives greater opportunity for both Magistrates and court officials to gain expertise and familiarity in the area of regulation concerned. This type of consolidation is already happening in certain areas of regulatory non-compliance. For example, in Greater London, health and safety prosecutions are initiated in the City of London Magistrates' Court. The British Potato Council, because of its location, concentrates prosecution in the Oxford Magistrates' Court and prosecutions for many regulatory offences under company law are heard before Cardiff Magistrates, reflecting the location of Companies House in Cardiff'.

then it emerges that the circumstances are sufficiently serious to warrant a criminal prosecution. So having investigated and evaluated the evidence, the regulator first decides whether the breach warrants a formal sanction; if a sanction is warranted, the regulator can then decide whether this justifies a criminal prosecution or the imposition of an administrative penalty. However, if a civil penalty has been imposed, there can be no criminal conviction for the same offence, and I am pretty clear that this would also rule out a private prosecution for an offence for which an administrative penalty has been imposed.

Some environmental offences are summary only with statutory maximum penalties (usually £5000). The proposals in the Review for administrative penalties were not designed to get round these statutory maxima (that would not be a proper motive for choosing the administrative rather than the criminal route), and the Act provides that if the original offence was summary only, then administrative penalties cannot exceed that maximum. But where the offence is either/or (and this covers the vast majority of core environmental offences such as illegal water and waste disposal),[6] then there is no upper limit to the administrative penalty just as there is no upper limit to the fine on indictment.

Where a regulator proposes to impose an administrative monetary penalty, notice of intent must be given before the final decision, and there must be an opportunity to make written representations. Clearly, as a matter of human rights and good practice, there must be an appeals system. I could have recommended going back to the ordinary criminal courts but evidence from countries such as Germany suggested this leads to confusion. Since the tribunal system was in the process of being reformed my report recommends that appeals concerning the imposition of an administrative penalty should go to what is now the first-tier tribunal. Such appeals are likely to end up in what will be called the 'regulatory chamber', consisting probably of a legal chair and expert assessors. The regulator decides initially whether the nature of the offence merits an administrative or a criminal response; thereafter there is either a criminal process or an administrative one and the two do not become entangled with each other. An appeal can be on the grounds that the decision was based on an error of fact or was wrong in law, that the penalty was unreasonable, or that the decision was otherwise unreasonable. The need to appeal against paying a penalty does, of course, ask businesses to do something other than defending themselves in a criminal court. It is to be hoped that the tribunal system will offer a more sympathetic, cheaper and expert environment for those who wish to appeal. The regulatory tribunal should be in place by April 2009. If it turns out that it only operates in the environmental field because only the Environment Agency has picked up these powers, it will slowly become an environmental tribunal, which would be an interesting development.

One of the important points is burden of proof. The Act does not specify who has to prove what in front of the tribunal. There was a major administrative appeal on emissions trading, the *Alphasteel*[7] case (a penalty of over £500,000 was mentioned) when it was agreed that the Environment Agency had the burden of proof in front of the inspector appointed by the minister. Clearly the grounds for appeal must be specified and then it will be up to the regulator to prove its case, and I think this is right. Costs provisions are to be determined under the tribunal reforms. Some people in industry are saying this is unfair – and this goes back to Lord Lyall's point – because suddenly rather than waiting for the Agency to prove its case in front of a magistrate, they have to appeal, and maybe they will have to pay for that, maybe they won't get costs even if they win. So that is an issue still to be resolved.

Another very important provision in the Act is for something called enforceable undertakings. This is a mechanism used very successfully in Australia and Canada. In certain circumstances, the industry which is in breach is offered the opportunity to suggest how it might make amends – in other words to devise its own penalties. The business approaches the regulator admitting a breach and stating what it proposes to do about it. The regulator has the option to accept the proposal, which then goes on file and becomes a public undertaking during which time any other prosecution or imposition of a civil penalty is suspended. This can be very useful for certain types of breaches, particularly in cases where the company is not making a big enough effort, although it is probably not so suitable for the rogue trader. Enforceable undertakings can include provisions for compensation, or reimbursement and other mechanisms which our current systems do not envisage, and can give industry a real sense of ownership of a particular problem.

So the key to the sanctions model I proposed and which has been adopted is that first of all it is up to the individual regulators to decide whether they want these powers. The offences remain the same for the time being (including any statutory defences), although future legislation could take the opportunity to make clear that there are different responses. The regulator decides, in the light of the penalty principles, on the best response to bring offenders back into compliance – warning, criminal prosecution, imposition of an administrative penalty, or acceptance of undertaking. The regulator also tries to avoid any distortions within the system that might affect that choice, such as income from penalties. What is not desirable, as sometimes happens in the United States, is

6 However quite a few significant offences such as those under the End-of-Life Vehicles Regulations 2003/2635 have been made under the European Communities Act 1972 where there is a statutory maximum of £5000. Administrative penalties in these areas will still be limited – if that is a problem, the issue concerns the constraints under the European Communities Act or over-use of the powers to make regulations under that Act.

7 EU Emissions Trading Scheme Phase 1 – Decision on Civil Penalty Appeal Hearing Welsh Minister for Environment, Sustainability and Housing 20 February 2008. http://new.wales.gov.uk/publications/accessinfo/drnewhomepage/environmentdrs2/environmentdrs2008/eustscivlappealhearingfeb08.

for individual regulators such as the Environment Agency to be set targets, such as so many prosecutions or so many administrative penalties. That is exactly the sort of institutional bias that should be avoided.

If regulators are to have a greater range of discretionary and sanctioning powers, they must also recognise a greater responsibility as to how those powers are exercised. All regulators will now be obliged to publish an enforcement policy which, if they are taking up these administrative powers, must reflect how they will use them. We found that only 17 of the 60 national regulators had a publicly available enforcement policy. That is going to change, and all regulators who acquire Macrory powers will be required to publish an enforcement policy. Regulators will also have to be sure of being transparent as to how they calculate penalties. Look at the Financial Services Authority or the Environmental Protection Agency (EPA) in the USA, which has a computer model which businesses can use to assess what the penalties are likely to be.

The Act provides that regulators will have to report annually on how they are performing. This focuses on outputs, for example the number of penalties imposed or undertakings accepted. But it is, to my mind, more important that there should be measurement of outcomes. If the Environment Agency, rather than bringing 800 prosecutions a year, now brings 200 prosecutions a year, 700 administrative penalties, and accepts 25 undertakings, it would not be cause for concern provided the outcomes are still secured. Measuring outcomes would enable the regulators, the regulated and the public to know the impact of the enforcement actions, whether compliance has been improved and the harm caused by non-compliance remedied, and whether there need to be any changes to achieve better results. Although outcome measurements are not easy to devise in all areas, it is disappointing that the Act does not include some guide to outcomes.

The key challenges for the regulators – and for the Environment Agency in particular – are to redraft their enforcement policies to reflect the new sanction options, to consider how to calculate administrative penalties, to develop robust outcome measures and to ensure that there is effective monitoring and feedback.

I originally thought the report would only be relevant to England and Wales but it has proved to have an influence beyond national jurisdictions. As we have seen, many of the individual ideas about sanctions are not totally new but are practised in countries such as Canada, the USA and Australia. The report is now being well received in those jurisdictions and elsewhere. If it is having an influence this is because, for the first time, the report looks at the systems as a whole, articulates principles and sets standards for regulatory governance. This has not yet been done properly elsewhere. I hope that in this country the Environment Agency will want to lead the way, as it did in risk-based regulation. There is now an opportunity to create a modern regulatory system that will work well on its own terms but will also be a leader in global terms. We will have to see what happens.