

# Penalty Notice

## Regulatory Justice: Making Sanctions Effective

Final Report

November 2006

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# **Regulatory Justice: Making Sanctions Effective**

Final Report

**November 2006**

Professor Richard B. Macrory



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## Foreword

Dear Minister,

In September 2005 I was asked by the then Chancellor of the Duchy of Lancaster, John Hutton, to examine the system of regulatory sanctions. The Minister wanted to ensure that regulatory sanctions were consistent with and appropriate for a risk based approach to regulation as set out in recommendation eight of the Hampton Review. The Hampton Review proposed that the penalty regime should be based on the risk of re-offending, and the impact of the offence, with a sliding scale of penalties that are quick and easier to apply for most breaches with tougher penalties for rogue businesses that persistently break the rules. My previous publications contained my initial thinking and findings on the penalties system and outlined my vision for an effective system of regulatory sanctions, which I invited all stakeholders to consider and comment on. I have considered these responses and make my final recommendations in this report.

Sanctions are an important part of any regulatory system. They provide a deterrent and can act as a catalyst to ensure that regulations are complied with and indicate that non-compliance will not be tolerated. Sanctions also help to ensure that businesses are not compromising citizens' health and safety, polluting the environment, violating the rights of consumers or are distorting a free and competitive market. A broad range of flexible and proportionate sanctions that can be applied in cases of regulatory non-compliance at an earlier stage improve outcomes for society as a whole. Moreover, having access to risk-based sanctions will help to raise standards across industry and create a level playing field for all compliant businesses.

Over the past few years, Government has already introduced a series of reforms designed to improve the efficiency of the sanctioning system. Many of the more recently created economic and financial regulators, such as the Financial Services Authority and the Office of Fair Trading, have broad sanctioning toolkits with flexible and proportionate responses to regulatory non-compliance such as monetary administrative penalties. The tribunal system is also looking to undergo a radical overhaul to make it more effective and this work is being led by the Department of Constitutional Affairs. Defra (Department for Environment, Food and Rural Affairs) is currently consulting on the introduction of administrative penalties for regulatory non-compliance in the fisheries sector. I recognise the good work done in these areas, and have built on it when setting out my vision for a flexible and fit for purpose penalties system.

The challenge this review sets out for Government and regulators is to build on these initial steps. This will mean a shift in the way regulators and departments approach sanctioning. Regulators will need to develop these sanctions for their area of regulation. They must also educate and inform their staff on how to use a new and more sophisticated toolkit. A long term goal should be to *change the culture* of many of these regulators who will need to operate with greater transparency and accountability than is often the case now. Use of this toolkit will also impose some burdens on regulators in order to ensure sanctions are used responsibly, safeguard the rights of the regulated communities and maintain public confidence in the regulated system.

I believe we can improve the effectiveness of criminal courts in dealing with regulatory non-compliance by having access to more imaginative sentencing options when dealing with businesses than the simple imposition of fines. The criminal law still has an important role to play in achieving regulatory compliance. I am also clear that where a regulatory breach justifies a formal sanction, the system should be less reliant on criminal prosecutions making greater use of other types of sanctions such as Monetary Administrative Penalties or Statutory Notices. Evolving the

sanctioning toolkits should enable the Hampton vision of risk based regulation to be realised more readily with a renewed focus on advice and education and less emphasis on inspections and enforcement for its own sake.

My vision for the penalties system is a step change from where we are today. It allows for a flexible and proportionate approach with a broad range of sanctioning options, where regulators can respond to the needs of individual cases and the nature of the underlying offence. Improving the ability of regulators to apply appropriate sanctions will improve overall compliance and add credibility to the regulatory system and means that minor breaches are treated as such. Effective sanctions can also incorporate wider aims such as restoring the harm caused by regulatory non-compliance and take into consideration the needs of victims, offenders and communities affected by regulatory breaches.

The changes needed to realise this vision will not happen overnight. Some will require legislation, others will require a shift of long-established culture and practice in regulators and business and an overall commitment to reform. These changes cannot be introduced in isolation, but rather in partnership with industry, enforcement staff, sponsoring departments and the wider community over time and Government has already taken some initial steps towards a more flexible sanctioning toolkit. I believe the vision set out in this document is achievable and in tune with the latest thinking on regulation in the UK and abroad.

## Acknowledgements

The breadth of organisations, the regulatory functions and issues as well as the range of stakeholders covered by the review has made it an extremely interesting challenge. The consultation process, both formal and informal, has been very extensive in time and scope and I am especially grateful for the contribution from Government departments, regulators, the judiciary, the academic community, restorative justice practitioners, victims and consumer groups and businesses and their representative bodies, including trade associations.

I am grateful for the tremendous efforts of the Review team: Paul Arnold, Jonathan Chan, Rosalyn Eales, Gareth Evans, Binnie Goh, Simon Hansen, Alex Hodbod, Mark Jackson, Sowdamini Kadambari, Pamela Morrison, Rosalind Plant, Edward Seed and Catherine White. Shainila Pradhan led the team and I want to pay special thanks to her energy and support throughout the review.



Professor Richard Macrory

# Executive Summary

## Introduction

- E.1 I have looked at sanctioning regimes and penalty powers in detail over the last twelve months with the aim of identifying a set of fit for purpose sanctioning tools that can be used effectively, fairly and proportionately by regulators and those enforcing regulations in situations of regulatory non-compliance. I have considered the work of 56 national regulators and 468 local authorities.
- E.2 I have published two previous reports as part of this review, a discussion paper, incorporating a call for evidence, which was published in December 2005 and a consultation document laying out options for reform in May 2006.<sup>1</sup> Both papers introduced many sanctioning options for consideration including administrative sanctions, venues for hearing regulatory cases, as well as alternative sanctions to be used by the judiciary such as reputation related sanctions or corporate rehabilitation, and the role for restorative justice. I present my final conclusions on these and other sanctioning tools in this report.
- E.3 The regulators within the scope of the review (see paragraph 1.07) carry out more than 3.6m enforcement actions each year. These regulators carry out at least 2.8m inspections per year, hand out at least 400,000 warning letters, 3,400 formal cautions, 145,000 statutory notices and take forward at least 25,000 prosecutions.<sup>2</sup> These enforcement actions are taken across businesses of all sizes often with small businesses and legitimate businesses feeling more of a regulatory burden than larger companies, or those firms engaged in rogue trading activity. This strikes me as counter intuitive and repeat offenders as well as those that have an intentional disregard for the law should, under a risk based system, face tough sanctions.
- E.4 I am therefore recommending that Government should consider:
- Examining the way in which it formulates criminal offences relating to regulatory non-compliance;
  - Ensuring that regulators have regard to six Penalties Principles and seven characteristics when enforcing regulations;
  - Ways in which to make sentencing in the criminal courts more effective;
  - Introducing schemes of Fixed and Variable Monetary Administrative Penalties, available to those regulators who are Hampton compliant, with an appeal to an independent tribunal rather than the criminal courts;
  - Strengthening the system of Statutory Notices;
  - Introducing pilot schemes involving Restorative Justice techniques; and
  - Introducing alternative sentencing options in the criminal courts for cases related to regulatory non-compliance.
- E.5 The current regulatory sanctioning system, including both criminal sanctions and non-criminal sanctions, is a system that has developed over time and as such there are variations between the powers and practices among regulators. The reforms the review proposes are designed to bring consistency into the sanctioning toolkits across the system, reflecting the risk based

<sup>1</sup> *Regulatory Justice: Sanctioning in a post-Hampton World*, Macrory, R., May 2006 and December 2005.

<sup>2</sup> Data submitted to Macrory Review, September 2006.

approach to regulation and the broader regulatory reform agenda. These proposals will provide regulators and industry with greater flexibility whilst ensuring that regulatory outcomes, such as increased compliance, are not compromised.

- E.6 The Hampton Review found that penalty regimes are cumbersome and ineffective.<sup>3</sup> I have taken forward Philip's findings and have considered options that could add to regulators' enforcement toolbox, broadening the flexibility available to both regulators and the judiciary to better meet regulatory objectives and improve compliance. These options would also benefit industry, by providing a transparent system with appropriate sanctions that would aim to get firms back into compliance, ensure future compliance, provide a level playing field for business and enable regulators to pursue offenders who flout the law in a more effective manner.

## Problems with the current system of regulatory sanctions

- E.7 Regulatory sanctions are an essential feature of a regulatory enforcement toolkit and are central to achieving compliance by signalling the threat of a punishment for firms that have offended. Sanctions demonstrate that non-compliance will not be tolerated and that there will be a reprimand or consequence that will put the violator in a worse position than those entities that complied with their regulatory obligations on time.
- E.8 It is important for Government to ensure that regulators have a flexible and proportionate sanctioning toolkit which also ensures the protection of workers, consumers and the environment. That toolkit should provide appropriate options to handle the regulatory needs of legitimate business as well as those businesses that intentionally and knowingly fail to comply with regulatory obligations on time.
- E.9 Evidence submitted to the review suggests that many regulators are heavily reliant on one tool, namely criminal prosecution, as the main sanction should industry or individuals be unwilling or unable to follow advice and comply with legal obligations. Criminal prosecution may not be, in all circumstances, the most appropriate sanction to ensure that non-compliance is addressed, any damage caused is remedied or behaviour is changed. The availability of other more flexible and risk based tools may result in achieving better regulatory outcomes.
- E.10 Many of the review's recommendations are a continuation of current Government proposals and reforms. The Home Office is exploring the role of restorative justice in areas such as corporate manslaughter and youth offending; whilst Defra is currently consulting on the introduction of administrative penalties in the area of fishing and marine activities.

<sup>3</sup> *Reducing administrative burdens: Effective inspection and enforcement*, Hampton, P., HM-Treasury March 2005.

E.11 Whilst the UK has a leading position in the area of regulatory reform and we have made advances in the development of sanctioning regimes in some areas of regulation, little has been done to evolve the sanctioning toolkit across all regulatory bodies. Across the board, we have failed to keep pace with the innovations being introduced in other leading OECD nations such as Australia and Canada, countries which share some of our legal tradition. The review believes that the UK must address this area in order to ensure that the Government's better regulation agenda, including the recommendations of the Hampton Review and the Better Regulation Task Force's report *Less is More*, is realised.<sup>4</sup>

## My recommendations

- E.12 The review has considered a broad spectrum of sanctioning tools, ranging from persuasive methods, such as warning letters or the use of informal, pragmatic means like advice and persuasion, to criminal prosecution at the top end of the enforcement pyramid [see annex A]. The review has also considered the major motivations for non-compliance and I have recommended that suitable sanctioning options should be available to allow regulators to deal appropriately with each type of offender, including the rogue trading element present in some industries.
- E.13 My recommendations are discussed throughout this document and summarised in chapter six. They include recommendations around the following areas:
- A list of Penalties Principles and a framework for regulatory sanctioning;
  - The role of the criminal prosecution as a regulatory sanction;
  - The role of Monetary Administrative Penalties;
  - Statutory Notices and other innovations such as Enforceable Undertakings and Undertakings Plus;
  - The role of Restorative Justice in regulatory non-compliance; and
  - Alternative sentencing options that could be available in criminal courts.
- E.14 Chapter one outlines the role of regulatory sanctions within the regulatory system setting out the context and scope of my review. Chapter two presents the underlying principles relating to regulatory sanctions, their purpose and function as well as the principles themselves. Chapters three and four set out the tools that I believe should be available in an expanded regulatory enforcement toolkit. This includes recommendations on Monetary Administrative Penalties, Statutory Notices, restorative justice and alternative sanctions within a criminal setting. I present some case studies to give examples of the way in which these tools could be used. Chapter five makes recommendations around issues of transparency and accountability for regulators and enforcers who use the enforcement toolkit. Finally, chapter six summarises all of my recommendations.

<sup>4</sup> *Less is More*, Better Regulation Task Force, March 2005

## The review's work

- E.15 The Penalties Review, as part of the implementation of the Hampton Report was commissioned by the Chancellor of the Duchy of Lancaster in September 2005, and its terms of reference are set out in *Regulatory Justice: Sanctioning in a post-Hampton World, December 2005*. Annex B contains more details.

## Publications

- E.16 The review published a discussion paper, *Regulatory Justice: Sanctioning in a post-Hampton World*, in December 2005 with a corresponding call for evidence.
- E.17 The review published a consultation document, *Regulatory Justice: Sanctioning in a post-Hampton World*, with specific policy proposals for consideration in May 2006.
- E.18 Following the publication of the interim report, the review team has been consulting extensively with key stakeholders and experts with a focus on the preparation of this final report.

## Conclusion

- E.19 The reforms suggested by this review are not intended to transform sanctioning systems overnight, but to bring into them the flexibility, efficiencies and responsiveness that can facilitate the full implementation of the Hampton agenda. This will result in better deterrence options for regulators, better compliance for business and better outcomes for the public.

**Box E1** List of recommendations

1. I recommend that the Government initiate a review of the drafting and formulation of criminal offences relating to regulatory non-compliance.
2. I recommend that in designing the appropriate sanctioning regimes for regulatory non-compliance, regulators should have regard to the following six Penalties Principles and seven characteristics.

**Six Penalties Principles**

A sanction should:

1. Aim to change the behaviour of the offender;
2. Aim to eliminate any financial gain or benefit from non-compliance;
3. Be responsive and consider what is appropriate for the particular offender and regulatory issue, which can include punishment and the public stigma that should be associated with a criminal conviction;
4. Be proportionate to the nature of the offence and the harm caused;
5. Aim to restore the harm caused by regulatory non-compliance, where appropriate; and
6. Aim to deter future non-compliance

**Seven characteristics**

Regulators should:

1. Publish an enforcement policy;
  2. Measure outcomes not just outputs;
  3. Justify their choice of enforcement actions year on year to stakeholders, Ministers and Parliament;
  4. Follow-up enforcement actions where appropriate;
  5. Enforce in a transparent manner;
  6. Be transparent in the way in which they apply and determine administrative penalties; and
  7. Avoid perverse incentives that might influence the choice of sanctioning response.
3. I recommend that in order to increase the effectiveness of criminal courts for regulatory offences, the following actions should be implemented:
    - The Government should request the Sentencing Guidelines Council to prepare general sentencing guidelines for cases of regulatory non-compliance;
    - Prosecutors should always make clear to the court any financial benefits resulting from non-compliance as well as the policy significance of the relevant regulatory requirement;
    - Prosecutions in particular regulatory fields be heard in designated Magistrates' Courts within jurisdictional areas, where appropriate; and
    - Regulators provide specialist training for prosecutors and discuss with the Judicial Studies Board (JSB) contributing to the training of the judiciary and justices' clerks.

**Box E1** List of recommendations

4. I recommend that with regards to Monetary Administrative Penalties:
  - Government should consider introducing schemes for Fixed and Variable Monetary Administrative Penalties, for regulators and enforcers of regulations, who are compliant with the Hampton and Macrory Principles and characteristics. This can include national regulators as well as local regulatory partners;
  - Appeals concerning the imposition of an administrative penalty be heard by a Regulatory Tribunal, rather than the criminal courts;
  - Fine maxima for Fixed Monetary Administrative Penalties (FMAP) schemes should be set out and not exceed level five on the standard scale; and
  - There should be no fine maxima for Variable Monetary Administrative Penalties (VMAPs).
5. I recommend that for an improved system of Statutory Notices:
  - Government should consider using Statutory Notices as part of an expanded sanctioning toolkit to secure compliance beyond the regulatory areas in which they are currently in use;
  - Regulators should systematically follow-up Statutory Notices using a risk based approach including an element of randomised follow-up;
  - In dealing with the offence of failing to comply with a Statutory Notice, regulators should have access to administrative financial penalties as an alternative to criminal prosecution. This power should be extended by legislative amendment to existing schemes of Statutory Notices; and
  - Government should consider whether appeals against Statutory Notices should be routed through the Regulatory Tribunal rather than the criminal courts.
6. I recommend that the Government should consider introducing Enforceable Undertakings and Undertakings Plus (a combination of an Enforceable Undertaking with an administrative financial penalty) as an alternative to a criminal prosecution or the imposition of VMAPs for regulators that are compliant with the Hampton and Macrory Principles and characteristics.
7. I recommend that Government should consider introducing pilot schemes involving the use of Restorative Justice (RJ) techniques in addressing cases of regulatory non-compliance. This might include RJ:
  - as a pre-court diversion;
  - instead of a Monetary Administrative Penalty; and
  - within the criminal justice system – as both a pre or post sentencing option.

**Box E1** List of recommendations (*continued*)

8. I recommend that the Government consider introducing the following alternative sentencing in criminal courts:
  - Profit Order – Where the profits made from regulatory non-compliance are clear, the criminal courts have access to Profit Orders, requiring the payment of such profits, distinct from any fine that the court may impose;
  - Corporate Rehabilitation Order – In sentencing a business for regulatory non-compliance, criminal courts have on application by the prosecutor, access to a Corporate Rehabilitation Orders (CRO) in addition to or in place of any fine that may be imposed; and
  - Publicity Order – In sentencing a business for regulatory non-compliance, criminal courts have the power to impose a Publicity Order, in addition to or in place of any other sentence.
9. I recommend that to ensure improved transparency and accountability:
  - The Better Regulation Executive should facilitate a working group of regulators and sponsoring departments to share best practice in enforcement approaches, the application of sanction options, development of outcome measures and transparency in reporting. Regulators and sponsoring departments should work with the Executive to include outcome measures as part of their overall framework of performance management; and
  - Publish Enforcement Activities – Each regulator should publish a list on a regular basis of its completed enforcement actions and against whom such actions have been taken.

## Chapter one

# The role and importance of sanctions within the regulatory system

**This chapter sets out the importance of sanctions in a modern regulatory system and discusses the scope and context of my review as well as an assessment of the current sanctioning system.**

**This review was set up following recommendation eight of the Hampton Review. Hampton set out in his principles:**

- **No inspection should take place without a reason;**
- **Businesses should not have to give unnecessary information, nor give the same piece of information twice;**
- **Regulators should provide authoritative, accessible advice easily and cheaply; and**
- **The few businesses that persistently break regulations should be identified quickly and face proportionate and meaningful sanctions.**

**This review has considered the last of these principles with a view to ensuring that a level playing field is created for all businesses because there is no financial gain from failing to comply. In such a risk based system most breaches will face penalties that are quicker and easier to apply while there will be tougher penalties for rogue businesses which persistently break the rules.**

## Introduction

- 1.1 This review was established to consider appropriate sanctions that could become part of an extended enforcement toolkit available to regulators and Government departments. This would be in addition to the existing sanctions of criminal prosecution and Statutory Notices set out in the relevant regulatory legislation.
- 1.2 This chapter gives some background on the work of the review and the sanctioning regimes I have been investigating.

## The Macrory Review is integral to the Hampton agenda

- 1.3 Philip Hampton in his report, *Reducing administrative burdens: effective inspection and enforcement*, published in March 2005, recommended that the Government establish a comprehensive review of regulators' penalty regimes.<sup>5</sup> Following this recommendation, the Macrory Review was established under my leadership in September 2005.
- 1.4 The Hampton report identified the cumulative burden of regulation – multiple inspections and overlapping data requirements as well as inconsistent practice and decision-making between and within regulators – as the main burden faced by the regulated community. Philip Hampton, in his recommendations, concluded that regulators should use risk assessment as an essential means of directing resources where they can have the maximum impact on outcomes. He went on to say that by eliminating unnecessary inspections, more resources

<sup>5</sup> *Reducing administrative burdens: Effective inspection and enforcement*, Hampton, P., HM Treasury, March 2005, Recommendation 8.

should be directed at compliance advice to the regulated community. Lastly, he suggested Government develop better practice to reduce the administrative burden.

- 1.5 The Hampton Review also found that regulatory penalty regimes can be cumbersome and ineffective. The following features were identified as shortcomings:
- Penalties handed down by courts are not seen as an adequate deterrent to regulatory non-compliance as the level of financial penalty can often fail to reflect the financial gain of non-compliance with regulatory obligations; and
  - The range of enforcement tools available to many regulators is limited, giving rise to disproportionate use of criminal sanctions, which can be a costly, time-consuming and slow process.
- 1.6 I have taken forward Philip's findings and I am recommending a suite of sanctions that could be added to the regulators' enforcement toolbox, broadening the flexibility available to regulators, the judiciary and business to better meet regulatory objectives, improve compliance and ensure a level playing-field for all.

## Scope

- 1.7 In this report, references to 'the regulators' refer only to those regulators that are within the scope of this review as mentioned at the start of Annex C. This includes regulatory bodies at both national and local level. Over 60,000 people work for over 650 regulatory bodies within the scope of my review and have a combined budget of approximately £4 billion.<sup>6</sup>
- 1.8 The division of responsibility between national and local bodies varies. In certain areas, such as environmental regimes, responsibilities are split between national and local regulators; in the area of food standards, a national agency sets standards and Local Authorities enforce them; while in the area of health and safety, Local Authorities enforce regulation on some businesses and national regulators enforce the regulations on other businesses.
- 1.9 My review did not examine regulators that are the responsibility of the devolved administrations in Scotland, Wales and Northern Ireland, but did consider the operation of UK wide regulators there. Many of the underlying principles, though, are likely to be applicable within the devolved administrations. Where I have referred to penalties available to economic regulators, such as the Financial Services Authority, this is solely for the purposes of comparison. Specific terms of reference for the review are presented in more detail in Annex B.
- 1.10 In my review I have concentrated on the sanctioning tools available to regulators. The processes by which regulatory legislation is made and enforced is not strictly within the scope of the review and does not feature in my recommendations, although it has been commented on in various places in this report. Nor was it within my remit to consider the actual substance of the regulatory legislation, though it is evident that sensibly drafted and appropriate substantive law is vital to the effectiveness of any regulatory system.

<sup>6</sup> Ibid 5, page 12-13.

## The Role of sanctions

- 1.11 The focus of my concern is with regulations that apply to businesses, whether individuals, partnerships, or companies, rather than to individual householders or consumers. Almost by definition regulations are introduced where Government cannot be confident that the whole of the sector covered will voluntarily comply with the standards or achieve desired outcomes. I accept, as did the Hampton report, that advice and incentives should play a key role in ensuring regulatory compliance, and should normally be the first response of regulators. Nevertheless, an effective sanction regime plays an equally vital role in a successful regulatory regime. It underpins the regulator's advisory functions, and its very existence will often act as an inducement to compliance without the need to invoke the formal sanctions.
- 1.12 Where regulatory non-compliance occurs, sanctions can ensure that businesses that have saved costs by non-compliance do not gain an unfair advantage over businesses that are fully compliant. Where breaches result in damage or other costs to society, sanctions can assist in ensuring that those in breach provide proper recompense. Sanctions can equally represent a societal condemnation of the regulatory breach, acting as a deterrent to the sanctioned business against future breaches, and sending a wider message to the regulated sector.

## My assessment of the current system

- 1.13 As part of my study to develop recommendations for an effective and proportionate sanctioning system, I have assessed the current regulatory sanctioning regimes in two prior publications.<sup>7</sup> Those documents highlight some of my findings in respect of the perceived shortcomings of the current system, which I summarise in the section below.

## Heavy reliance on criminal sanctions

- 1.14 Regulators have a range of responses to regulatory breaches, including issuing warning letters, giving advice, and serving various forms of Statutory Notices. But I found that ultimately there is heavy reliance on criminal sanctions as a formal response to regulatory non-compliance. I suggest that, although criminal sanctions are in some circumstances an effective tool, too heavy reliance on criminal sanctions in a regulatory system can be ineffective for the following reasons:
- Criminal sanctions currently are often an insufficient deterrent to the 'truly' criminal or rogue operators, since the financial sanctions imposed in some criminal cases are not considered to be a sufficient deterrent or punishment. Where businesses (as opposed to individuals) are prosecuted, criminal courts have a limited range of sanctioning options available beyond a fine, and must take into account the financial means of business concerned in setting a fine;

<sup>7</sup> *Regulatory Justice: Sanctioning in a Post-Hampton World*, Macrory, R., May 2006 and December 2005.

- In instances where there has been no intent or wilfulness relating to regulatory non-compliance a criminal prosecution may be a disproportionate response, although a formal sanction rather than simply advice or a warning, may still be appropriate and justified. However, regulators may not have any alternative available to them in their toolkit and so must prosecute, even where a different type of sanction may be more effective;
- Heavy reliance on criminal sanctions leads to some non-compliance not being addressed at all. Criminal sanctions are costly and time-consuming for both businesses and regulators. In many instances, although non-compliance has occurred, the cost or expense of bringing criminal proceedings deters regulators from using their limited resources to take action. This creates what has come to be known as a *compliance deficit*;
- Criminal convictions for regulatory non-compliance have lost their stigma, as in some industries, being prosecuted is regarded as part of the business cycle. This may be because both strict liability offences committed by legitimate business, and the deliberate flouting of the law by rogues is prosecuted in the same manner with little differentiation between these two types of offender; and
- Since the focus of criminal proceedings is on the offence and the offender, the wider impact of the offence on the victim may not be fully explored. There has been a limited evolution of the rights and needs of victims in the area of regulatory non-compliance which I have explored in more detail in my consultation paper.<sup>8</sup>

<sup>8</sup> Ibid, see chapter five of my interim report.

Table 1.1 Range of sanctions used by some regulators'

	Inspections Carried out	Warning Letters	Formal Cautions	Statutory notices	Prosecutions	Fixed Penalties
<b>Environmental Health<sup>9</sup></b>	2,029,793	232,023	*	105,681	*	
<b>Trading Standards and related services<sup>10</sup></b>	203,697	40,806	2,486		4,692	
<b>Environment Agency<sup>11</sup></b>	140,528		413	515	883	
<b>Health and Safety Executive<sup>12</sup></b>	59,865			8,445	712	
<b>Companies House<sup>13</sup></b>					7,570	190,945
<b>Vehicle and Operator Services Agency<sup>14</sup></b>	134,164	1,078		16,666	10,642	
<b>Meat Hygiene Service<sup>15</sup></b>		6,285	24	2,053	17	
<b>Forestry Commission<sup>16</sup></b>	12,744	1,695		20	17	

Sources: CIPFA Trading Standards Statistics 2004, CIPFA Environmental Health Statistics 2003-04, Environment Agency, Health and Safety Executive, Companies House, Department for Transport, Rural Payments Agency, Meat Hygiene Service, and The Forestry Commission.

\* Figures for Environmental Health Formal Cautions and Court summons for 2003/04 was 11,704 and is only available as an aggregate figure.

## Limited Range of enforcement tools

1.15 Over the course of my review, I have received evidence and submissions from many stakeholders including regulators, businesses, academics and many others that have supported my view that regulators have a limited range of enforcement sanctions within their toolkits.

<sup>9</sup> 2003/04 figures, England and Wales only. Includes figures for Pest Control services.

<sup>10</sup> 2004 figures, apart from 'Inspections carried out' which is taken from 2003.

<sup>11</sup> 2005 figures.

<sup>12</sup> 2004/05 figures.

<sup>13</sup> 2004/05 figures.

<sup>14</sup> 2004/05 figures.

<sup>15</sup> 2004/05 figures apart from warning letters that relates to the calendar year 2004.

<sup>16</sup> 2005/06 figures.

“Defra supports the widely held view, espoused also in Hampton, that the current system is not sufficiently responsive, targeted and sensitive to ensure that appropriate penalties are applied in all cases. To this end, the department accepts that there is room for improvement but restates its basic tenet that a robust penalties framework should encompass different types and levels of sanctions depending on the nature, frequency and seriousness of non-compliance.” **Defra**

*Source: Response from Defra to the Macrory Review, February 2006*

- 1.16 Criminal prosecutions remain the primary formal sanction available to most regulators. While this sanction is appropriate in many cases, the time, expense, moral condemnation and criminal record involved may not be appropriate for all breaches of regulatory obligations and is burdensome to both the regulator and business. While the most serious offences merit criminal prosecution, it may not be an appropriate route in achieving a change in behaviour and improving outcomes for a large number of businesses where the non-compliance is not truly criminal in its intention.

**Table 1.2 Mapping of regulators' enforcement tools**

	Financial Services Authority <sup>17</sup>	Health Safety Exec.	Food Standards Agency	Environment Agency <sup>18</sup>	Comp. House <sup>19</sup>	Charity Comm. <sup>20</sup>	Defra Core dept. regulators <sup>21</sup>
Criminal prosecution	●	●	●	●	●	●	●
Licence revocation	●	●	●	●	N/A	N/A	●
Licence suspension		●	●	●	N/A	N/A	●
Admin financial penalty	●						
Fixed admin financial penalty				●	●		
Statutory Notices		●	●	●	●	●	●
Warning letter	●	●	●	●	●	●	●
Persuasion	●	●	●	●	●	●	●

*Source: Responses from regulators to the Macrory Review, February 2006*

1.17 Table 1.2 sets out the sanctions that regulators are currently able to access through their relevant legislation. The sanctions that the majority of regulators have access to are either a warning letter at the informal end of the spectrum or a criminal prosecution at the other. In some cases, they have access to civil injunctions. Most regulators have limited access to administrative penalties and other intermediate sanctions as a further step before escalating to prosecution or licence suspension or withdrawal as indicated in the table.

<sup>17</sup> Financial Services and Markets Act 2000, section 126, 127 for warning and decision notices and Part XXV, sections 380 and 382 for injunctions and restitution orders. The FSA does not provide for the use of Statutory Notices such as enforcement notices which require compliance on the part of a firm or a person, but the FSA does issue warning notices, decision notices and final notices. The FSA have access to other enforcement options, which are not in the table, and can for example seek injunctions, make restitution orders and make prohibition orders against persons who are not fit and proper.

<sup>18</sup> Many regulators including the Environment Agency can issue Cautions. These are formal written admissions of guilt which obviate the need for a prosecution.

<sup>19</sup> Companies House does not operate a licence regime. Therefore the licence suspension and licence revocation sanctions are not applicable.

<sup>20</sup> The Charity Commission does not operate a licence regime. Therefore the licence suspension and licence revocation sanctions are not applicable.

<sup>21</sup> DEFRA core departmental regulators include regulators operating in the areas of Environmental Impact Assessment (uncultivated land), Cattle Identification Scheme, Horticulture (classification of imported fruit and vegetables), Pesticides Safety, Waste Management, and Fisheries.

## Financial penalties sending the wrong signal

- 1.18 Evidence presented to me over the course of the review has demonstrated that, in some instances, the fines handed down in court often do not reflect the financial gain a firm may have made by failing to comply with an obligation. This means that these penalties do not act as a deterrent and, in effect, give businesses an incentive to continue to fail to comply in return for a profit. In some cases fines do not fully reflect the harm done to society.

### Box 1.1 Examples of fines that do not reflect the financial benefit or seriousness of the offence (environment regulation)

- An Oxfordshire man was fined £30,000 for abandoning 184 drums of toxic waste. The man received £58,000 for disposing of the material, and the Waste Authorities had costs of £167,000 to incinerate the waste properly.
- A fine of £25,000 was handed down to a small waste disposal company which was operating without a licence. The company saved £250,000 by operating illegally over a 2 year period.

Source: Examples submitted to the Macrory Review by the Environment Agency, March 2006

- 1.19 These apparently low financial penalties could be seen as an acceptable risk by businesses that have chosen to be deliberately non-compliant. In these instances it might be assumed that financial penalties in the current system are failing to achieve even the most basic objectives of an effective sanctioning regime.
- 1.20 If regulators are pursuing, as they should, a risk based compliance orientated enforcement strategy, prosecution will be a sanction applied for the most serious cases of regulatory non-compliance. When prosecutions do take place, it is reasonable to assume that they are for the most serious offences and offenders. Sentencing should also reflect this level of seriousness and be a strong deterrent signal for others in the regulated community.
- 1.21 This lack of an effective deterrent compromises the effectiveness of the regulatory relationship. Without credible and meaningful sanctions, regulators are forced to pursue a more burdensome and bureaucratic enforcement policy. Regulators are deterring non-compliance through their inspection activities. Effective sanctioning is an important signal in achieving deterrence. If criminal prosecutions sent out a strong signal of deterrence, then regulators would be able to impose less onerous burdens on legitimate business by conducting fewer inspections. However, currently legitimate businesses see their unscrupulous competitors cut corners, and gain competitive advantage, without facing serious financial or other consequences.
- 1.22 Information from my call for evidence suggests that the average fines handed down by Magistrates are relatively low, when compared to the fine maxima available. As set out in Table 1.3 below, average fines for businesses ranged from as little as £488 to £6,855. In environmental and health and safety cases, the average fines are in the range of £5,000 to £7,000. This does indicate that the deterrent effect of fines is likely to be limited for all but the smallest businesses.

1.23 The level of fines seen in criminal courts tend to be small in relation to the size and financial position of large businesses. For example, the largest fine handed down to date for a health and safety offence is £15 million imposed against Transco (for breaches of regulations that resulted in the death of four members of the same family in a gas explosion). The financial penalty, while significant in absolute terms, represented five percent of after-tax profits and less than one percent of annual revenues for the company.<sup>22</sup> This shows that even large fines can be absorbed by companies and may not carry the necessary deterrent effect or motivate a change in a firm's behaviour although Transco began an accelerated programme of pipe replacement as an outcome of the incident and did change its behaviour.

**Table 1.3 Level of financial penalties 2004/2005**

	Prosecutions	Convictions	Average financial penalty
Health and Safety Executive <sup>23</sup>	1,267	999	£6,855 <sup>24</sup>
Environment Agency <sup>25</sup>	887	876	£5,007
British Potato Council <sup>26</sup>	246	28	£488
Company House	5,867	2,944	N/A
Financial Services Authority <sup>27</sup>	6	6	£75,500
Pesticide Safety Directorate	3	1	£1,800
Food Standards Agency	570	458	N/A

Source: Data submitted by regulators to the Macrory Review, Spring 2006

<sup>22</sup> Transco v HSE August 2005, Edinburgh High Court.

<sup>23</sup> Figures for 2005.

<sup>24</sup> Sentencing handed down in courts reflects many factors including the ability to pay (JSB Adult Court Bench Book, pg 33). There is generally a band within which some fines will be small and others will be large. This figure excludes the convictions with fines of over £100,000. Of those excluded, there was one fine of £2,000,000; three fines at £300,000 or above; and thirteen fines of between £100,000 and £300,000. If these seventeen convictions were included, the average for 2004/05 rises to £12,642.

<sup>25</sup> Figures for 2005.

<sup>26</sup> Figures for 2003/2005. Of those businesses who receive a notification for summons, most decided to provide the requested information before the cases actually proceeded to Court. All cases that proceeded to court resulted in a successful conviction.

<sup>27</sup> Figures since 2000, under the Financial Services and Markets Act 2000.

1.24 There is also evidence that for some offences the average fines are considerably below the maximum available fine. For example, the average fine for non-compliance with the Trade Descriptions Act 1968 was £1,524 against a maximum fine available in the legislation of £5,000. Offences under the Health and Safety at Work etc. Act 1974 led to fines of £6,014 on average, against a maximum fine up to £20,000 depending on the offence.<sup>27</sup> Finally, the maximum penalty available in a Magistrates' Court for non-compliance with controls on the transport of waste is currently £5,000, but the average fine is just £530.<sup>28</sup> These are only a few examples and are not meant to suggest that courts should always aim for the maximum penalty available. I do believe, though, that these examples are indicative of the level of fines currently handed down by the criminal courts for particular offences.

## Previous comments on low financial penalties

- 1.25 I am not the first person to recognise that financial penalties handed down in the criminal courts may not be sending a strong deterrence signal.
- 1.26 The Government has previously recognised that in the area of health and safety, courts are in need of greater sentencing power and that there is scope for extending maximum fines available in the health and safety legislation.<sup>29</sup>
- 1.27 In 2004, the House of Commons Environmental Audit Committee found, in its sixth report, that the level of sentences given in courts for environmental crimes is too low and recommended the introduction of alternative sentencing powers such as adverse publicity orders and environmental service orders.<sup>30</sup> In its response, the Government noted the Committee's concerns and agreed that imaginative methods of dealing with offenders are necessary.<sup>31</sup> In addition to my report, new approaches have been considered by the Defra-led review of Enforcement in Environmental Regulation, which was tasked with identifying obstacles to effective environmental enforcement and ways to overcome them. The report from the environmental review includes the suggestion that variable administrative penalties, financial and non-financial, would have the potential to create stronger incentives for compliance in a new balance with criminal prosecution. The report also sets out ideas for relating environmental penalties more transparently to the purposes of enforcement: removing financial gain from non-compliance; making damage good; making restitution to adversely affected communities; and exposing culpability where it exists.<sup>32</sup>

<sup>27</sup> Data from the DCA, selected offences in Magistrates' Courts during 2004.

<sup>28</sup> Average fine awarded by the Magistrates' Courts in the 156 successful prosecutions taken in 2003

<sup>29</sup> *Revitalising Health and Safety*, Department for Environment Transport and Regions, June 2000, p.24.

<sup>30</sup> *Environmental Crime and the Court*, House of Commons Environmental Audit Committee Sixth Report, 2004. Reference Introduction paragraph 15, see [www.publications.parliament.uk/pa/cm200304/cmselect/cmenvaud/126/12604.htm](http://www.publications.parliament.uk/pa/cm200304/cmselect/cmenvaud/126/12604.htm)

<sup>31</sup> <http://www.publications.parliament.uk/pa/cm200304/cmselect/cmenvaud/cmenvaud.htm>

<sup>32</sup> <http://www.defra.gov.uk/environment/enforcement/>

- 1.28 The academic literature on penalties often reaches similar conclusions. For example, a study of penalties for environmental offences found that, with the exception of the Netherlands, fines were generally low in the European Union. Low judicial and public awareness of the harmful consequences of pollution were among the reasons for this, in addition to a lack of familiarity with environmental law on the part of the judiciary.<sup>33</sup>
- 1.29 I acknowledge that the financial circumstances of each firm and their ability or means to pay a fine must be taken into account by a court in determining the appropriate financial penalty. However, the low level of average financial penalties indicates that the deterrent effect of these penalties will be less meaningful for all but the smallest of businesses.

## Resolution of criminal cases takes time and money

- 1.30 Criminal prosecutions are time and resource intensive for business and for regulators. It may be that they are currently used in the absence of other formal sanctions, rather than because they are an appropriate response. For instance, the long and resource intensive process of taking a criminal prosecution through court may seem inappropriate for a company that is being prosecuted for a strict liability offence. The Environment Agency reported that, in its experience, cases take an average of seven months from discovery of non-compliance to when proceedings are commenced. The Health and Safety Executive (HSE) estimated that, from offence to approval of prosecution, about 20 per cent of cases are approved for prosecution within three months of the offence date, and by 12 months from the offence date four out of five cases will have been approved for prosecution.
- 1.31 For a business this means that, although the time spent preparing and investigating a case is necessary, a rectified regulatory non-compliance can still be an issue several months on. Industry and the regulator may prefer a timelier and less costly resolution to appropriate cases of regulatory non-compliance as the delay and uncertainty of prosecution is burdensome for both.
- 1.32 Furthermore, regulators may not choose to pursue cases for prosecution because of the low expected outcome. Enforcers may not pursue cases because the level of penalty is not seen to justify the time, effort and resources that will need to be deployed in order to bring a successful prosecution.

<sup>33</sup> *Criminal Enforcement of Environmental Law in the European Union*, Faure, M. & Heine, G., IMPEL Working Group on Criminal Prosecution in Environmental Cases, 2000.

## Is there a compliance deficit?

- 1.33 I believe that in many sectors compliance levels in the UK are generally high. However, it can be frustrating for both regulators and businesses when regulatory non-compliance is not addressed because the regulator lacks the appropriate enforcement mechanism. This problem creates what is known as a *compliance deficit*: where non-compliance exists and is identified but no enforcement action is taken because the appropriate tool is not available to the regulator.
- 1.34 It is difficult to assess the general level of compliance in the UK because not every firm is inspected and not every incidence of regulatory non-compliance is identified. Tangible data is absent in this area. However, I have attempted to get some indication from regulators on the overall effectiveness of enforcement strategies on compliance levels. This was a difficult process, as most regulators are able to comment on their outputs such as numbers of prosecutions or number of Statutory Notices imposed, but are unable to draw any conclusions on what impact this has on overall compliance. The results of this are discussed in my consultation document.<sup>34</sup>

## Important issues beyond my remit

- 1.35 It was clear from the responses to the consultation paper that there were certain subject areas that respondents wanted me to comment on, but which are outside of the remit of my review. I am constrained by the subject matter of regulatory legislation. It is outside the scope of this review to comment on the substance of regulatory requirements and I therefore have adopted the working assumption that regulations are sensible and necessary. Government should be regularly reviewing existing regulations to ensure this is the case.
- 1.36 In addition, it is not within my scope to comment on the structure of enforcement agencies. Philip Hampton recommended a change in regulatory structures with 35 regulators being merged into nine by April 2009.
- 1.37 At the conclusion of this review, I am not laying down prescriptive rules as to how regulators should respond to individual breaches of regulation, but I am suggesting that a more flexible range of sanctioning options is made available to them. I also suggest what safeguards should be present alongside an extended toolkit. Regulators will still retain the discretion as to how best to respond, and to choose the most appropriate sanction to ensure positive outcomes.
- 1.38 I do not wish to trespass on the sentencing discretion of the criminal courts. This report does not intend to make recommendations that will impinge on this discretion. I am, however, recommending options that enhance the sanctioning choices available to the criminal courts. I also make recommendations concerning specialisation and training which I believe will improve their effectiveness when dealing with criminal prosecutions for regulatory non-compliance.

<sup>34</sup> *Regulatory Justice: Sanctioning in a Post-Hampton World*, Macrory, R., May 2006, p36.

- 1.39 Lastly, I am not prescribing changes to the legal framework or status of current offences relating to regulatory non-compliance. Offences relating to regulatory non-compliance come in many forms: some impose true strict liability, some allow for defences like taking reasonable precautions or similar wording, some require proof of knowledge or intent. The rationale for the differences is not always clear. This is a subject that I believe will merit further investigation in the future. Some interesting work relevant to this has been done in the course of my review. At Annex D and E of my interim report, I discuss the role of strict liability offences in the regulatory field. Some consultation responses have supported my view that there may be a case for decriminalising certain offences thereby reserving criminal sanctions for the most serious cases of regulatory non-compliance. It is however outside my terms of reference to consider this in great detail. My review has started a debate in this area and it may be something that the Government wishes to investigate further.

We support the view that a distinction must be drawn between matters of regulation and criminal offending. There is a pressing need to avoid expensive court time being taken up with matters that are better suited to an administrative penalty.

*The Criminal Sub committee of the Council of HM Circuit Judges*

**Recommendation 1:**

I recommend that the Government initiate a review of the drafting and formulation of criminal offences relating to regulatory non-compliance.

- 1.40 My recommendation above relates to exploring options for distinguishing whether some offences could now be better sanctioned administratively.

## The following chapters

- 1.41 In the following chapters I recommend an extension to the range of sanctioning options available to enforcement agencies where formal sanctions are considered appropriate to deal with the regulatory non-compliance. This is a response to the findings of my review both from the analysis of original evidence presented to me and from further consultation with stakeholders.
- 1.42 I believe that the recommendations presented in this review constitute a blueprint of sanctioning tools that is fit for a risk based regulatory society. They present flexible and proportionate sanctions that will help to close the compliance deficit and do so in an effective and coherent manner.

- 1.43 In chapter two, I outline the underlying principles that my blueprint of sanctions should be based on. In chapters three and four, I recommend a suite of sanctions that I believe will be the blueprint and I describe how they will work. These are:
- Recommendations to improve the effectiveness of the criminal courts;
  - Recommendations to introduce Fixed and Variable Monetary Administrative Penalties;
  - Recommendations introducing an independent regulatory tribunal for the appeal of administrative sanctions;
  - Recommendations for strengthening the system for Statutory Notices;
  - Recommendations introducing Enforceable Undertakings and Undertakings Plus;
  - Recommendations introducing Restorative Justice; and
  - Recommendations introducing further sentencing options for the criminal courts.
- 1.44 I believe that these recommendations will bring a paradigm shift to the way in which regulatory sanctions are designed and used, making them more flexible and encouraging compliance.
- 1.45 The range of sanctions that are being recommended is wider than the current powers that are generally available. They would give many regulators sanctioning options that they will not have had before. This wide range of powers requires appropriate safeguards to prevent misuse of the system, as a disproportionate use of these powers could damage constructive relationships between regulators and legitimate business.
- 1.46 Consequently, in chapter five, I have set out my recommendations for making this a transparent system with appropriate frameworks for regulator accountability. I believe these proposals will be vital to the effectiveness and acceptability of the sanctioning system I am advocating.
- 1.47 Finally, chapter six sets out all of my recommendations for easy reference.

Transparency and  
Accountability

## Chapter Two

### Underlying principles for regulatory sanctions

**This chapter sets out the ‘Penalties Principles’ that underpin my recommendations. I also describe the characteristics of the framework within which the principles must operate to ensure successful and consistent application across all regulators.**

#### Introduction

- 2.1 My recommendations not only widen the range of regulatory sanctions, but deliberately shift some of this activity away from the criminal courts to regulatory bodies themselves. This means that regulators will have new and increased powers. Given this expanded role, I believe it is necessary to provide regulators and their sponsoring departments with guidance on the parameters within which an extended sanctioning toolkit should operate. I have done this by identifying a series of principles and characteristics. These are consistent with the Hampton principles as well as the Five Principles of Good Regulation.<sup>35</sup>
- 2.2 I have also considered the Criminal Justice Act 2003 and the guidance it gives the criminal courts when considering a sentence.<sup>36</sup> It refers to five purposes of a sentence that the courts must have regard to when determining a sentence. I have attempted to mirror these five purposes in my own principles. These five purposes are summarised below:
- The punishment of offenders;
  - The reduction of crime (including deterrence);
  - The reform and rehabilitation of offenders;
  - The protection of the public; and
  - The making of reparation by the offenders to those persons affected by their offences.

#### The need for principles

- 2.2 My vision of a contemporary sanctioning regime for regulatory non-compliance is underpinned by a set of Penalties Principles that I defined and invited comments on in my interim report. I believe offering regulators a new suite of sanctions brings with it a need to provide guidance on how these sanctions should be applied.
- 2.3 My principles are primarily intended to set out the underlying rationale for my analysis and detailed recommendations. They will help build a common understanding of what a sanctioning regime should achieve amongst regulators and the regulated community, and in turn will act as a framework for regulators when considering what sort of sanction or enforcement action to take. This will provide a safeguard that the new sanctions will be used fairly and consistently. This is particularly important during the transition phase, as my recommendations are introduced and regulators develop capacity and understanding of a newer and wider toolkit.

<sup>35</sup> *BRTF Principles of Good Regulation* – Proportionality, Accountability, Consistency, Transparency and Targeting, 2003

<sup>36</sup> Criminal Justice Act 2003, Part 12, section 142.

- 2.4 Consultation responses were broadly supportive of the principles described in my interim report. However, some concern was expressed that the principles should be applied flexibly, taking in to account circumstances of individual cases, the relevant legislative frameworks within which regulators in the UK operate, and existing practice and policy of regulators.
- 2.5 A general concern amongst consultation respondents was that restrictive application of the principles may lead to adverse outcomes. I discuss an example in the box below.

### **Application of Penalties Principles**

In relation to **Principle #5**: *sanctions should include an element of ensuring that the harm caused by regulatory non-compliance is put right.*

The Financial Services Authority (FSA) suggest that although the principle *is* a relevant consideration, not all cases can or should include a restorative element. For example, in some cases it may not always be possible to quantify the losses suffered by an identifiable person and in others individual losses as a result of regulatory breaches are more efficiently and effectively redressed through individuals directly pursuing claims with the firm concerned (through the Financial Ombudsman Services or through the Financial Services Compensation Scheme). The FSA suggest that Principle #5 be qualified to make it clear that regulators need only consider whether a sanction should include a restorative element.

*Financial Services Authority (FSA)*

- 2.6 I believe that the Financial Services Authority make a valid point and I want to emphasise that the principles should be taken into consideration only where appropriate. Following on the example in the box above, not all cases may have caused harm to a party. In these instances, restoration to a person or community may not be necessary or appropriate. In other instances, some of the other principles may not be relevant. It may not be appropriate for all of the principles to apply in every single case, but there is a need for a consistent approach in that the principles should always be considered when a regulator is taking an enforcement action, or designing a specific sanctioning scheme.
- 2.7 In addition, I wish to emphasise that the Penalties Principles should be regarded as the underlying basis of regulators' sanctioning regimes in order to achieve consistency, rather than legally binding objectives in themselves. To this end, I have qualified some of the original principles, expressing them as aims rather than absolutes.

## Using the principles

- 2.8 I envisage that the principles I have set out will be of particular value to:
- Government departments in the design of detailed regulatory structures should they accept the recommendations in my report;
  - Enforcement agencies in the design and implementation of enforcement policies;
  - Regulators when deciding what sanction to impose;
  - The regulated community in that the principles provide clarity overlaying specific sanctioning policies and reassurance that non-compliance will be dealt with appropriately; and
  - All stakeholders in the future assessment of sanctioning regimes.
- 2.9 Regulators need to have the flexibility to impose the sanction they believe is appropriate, and my principles aim to provide a framework for deciding what type of sanction is suitable in individual circumstances. The spirit of my recommendations around the Penalties Principles is that they are there for guidance and should not be a basis for specific legal challenges. I do not prescribe a particular priority with regard to the individual principles as I believe, regulators should have the discretion to when particular principles are more appropriate or relevant.
- 2.10 Fundamental to the Penalties Principles is the notion that the underlying regulation is fit for purpose and provides for a greater social objective such as correcting a market failure or the protection of consumers, workers, or the environment.

## The Six Penalties Principles

- 2.11 Consultation responses generally supported the six principles I detailed in my interim report. The principles that I recommend are therefore as follows:
- Principle #1 – Changing behaviour  
**A sanction should aim to change the behaviour of the offender.** This means that a sanction is not focused solely on punishment but should also ensure that the offender changes its behaviour and moves back into compliance. Changing behaviour could involve culture change within an organisation or a change in the production or manufacturing process to ensure that regulatory non-compliance is minimised. When choosing between different sanctions, regulators should consider how best to achieve changes in behaviour.
  - Principle #2 – No financial benefit  
**A sanction should aim to eliminate any financial gain or benefit from non-compliance.** Firms may calculate that by not complying with a regulation, they can make or save money. They may also take a chance and hope that they are not caught for failing to comply with their regulatory obligations or for deliberately breaking the law. Some firms may even believe that if they are caught, the financial penalties handed down by the courts will usually be relatively low and they will probably still retain some level of financial gain.

If, however, firms know that making money by breaking the law will not be tolerated and sanctions can be imposed that specifically target the financial benefits gained through non-compliance, then this can reduce the financial incentive for firms to engage in this type of behaviour. For firms that persist in operating this way, removing financial benefits will ensure that, in future, the financial gains are not enough of an incentive to break the law. I accept that determining the financial benefit is a difficult process in some instances, and that there may be some areas of regulation where the notion of identifiable profits gained from non-compliance is not applicable. But I believe it is a challenge that can be met as demonstrated by the methodologies developed by several leading regulators in the UK and abroad including the Canadian Border Services Agency, the US Environmental Protection Agency and the Federal Office of Consumer Protection and Safety in Germany.

- Principle #3 – Responsive sanctioning

**A sanction should be responsive and consider what is appropriate for the particular offender and the regulatory issue, which can include punishment and the public stigma that should be associated with a criminal conviction.** The regulator should have the ability to use its discretion and, if appropriate, base its decision on what sort of sanction would help bring the firm into compliance. It may be that some firms would respond better to a sanction such as an administrative penalty combined with advice regarding best practice, while other firms may need to be sanctioned by way of a criminal prosecution. It is important that among other factors, the regulator also considers the size of the individual firms when deciding which sort of sanction is most likely to bring about a change in a firms' behaviour.

Ultimately, a regulator is obliged to uphold the public interest and maintain a credible enforcement and sanctioning regime. It should have the flexibility to apply a sanction for punitive reasons even though a lesser sanction could be applied. This may be necessary for so-called 'repeat offenders' who have been given previous opportunities – alongside advice and guidance – to comply, but have deliberately and intentionally failed to do so. Similarly, a punitive sanction may be appropriate for a single contravention with very serious external consequences.

The regulator should also consider the needs of victims and the public when determining what enforcement action is necessary in any particular case. Responsiveness is a positive quality and I believe that as long as procedural fairness is maintained and regulators pursue consistent policy objectives, regulatory outcomes will be improved.

### **Punitive sanctions**

Postcomm (Postal Services Commission) commented that whilst it is in agreement with the six principles in my interim report, it suggested that some contraventions may be so serious that they deserve a serious public mark of disapproval through imposing a substantive financial penalty and that the principles need to recognise this.

*Principle #4 – Proportionate sanctioning*

**A sanction should be proportionate to the nature of the offence and the harm caused.** Whilst the previous principle is concerned with addressing the reasons for the failure to comply, this principle takes into account the nature of the non-compliance and its consequences. Inclusion of these factors will ensure that firms are held accountable for the impact of the actual or potential consequences of their actions and that these are properly reflected in any sanction imposed. The sanction should reflect the individual circumstances of the firm and the circumstances surrounding the non-compliance.

### Overlap between the Penalties Principles

In their consultation response the FSA (Financial Services Authority) commented that there was some overlap between Principles #3 and #4. Although I agree that, on a wide interpretation, some of the principles can be construed as overlapping, I nonetheless believe that there is a distinct element in each principle I have identified and a value in setting these out separately.

- *Principle #5 – Restore the harm caused*  
**A sanction should aim to restore the harm caused by regulatory non-compliance, where appropriate.** This principle encompasses the needs of victims as well as ensuring that business offenders take responsibility for their actions and its consequences.
- *Principle #6 – Deterrence*  
**A sanction should aim to deter future non-compliance.** Sanctions should signal to others within the regulatory community that non-compliance will not be tolerated and that there will be consequences. Whether this is by a criminal prosecution or some other sanction would remain at the discretion of the regulator, within the scope of the powers available to it in relevant legislation, but firms should never think that non-compliance will be ignored or that they will 'get away with it'.

## Framework for operation of the Penalties Principles: the seven characteristics

2.12 It is important, particularly from the perspective of the regulated community, that there is a consistent approach to sanctioning across all regulators. To help ensure this my interim report proposed a framework within which the Penalties Principles should operate. It would be for regulators themselves to establish this framework. Consultation responses were positive towards the seven characteristics of this framework I described in my interim report.

- *Characteristic # 1 – Enforcement policy*  
**Regulators should publish an enforcement policy.** This will improve transparency and accountability from regulators by signalling to business and society the kind of responses and standards they can expect from regulators in dealing with non-compliance. A public enforcement policy will also show that regulators will use their sanction powers in a proportionate and risk based way. The regulator would need to be able to justify any departure from its own enforcement policy. Research carried out for my review indicated that currently only 17 out of 56 national regulations have a published enforcement policy. Enforcement policies will need to incorporate the new range of sanction options that I recommend and should be consistent, where appropriate, with the Regulators' Compliance Code to be issued under Part Two of the Legislative and Regulatory Reform Act 2006.
- *Characteristic # 2 – Measure outcomes*  
**Regulators should measure outcomes not just outputs.** Regulatory outputs are quantitative measures such as the number of prosecutions, or the number of Statutory Notices imposed by a regulator, whereas a regulatory outcome seeks to measure what impact regulatory outputs may have had. Measuring outcomes will enable regulators and the public to know what impact the enforcement actions are having, whether these have improved compliance, or remedied the harm caused by regulatory non-compliance, and whether there needs to be any modification to the balance between different types of enforcement actions to get better results. I acknowledge this may not be an easy exercise and there may be difficulties in determining these measures, but I maintain that regulators and government departments should make every effort to identify and measure regulatory outcomes.
- *Characteristic # 3 – Justify choice of enforcement actions*  
**Regulators should justify their choice of enforcement actions year on year to stakeholders, Ministers and Parliament.** I recommend that regulators should be required to justify overall what their general enforcement strategy is and why they have chosen the enforcement actions that make up their strategy in any given year. This will not just provide protection for legitimate business, but increase public and private sector confidence and understanding in the way regulatory non-compliance is dealt with. I consider this in more detail in chapter five when I discuss accountability and transparency.
- *Characteristic # 4 – Follow-up enforcement actions*  
**Regulators should follow up their enforcement actions where appropriate.** This is of particular importance for low-level enforcement actions such as warning letters or enforcement/improvement notices, where I am concerned that lack of follow-up on the part of regulators means that they are not taken seriously and credibly by firms.

However, I recognise that follow-up activity is dependent on the resources available to individual regulators and must be consistent with a risk based approach to regulation. I do take account of other priorities faced by regulatory bodies operating with finite resources, who may not want to dedicate any resource to following up minor enforcement actions. I suggest that in order to make these enforcement actions credible, some follow-up is necessary, even if this is done on a random selection basis. One outcome measure that might be adopted is whether enforcement action has been effectively brought a business into compliance – systematic follow-up by regulators would be one way of measuring the extent to which such an outcome measure has been achieved.

- *Characteristic # 5 – Be transparent in what enforcement actions have been taken*  
**Regulators should enforce in a transparent manner.** Regulators should disclose to key stakeholders and the wider public when and against whom enforcement action has been taken. This should not be isolated to criminal prosecutions, but should also be used for other enforcement action such as administrative penalties, enforcement or improvement notices or any other formal sanction, where appropriate. This information should be easily accessible and serves as a safeguard for firms, the regulator and the public interest. I talk more about the importance of transparency in chapter five.
- *Characteristic # 6 – Be transparent in the methodology for determining or calculating administrative financial penalties*  
**Regulators should be transparent in the way in which they apply and determine administrative penalties.** Regulators should disclose the methodology for calculating variable administrative fines including the relevant mitigating and aggravating factors firms should be aware of. Regulators should also publish a schedule of fixed administrative fines if operating an FMAP scheme. I discuss this further in chapter three.
- *Characteristic #7 – Avoid perverse incentives influencing the choice of sanctioning response*  
**Regulators should avoid perverse incentives that might influence the choice of sanctioning response.** Regulators should, for example, avoid any rise of perverse incentives when determining the appraisal and evaluation schemes of enforcement staff. It is important that regulators do not have targets for different types of enforcement actions or any correlation with salary bonuses or similar incentives. This might incentivise staff to pursue certain enforcement actions inappropriately. Secondly, while there is already Government guidance on revenue from administrative penalties, I would emphasise that regulators should not retain the revenue from Monetary Administrative Penalties, or exercise any control over how that revenue should be spent. I describe these arrangements more fully in chapter three.

## Link with the Compliance Code

2.13 The Legislative and Regulatory Reform Act 2006, contains a power which will enable some of the Hampton principles of regulatory enforcement (see section 2.92 of the Hampton review '*Reducing administrative burdens: effective inspection and enforcement*') to be placed on a statutory footing through a statutory Code of Practice (the 'Regulators' Compliance Code'). I would envisage, subject to consultation, that the section of the final version of the Code relating to proportionate and meaningful sanctions for businesses that consistently breach regulations will be consistent with the Macrory Penalties Principles. Regulators should be able to demonstrate transparency in process and procedures in order to comply with the Code and I would expect regulators' enforcement policies to be consistent with both the Code and the Penalties Principles.

## Link with the 'Five Principles of Good Regulation'

- 2.14 The consultation response from the Better Regulation Commission (BRC) highlighted that we already have the Five Principles of Good Regulation and the ten Hampton principles of inspection and enforcement.<sup>37</sup> The Commission expressed concern that adding further principles and providing too much guidance risked confusing both regulators and those they regulate.
- 2.15 I should like to make it clear, if I have not previously done so, that the wider purpose behind my review is to further the better regulation agenda as a whole and build on the good work already completed or underway. To this end I share the BRC's concern that the regulatory regime remains light-touch and I acknowledge that so-called 'principles proliferation' risks duplication and dilution. However, I believe that my Penalties Principles, set in the context of regulatory sanctioning, are a natural extension of the Commission's own work. Although I agree that some of my Penalties Principles may be construed as an application of the existing Five Principles of Good Regulation, I believe that there is a need to set them out separately.
- 2.16 The radical changes I am proposing need to incorporate safeguards for industry and the public. By identifying a series of principles and characteristics, I have specified what I think regulators should have regard to when extending their toolkits. I have taken the concerns of stakeholders seriously, and have attempted to provide a workable framework within which regulators should operate when expanding their sanctioning toolkits and have sought to limit the scope for any inappropriate behaviour by regulators, such as over-zealous parking ticket writing, through the drafting and application of a series of common principles.

<sup>37</sup> The Five Principles are proportionality, accountability, consistency, transparency and targeting <http://www.brc.gov.uk/publications/principlesentry.asp>

**Recommendation 2:**

I recommend that in designing the appropriate sanctioning regimes for regulatory non-compliance, regulators should have regard to the following six Penalties Principles and seven characteristics.

**Six Penalties Principles**

A sanction should:

1. Aim to change the behaviour of the offender;
2. Aim to eliminate any financial gain or benefit from non-compliance;
3. Be responsive and consider what is appropriate for the particular offender and regulatory issue, which can include punishment and the public stigma that should be associated with a criminal conviction;
4. Be proportionate to the nature of the offence and the harm caused;
5. Aim to restore the harm caused by regulatory non-compliance, where appropriate; and
6. Aim to deter future non-compliance.

**Seven characteristics**

Regulators should:

1. Publish an enforcement policy;
2. Measure outcomes not just outputs;
3. Justify their choice of enforcement actions year on year to stakeholders, Ministers and Parliament;
4. Follow-up enforcement actions where appropriate;
5. Enforce in a transparent manner;
6. Be transparent in the way in which they apply and determine administrative penalties; and
7. Avoid perverse incentives that might influence the choice of sanctioning response.

- 2.17 I believe that only when regulators can demonstrate that they are compliant with a Hampton risk based approach to regulation, should they be allowed by Government to use the toolkit I propose later in this document.

## Chapter Three

# My vision for contemporary sanctioning regimes: financial sanctions

**The previous chapter outlined my Penalties Principles and characteristics, which I believe provide the necessary framework and parameters for an expanded sanctioning toolkit. This chapter sets out my recommendations for what types of sanctions should become available to regulators and enforcers in order to be more flexible, effective and better meet the compliance needs of industry and the public with a specific focus on Monetary Administrative Penalties and improvements of financial penalties in the criminal courts.**

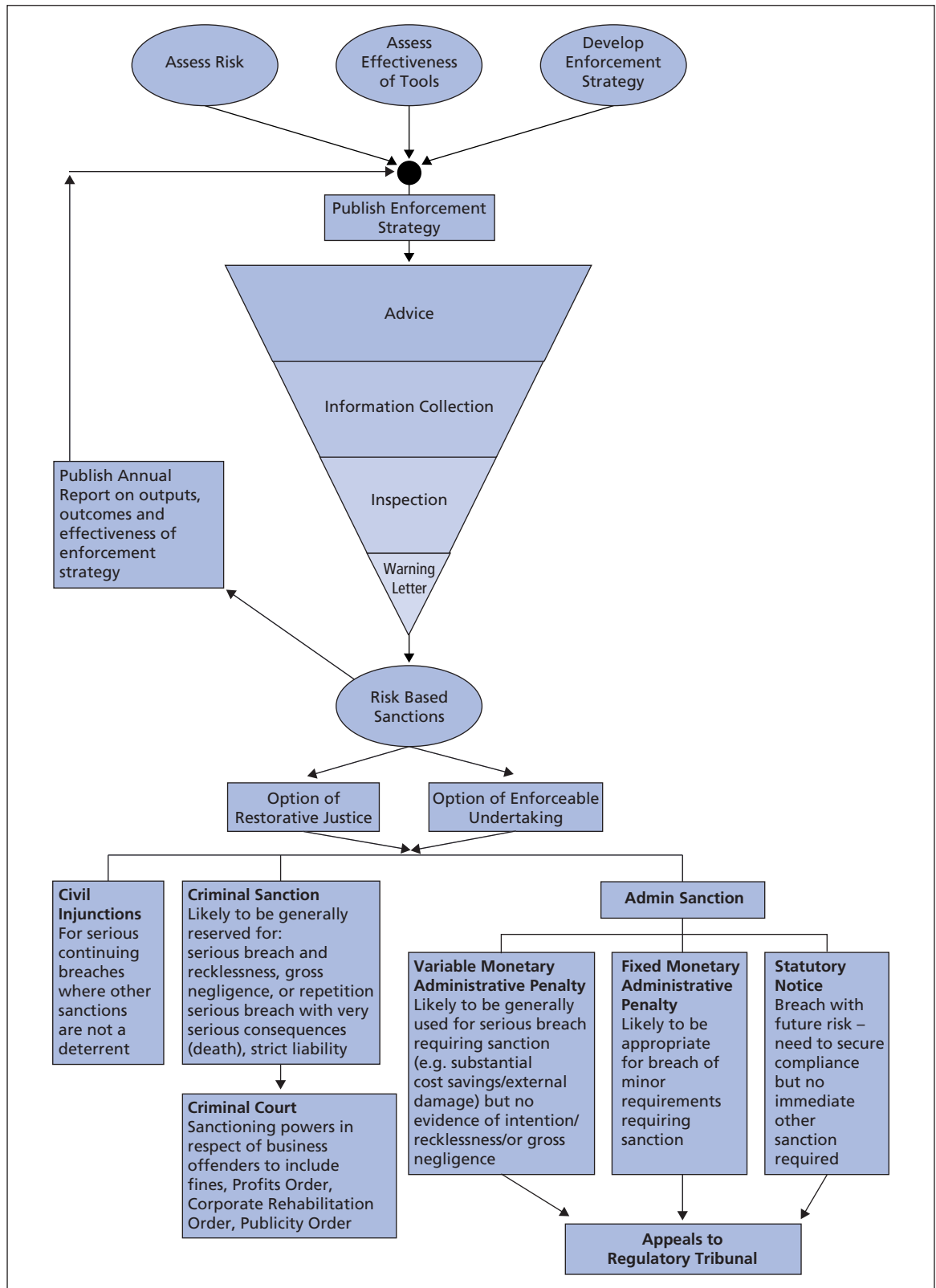
### Introduction

- 3.1 The reformed sanctioning system that I propose is designed to increase public confidence, give greater awareness of the needs of victims and ensure that business non-compliance is met with a proportionate response both by regulators and in the courts. It will do this by providing a transparent system with sanctions that encourage and assist firms to comply with their regulatory obligations while ensuring that the most serious acts of regulatory non-compliance are dealt with appropriately and effectively by the criminal justice system.
- 3.2 The reforms that I suggest are not intended to transform regulatory sanctioning regimes overnight. Rather, they are to bring into them the flexibility, efficiencies and responsiveness that can facilitate the full implementation of the Hampton agenda, resulting in better deterrence options for regulators, better compliance for business and better outcomes for society as a whole.
- 3.3 I consulted upon suggestions for reform that were outlined in my interim report and in this report I publish my final recommendations with regards to alternative sanctions for both regulators and the courts.

### A vision for the future

- 3.4 I consulted upon a richer range of sanctioning tools to be made available to regulators which would permit a range of regulatory offences to be handled other than by means of criminal prosecution, leaving the most serious cases to be dealt with by the criminal courts. Making such options available would itself reinforce a more appropriate role for the criminal courts, where in turn I propose recommendations for improving effectiveness of criminal prosecution for regulatory non-compliance.
- 3.5 My vision of sanctioning options for a risk-based sanctioning system, based upon risk based enforcement is illustrated in Figure 3.1. Regulators would, against the background of their enforcement policy and the proposed Compliance Code and having regard to my principles, continue to exercise discretion as to when it is appropriate to apply a sanction, and the choice of the sanction would be determined by the nature and circumstance of the regulatory non-compliance. With the availability of additional administrative sanctions, I would expect to see some shift in the current use of sanctions.

Figure 3.1 An effective sanctioning system



- 3.6 As part of this vision, the use of criminal prosecutions would remain appropriate for serious breaches where there was evidence of intentional or reckless or repeated flouting of the law. Regulators may decide within their discretion that criminal proceedings are justified where there is evidence of gross negligence and/or where the actual or potential consequences of the breach are so serious (such as a death or serious injury) that the public interest demands a criminal prosecution.
- 3.7 Some incidents of non-compliance with regulatory requirements would, I believe, be generally, more effectively dealt with by the use of fixed or variable penalties (giving the offender an opportunity to have the case heard before an independent tribunal). Thus, breaches involving, for example, carelessness or negligence but still requiring a sanction (because, say, a substantial financial gain has been made or where there has been an external impact) are likely to be more appropriate for administrative sanctions rather than criminal proceedings.
- 3.8 Enforceable Undertakings may be introduced as an additional sanction for cases where the regulator has the necessary evidence to proceed to a criminal prosecution or the imposition of a Monetary Administrative Penalty, but where the business has committed to address the issues surrounding the regulatory non-compliance through an undertaking. These may offer business a less punitive sanction leading to a desirable change in behaviour and outcomes within the business.
- 3.9 I emphasise again, that I do not believe that all regulatory breaches require the imposition of a formal sanction. Warnings, advice and Statutory Notices will continue to play a key role in ensuring compliance. But where (in accordance with its enforcement policy) a regulator decides a formal sanction is justified, my proposals offer a richer range of appropriate response that is currently available.
- 3.10 I have given some views as to when each of the sanctioning options above might be appropriate. It is not possible to set out detailed factors for choosing between the options and it is ultimately up to regulators to decide what the appropriate response is in any particular case. The views I have expressed above may indicate a direction in which sanctioning regimes might develop. I accept, that there will be instances, for example, where a regulator feels that an offender who has been subjected to several prosecutions without changing their behaviour and may be more appropriately sanctioned with an administrative penalty. Conversely, there will be instances where a company has committed a strict liability offence giving rise to such serious consequences that a criminal prosecution is justified even though accidental circumstances or inadvertence was involved. Given this, any enforcement policy, while giving signals of a likely response, should allow for some degree of flexibility.

## Specific recommendations

- 3.11 Following the above discussion on my overall vision, I detail specific recommendations in several areas relating to penalties. These are presented as follows:
- Improving the effectiveness of criminal courts for cases of regulatory non-compliance;
  - Introducing Fixed and Variable Monetary Administrative Penalties with appeals heard through an independent Regulatory Tribunal;

- Strengthening and extending the system of Statutory Notices in cases of regulatory non-compliance;
- Introducing Enforceable Undertakings and Undertakings Plus for cases of regulatory non-compliance;
- Introducing Restorative Justice for cases of regulatory non-compliance; and
- Introducing alternative sanctioning options for cases of regulatory non-compliance heard in the criminal courts.

## Improving the effectiveness of criminal courts for cases of regulatory non-compliance

3.12 More than two million cases are heard annually in the Magistrates' Courts in England and Wales.<sup>38</sup> A small proportion of these relate to cases of regulatory non-compliance. I have some recommendations which should improve the effectiveness of the courts when working with cases of regulatory non-compliance.

3.13 The Government should invite the Sentencing Guidelines Council to produce sentencing guidelines for cases of regulatory non-compliance. These would be of great value to Magistrates in the UK. The legal advisors in many of the local courts the review visited had prepared their own guidance documents and I think it would be beneficial for central guidance documents to exist. These guidelines could be high-level and focused on the principles that should be taken into consideration for sentencing cases of regulatory non-compliance.

Sentencing  
Guidelines

3.14 Magistrates from around the UK commented to me that many prosecutors failed to provide adequate information to the court regarding the significance of the regulatory regime they are dealing with, the financial benefit gained through or financial circumstances surrounding cases of regulatory non-compliance. Prosecutors must make such matters clear to the court in order to better inform the courts so that the sanctions handed down can reflect more closely the financial and social impact of the case.

Make the financial  
case clear

3.15 Studying the existing practice of certain courts and regulatory areas, I believe it is sensible to consider consolidating certain types of regulatory non-compliance cases in a particular geographic area where possible. Focussing 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.

Focus cases

<sup>38</sup> HM Court Service <http://www.hmcourts-service.gov.uk/infoabout/magistrates/index.htm>

It would appear sensible if further moves in this direction were taken. There must be limits – not least because of fairness implications for offenders who might be forced to travel long distances to a criminal court – to the extent this can be taken, but within the jurisdictional areas of Magistrates, there may be further opportunities for particular Magistrates’ Courts to take the lead in handling different types of regulatory offences. I believe the Government should consider this type of consolidation as part of the overall direction of Her Majesty’s Court Service.

- 3.16 Almost all criminal prosecutions for cases of regulatory non-compliance against businesses are heard in the Magistrates’ Courts.<sup>39</sup> There are over 28,000 Magistrates at present in England and Wales, and I do not think it would be an effective use of time and resources to expect all Magistrates to have specialized training concerning cases of regulatory non-compliance. But I believe that there should be more systematic training made available which could be focussed on district judges, prosecutors and justices’ clerks who advise Magistrates, and on those courts where it has been decided to focus particular regulatory prosecutions. The Judicial Studies Board (JSB) is responsible for judicial training. Regulators and sponsoring departments should discuss with the JSB the development of specialist training for district judges, justices’ clerks and Magistrates where there is a sufficient volume of cases to merit this effort.

Training legal advisors

**Recommendation 3:**

I recommend that in order to increase the effectiveness of criminal courts for regulatory offences, the following actions should be implemented:

- The Government should request the Sentencing Guidelines Council to prepare general sentencing guidelines for cases of regulatory non-compliance;
- Prosecutors should always make clear to the court any financial benefits resulting from non-compliance as well as the policy significance of the relevant regulatory requirement;
- Prosecutions in particular regulatory fields be heard in designated Magistrates’ Courts within jurisdictional areas, where appropriate; and
- Regulators provide specialist training for prosecutors and discuss with the Judicial Studies Board (JSB) contributing to the training of the judiciary and justices’ clerks.

<sup>39</sup> 15,369 cases are heard in the Magistrates’ Courts of a total of 15,445 cases of regulatory non-compliance committed by companies. HM Court Service.

## Monetary Administrative Penalties (MAPs)

3.17 Monetary Administrative Penalties, in the context of my recommendations, are monetary penalties that are applied directly by a regulator, and I refer to them below as MAPs. Criminal courts do not play a part in the MAP process, and are generally not involved in issuing or enforcing such penalties. The recipient of a MAP has a right to appeal through an administrative appeals mechanism which usually takes the form of an administrative specialist tribunal. For example, a recipient of an administrative penalty under the Financial Services and Markets Act 2000 is entitled to a complete rehearing of their case before the Financial Services and Markets Tribunal.

### Current use of Administrative Penalties

3.18 Administrative penalties are widely used in countries such as the US, Australia and Canada. In addition, many European countries, including Germany and Sweden, make extensive use of administrative penalties especially in areas of environmental regulation, health and safety, financial services and within other regulatory regimes, such as the regulation of utilities and water.

3.19 The UK experience with administrative penalties is largely limited to the financial regulators. The Financial Services and Markets Act 2000 gives the Financial Services Authority (FSA) a broad range of civil, administrative and criminal sanctioning powers, including the power to issue monetary administrative penalties. The majority of FSA cases are dealt with by using administrative routes. Since 2000 more than 70 cases have been concluded with an administrative penalty. Only six cases have been pursued through the criminal court system.

3.20 The Competition Commission can impose financial penalties under the Enterprise Act 2002 (set out in sections 109-111) in relation to its investigation powers. The penalties can either be a fixed amount, not exceeding £20,000 or calculated as a daily rate, not exceeding £5,000 per day.<sup>40</sup>

3.21 The Office of Fair Trading (OFT) has access to financial penalties for non-compliance with competition law. The OFT has discretion to impose financial penalties that can be severe, but may not exceed ten percent of turn over.<sup>41</sup> This power is set out in section 36 of the Competition Act 1998.

3.22 While the use of administrative penalties in the UK regulatory context is not unprecedented, they have tended to be used for cases of civil regulatory non-compliance rather than criminal regulatory non-compliance. The Hampton Review identified that out of the 60 regulators in scope only 15 were able to impose administrative penalties.<sup>42</sup> Of these 15, the majority only have access to fixed penalties which are for a low financial amount. I believe that the introduction of monetary administrative penalties, both fixed and variable, in more regulatory regimes, whether civil or criminal, would serve to help fill the gap that exists in the current enforcement toolkit of many UK regulators, where there is a lack of intermediate sanctions.<sup>43</sup>

<sup>40</sup> As provided for in the Competition Commission (Penalties) Order 2003 [SI 2003/1371.]

<sup>41</sup> As defined in the Competition Act 1998 (Determination of Turnover for Penalties) (amendment) Order 2004 [SI 2004/1259]

<sup>42</sup> *Reducing administrative burdens: Effective inspection and enforcement*, Hampton, P., HM Treasury, March 2005, p.23

<sup>43</sup> see paragraphs 1.33- 1.34 on the compliance deficit

## The Effectiveness of Monetary Administrative Penalties

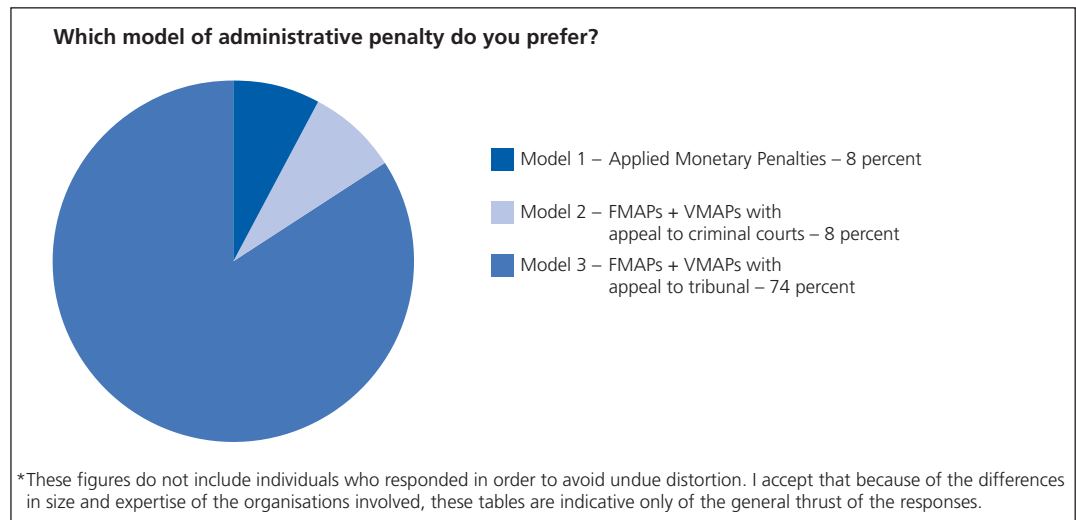
- 3.23 I have considered the academic literature, international experience and the responses provided to me through the consultation process and have found that administrative penalties are an effective way of ensuring regulatory compliance whilst reserving criminal prosecutions for the most serious of cases of regulatory non-compliance.
- 3.24 As discussed in my interim report, administrative penalties can provide an intermediate step between the formal, costly and stigmatising action of criminal prosecution and the more informal means of advice and persuasion to get firms back into compliance.<sup>44</sup> I believe that breaches of regulatory requirements can take in circumstances that require a formal sanction but not necessarily a criminal prosecution.
- 3.25 Well designed administrative schemes can also be flexible and take a more customised approach in dealing with regulatory non-compliance, especially in cases of variable penalties. For example, compliance history, the seriousness of the offence and its impact on the external environment or community can be taken into consideration. This flexibility can allow the regulator to ensure that the level of the MAP is appropriate to reflect the various aggravating and mitigating factors, encourage future compliance and be reflective and proportionate to the size of the business. Such a system could motivate offenders to take actions to move into compliance and provide a sanctioning option for those cases where it may not be appropriate to prosecute the offender and where previous advice or Statutory Notices have not been effective.

Overall responses to my consultation document showed that over 70 percent of respondents believed regulators should have access to Monetary Administrative Penalties as part of their enforcement toolkits

## Fixed & Variable Monetary Administrative Penalties

- 3.26 In my interim report *Regulatory Justice: Sanctioning in a Post Hampton World* I set out three models of Monetary Administrative Penalties. The majority of consultation responses supported my preferred option, in which regulators have access to Fixed and Variable Monetary Administrative Penalties with business being able to appeal to an independent Regulatory Tribunal.

<sup>44</sup> *Regulatory Justice: Sanctioning in a post-Hampton World*, Consultation Document, Macrory, R., May 2006 p. 45 par 3.9

**Figure 3.2: Models of administrative penalties**

Source: *Macrory Review, Consultation August 2006.*

- 3.27 This is the model that I have chosen to recommend because I believe that there are a number of advantages to this option which I mentioned in my interim report. I discuss the appeal mechanism for this system of fixed and variable penalties in the following section.

## Fixed Monetary Administrative Penalties (FMAPs)

- 3.28 Fixed Monetary Administrative Penalties (FMAPs) are generally fines for a relatively low fixed amount that are applied in respect of low level, minor or high-volume instances of non-compliance. They can be applied directly by the regulator, where a business has been found to have failed to comply with regulations. Legislation specifies both the nature of the offence as well as the maximum amount of the fine. The regulator does not have discretion as to the level of the financial penalty, but does have discretion in whether or not to apply a penalty in the first instance.

There are a number of offences for which a fixed monetary administrative penalty would be appropriate across the range of enforcement functions in local authorities, including Health and Safety, Food Safety and Trading Standards. This type of sanction may be particularly useful in tackling 'low-level, minor, high volume instances of non-compliance'.

*Glasgow City Council*

We believe FMAPs could be available in circumstances where the outcomes of the breach have little effect on consumer protection. Such examples might include late filing of accounts because the deadlines in one sense are 'arbitrary'.

*Cattle PLC*

- 3.29 As FMAPs are for relatively minor amounts, they may not be appropriate for more serious or deliberate cases of regulatory non-compliance or where a firm has made significant financial gains or where the public interest would be best served by a criminal prosecution. However, international practice suggests that they can still be meaningful and significant as a sanctioning tool. As set out in the box below, in the area of health and safety in New South Wales, Australia, the on-the-spot fine scheme in operation by WorkCover, ranges in level of fine from A\$80 to A\$1,200 (£30-£500). The average fine is A\$550 (£220). The schedule for the penalties is set out in the relevant legislation (Occupational Health and Safety Act 2002).

### Box 3.1 Fixed Penalty Notices – A case study – WorkCover, New South Wales, Australia

The health and safety regulator, WorkCover, in New South Wales, Australia, uses fixed penalty notices as an enforcement tool against employers. The options include penalty notices, an on-the-spot-fine handed down to businesses where the inspector is of the opinion that advice or direction is not sufficient. WorkCover considers penalty notices are an effective method of dealing with less serious breaches of the legislation.

Inspectors will consider various factors when determining whether to issue a penalty notice.

These factors include:

- whether the breach can be remedied quickly
- whether the issuing of a penalty notice is likely to have the desired deterrent effect
- whether the breach is a one-off situation or part of an ongoing pattern of non-compliance

The Occupational Health and Safety Act 2002 identifies a range of offences and determines a corresponding penalty. Fines range from A\$80 to A\$1,200. (£30-£500) The average fine is A\$550 (£220).

The schedule of breaches with corresponding fixed financial penalties secures that there is transparency when the decision is taken to impose an on-the-spot-fine on a business.

A person served with a penalty notice may elect not to pay the penalty and to have the matter dealt with by the court. The procedure for making an election is set out on the back of the penalty notice.

*Source: WorkCover compliance policy and prosecution guidelines, WorkCover, New South Wales, March 2004*

## Scaling the FMAP

- 3.30 Small as well as large businesses could be liable for FMAPs but each type of business can have significantly different abilities to pay and absorb financial penalties. I believe it would be beneficial if the FMAP could reflect the size of the firm, relying on factors such as the number of employees or annual turnover, where small firms would get a fixed penalty and larger firms would get the same fixed penalty, but scaled up by a certain factor. This would ensure that regardless of the size of a business, an FMAP could still represent an effective deterrent.

## Current use of Fixed Monetary Penalties

3.31 FMAPs already exist as an enforcement option in the UK for certain offences, for example Her Majesty's Revenue and Customs can issue fixed penalties of £100 for failure to deliver a self assessment tax return when required or if the delivered tax return is incorrect. They can also issue a fine of an amount up to a specified limit per day, for example up to £60 a day for continued failure to deliver a self assessment form.<sup>45</sup> The Clean Neighbourhoods and Environment Act 2005 enables authorised officers of a local authority to issue fixed penalty notices for failure to comply with some of the requirements of the Act, for example £100 for nuisance parking offences.<sup>46</sup> Companies House can also impose a penalty notice against a company because company accounts were not received on time. Companies House operates a scale of penalty that is dependent on how late the accounts are and whether the company is a private firm or a publicly listed company. These range from £100 to £5,000.<sup>47</sup>

Companies House is a regulator with access to FMAPs under the Companies Act 1985. Companies House can levy a Late Filing Payment (LFP) for the late submission of company accounts. These were introduced in 1992. The Registrar of Companies House has discretion of not collecting a LFP in exceptional circumstances.

In 1991, the compliance rate for accounts was 86 percent. With the introduction of the late filing penalty regime in June 1992 the rate immediately increased to 92 percent and has continued to increase to a level of around 96 percent. There is no doubt, therefore that the penalty regime has achieved two major effects. Not only has it secured an initial significant increase in the level of compliance, but it has also maintained that level of compliance at that high percentage of companies.

*Source: Companies House submission to Macrory call for evidence, February 2006.*

## Variable Monetary Administrative Penalties

3.32 Variable Monetary Administrative Penalties (VMAPs) are sanctions applied by the regulator where the amount is at the discretion of the regulator. Instead of being for a relatively small fixed amount whose maximum is pre-determined by legislation (as with FMAPs above), a variable penalty can, where appropriate and proportionate, be for a more significant amount initially determined at the discretion of the regulator in accordance with a published scheme. Relevant mitigating or aggravating factors, the specific circumstances of the offence and the means of the non-compliant business must be taken into consideration by the regulator when determining the amount of the penalty in any particular case. I discuss these factors in the following sections.

<sup>45</sup> The penalty is set out in section 93 of the Taxes Management Act 1970, as amended by s196 and paragraph 25 of Schedule 19 of the Finance Act 1994 (in relation to the year 1996\*97 and subsequent years of assessment in accordance with s 199(2) of the 1994 Act).

<sup>46</sup> The Clean Neighbourhoods & Environment Act 2005, Part 2, Section 6, Subsection 1. In 2004/5, Local Authorities issued 15,582 fines for litter, 2,296 for dog fouling, 19 for graffiti, 52 for fly-posing and 1 for noise.

<sup>47</sup> <http://www.companieshouse.gov.uk/infoGuide/faq/lateFilingAppeal.shtml> Companies Act 1985, section 242a

Yes, we agree that it would be a good idea for VMAPs to be made available to all regulators. The situations in which the FSA can impose VMAPs includes breaches of FSA rules by authorised firms, misconduct by FSA approved individuals, breaches of FSA listing rules by listed companies or certain other persons, and market abuse by any person whether regulated or not. We find our VMAP powers operate very effectively for us. They allow us a degree of flexibility with which to respond to different cases, and ensure that the penalty matches the misdemeanour.

*Financial Services Authority*

Yes, VMAPs should be available to regulators as part of a mixed system. A variable fine allows the regulator to operate flexibly and proportionately.

*British Chamber of Commerce*

It is important VMAPs are available. In high profitability areas, the costs of FMAPs could simply be built into business plans. This is certainly the case in the premium rate industry where even substantial fines (£100,000) can be simply written off as a business expense. Therefore VMAPs must be an option to ensure the principle of removing the benefit from the crime can be upheld. The consultation provides some good illustrations that can be used to good effect in preference to prosecution – it is a case of using the right tools for the right job.

*South West England Coordination of Trading Standards*

## Relationship between criminal offences and VMAPs – parallel but connected

- 3.33 As I have indicated in chapter one, I do not envisage a root and branch reform of existing offences relating to regulatory non-compliance. For those existing criminal offences where it is decided that a VMAP is an appropriate alternative sanction, the legislation would need to be amended to allow for the imposition of a Monetary Administrative Penalty. A regulator would then have the option, in line with its enforcement policy, and my suggested principles, to choose in appropriate cases the sanction of a VMAP rather than a criminal prosecution. A regulator would investigate a potential offence as usual and if satisfied that the evidence of a breach exists, then decide the most appropriate sanctioning route.
- 3.34 Criminal sanctions and VMAPs will be available as sanctions for the same regulatory non-compliance. The elements of the regulatory non-compliance would need to be proved to the requisite evidential standard. Where a criminal sanction is pursued, the regulator would need to meet the criminal standard of beyond reasonable doubt. Should the regulator choose to pursue a VMAP, the evidence should meet the civil standard of the balance of probabilities.

In the CBI's view, administrative fines may be viewed simply as a 'cost of doing business' for the deliberately non-compliant firm. There is also concern within the business community that introducing more administrative fines will foster a 'parking ticket' type mentality amongst inspectors, which will fundamentally change the existing relationship between inspectors and businesses – at a time when the aim should be to encourage more co-operation and flexibility and discussion between inspectors and businesses.

*Confederation of British Industry*

We reject the view that the application of penalties in such cases helps to secure compliance. Nothing could be more calculated to enhance tick a box inspections than the desire to levy such on the spot fines for instances that would almost certainly today be ignored or subject to advice. The plain fact is that compliant businesses would willingly act on such advice and introduce any necessary procedures to mitigate the chances of the offence recurring. On the other hand rogue traders would be more likely to be compliant with the threat of a court action than with an administrative fine that could be considered part of the costs of doing business.

*British Retail Consortium*

- 3.35 I recognize that there are concerns in some of the business community that this may unfairly encourage the use of VMAPs in place of current prosecutions and that smaller businesses may not have the financial resource to challenge a VMAP, but I do not believe these are sufficiently convincing to outweigh the advantages that the VMAP would bring as an alternative sanctioning route. I would note that the civil standard of proof does have adequate safeguards to protect the rights of the accused. The regulator would still need to ensure that the investigation process and the imposition of the VMAP protects the procedural rights of the recipient of the administrative penalty. These proposals are not about making it easier to penalise businesses but to create a system of sanctions that is more responsive and proportionate to the nature of the non-compliance.
- 3.36 The choice between criminal prosecution and the imposition of a VMAP should be based upon the principles I have set out in chapter two rather than on the applicable evidential standard. Regulators should consider which is the most appropriate sanctioning route relying on factors such as ability to change behaviour, ability to eliminate financial gain, and proportionality, I consider that VMAPs are a more responsive and appropriate sanction than criminal prosecution in a wide range of cases. Criminal prosecution should however be reserved for serious breaches of regulatory obligations such as cases of deliberate, reckless or repeated non-compliance.
- 3.37 It should be noted that these proposals are not about "letting off" businesses for their regulatory non-compliance. While the imposition of an administrative fine such as VMAPs may not have the same stigma as a criminal conviction, the imposition of a VMAP can represent a significant sanction. One of the aims of VMAPs is to remove the financial gain made from the regulatory non-compliance – something a criminal conviction may not always achieve. This will help create a level playing field for compliant businesses and deter rogue businesses from non-compliance in the future.

## Level of financial penalty

3.38 I have carefully considered the issue of the level of financial penalties for both FMAPs and VMAPs and there are advantages and disadvantages to setting a fine maxima in both instances.

3.39 In the case of FMAPs, I believe that these should have a statutory maximum level which should be set out in the relevant underlying legislation. By definition, FMAPs are for low level breaches and the financial penalty should be for a relatively low amount. I believe it makes sense for the maximum level of FMAPS to not exceed level five on the standard scale.<sup>48</sup> This is currently set at £5,000.

FMAPs

3.40 I have carefully considered the advantages and disadvantages of setting an upper limit to VMAPs in underlying legislation and in particular whether some cap such as a 10 percent turnover maximum should be provided in the legislation. I believe that to impose such an upper limit would pose undue legal complexity on the system, and could encourage regulators to set VMAPs at inappropriately high levels. I want to ensure that regulators have the flexibility and ability of capturing the financial benefit businesses may have acquired through a regulatory breach. I do not believe the legislation should specify an upper limit.

VMAPs

3.41 The business community clearly will need to be confident that such a scheme is not being used inappropriately or irresponsibly by a regulator. I have some recommendations that will seek to give business transparency into the way in which VMAPs are calculated.

<sup>48</sup> Criminal Justice Act 1982, Section 37

### Box 3.2 Aggravating and Mitigating Factors that should be considered for VMAPs

In a system with Variable Monetary Administrative Penalties regulators would be required to develop and publicise a method for calculating the penalty for regulatory non-compliance. The following are examples of aggravating and mitigating factors which regulators could take into account when determining the appropriate level of Variable Monetary Administrative Penalty, although this list is not exhaustive and each decision will depend on the circumstances of the individual case:

#### ***Aggravating factors***

- Seriousness of the regulatory non-compliance, e.g. the harm or potential for harm to human health or the environment, the duration of non-compliance etc.;
- Evidence of intention (if any) behind the regulatory non-compliance;
- Disciplinary record or history of non-compliance of the business;
- Financial gain made by the business as a result of non-compliance with regulations;
- Size and financial resources of the firm that failed to comply with regulations;
- The conduct of the business after the regulatory non-compliance has come to the attention of the regulator; and
- Previous actions taken by the regulator, or other regulators, to help the business into compliance.

#### ***Mitigating factors***

- Actions taken to eliminate or reduce the risk of damage resulting from regulatory non-compliance;
- Actions taken to repair the harm done by regulatory non-compliance;
- Co-operation with the regulator in responding to regulatory non-compliance;
- Fast and accurate reporting of regulatory non-compliance;
- Size and financial resources of the firm that failed to comply with regulations;
- The conduct of the business after the regulatory non-compliance has come to the attention of the regulator; and
- Vicarious liability for failures by employees including the adequacy of management controls and the extent to which the employee was acting outside of his or her authority.

## Who makes the decision to impose the sanction?

- 3.42 While Monetary Administrative Penalties could be a valuable addition to the enforcement toolkit, it is important that the regulatory relationship between business and the regulator is not compromised. I believe it is essential that I comment on what level of decision-maker should be involved in decisions of whether or not to impose a MAP so as to provide guidance to regulators. It is important that decision makers have sufficient experience and authority to impose MAPs. This would serve to maintain the current pragmatic relationship many within the regulated community have come to value with their enforcers.
- 3.43 FMAPs, because they are generally imposed for low-level, minor offences and for a low financial amount, could be issued by lower levels of staff within a regulator who have undergone the appropriate training. However, I want to assure the regulated community that such a regime should not bear resemblance to the ‘parking-ticket’ mentality mentioned to me by many respondents in my consultation. In order to avoid FMAP training becoming a tick-box exercise, I believe regulators should look to on-going monitoring in order to test that the FMAPs are being used appropriately and I make further suggestions concerning transparency and accountability in chapter five.
- 3.44 As VMAPs can be for more significant sums, decisions should be taken independently from field staff or inspectors. Regulators may also want to consider seeking representations from a business on the penalty proposed in advance of it being imposed. The field staff could make a recommendation on whether a VMAP should be imposed or not and recommend a level of penalty, but I believe the final decision should be taken by more senior officials within the regulator. This would serve to ensure that the relationship between the inspector and the business is not compromised. In addition, it would encourage consistent behaviour from the regulator since decisions on imposing VMAPs would be taken by the same group within a regulator. This would provide a good check on what VMAPS are being imposed, against whom and for how much.

## Fines would not be accessed by the regulator

- 3.45 Many of the concerns from the business community regarding MAPs is due to an uncertainty as to whether regulators will financially benefit from imposing administrative penalties. I have reflected this concern in my principles and characteristics. MAPs should not be viewed by regulators as a means to raise revenue from the businesses they regulate. I want to avoid creating any perverse financial incentives for regulators that might influence their choice of sanctioning tool. This view is already entrenched in relevant section of HM-Treasury’s Consolidated Budgeting Guide and I echo their views on the separation of revenue streams in order to eliminate perverse incentives.<sup>49</sup> I have also emphasised that regulators must avoid creating perverse incentives (such as staff appraisal criteria) that will encourage the use of financial penalties without regard to the regulatory outcomes to be achieved.

<sup>49</sup> *Consolidated Budgeting Guidance for 2006/07*, HM-Treasury, Chapter 3.

## Recovery of costs to the regulator

- 3.46 I am aware that bringing any form of enforcement action generates costs for regulators. Regulators are able to recover some of their costs in pursuing the prosecution. I believe a similar system should exist for regulators that choose to use the MAP system. I do not think it is right that regulators should be incentivised to use the criminal system and I want to mention this so that cost recovery is a part of the consideration of any MAP scheme. Cost recovery should include the cost of collection of an administrative penalty, which I discuss in the next paragraph.

## Enforcement of Monetary Administrative Penalties

- 3.47 In order for any administrative penalty regime to have credibility, businesses must know that when an administrative penalty is imposed, it will be enforced and that the regulator will pursue the collection of the penalty. If a business refuses to pay the penalty without initiating an appeal, then regulators should be able to pursue the payment of this penalty through ordinary civil debt recovery procedures.

## Administrative penalties and private prosecutions

- 3.48 Some regulatory schemes permit private prosecutions. In theory, someone other than a regulator, who feels that the regulatory non-compliance justifies a criminal rather than an administrative sanction could also initiate a private prosecution for the same offence. This, of course, can happen under current arrangements where a regulator decides, in line with its enforcement policy, to issue, say, only a warning in response to an offence. A private prosecution could still be initiated in such circumstances. As a matter of general policy, I believe that the existence of the power of private prosecution can be a valuable check on regulator behaviour. There exist a number of mechanisms (such as the right of the Director of Public Prosecutions to take over a private prosecution) designed to prevent abuse or vexatiousness of private prosecutions.
- 3.49 I recognize that where a VMAP has been imposed on a business, it needs to be insulated from the risk of double jeopardy which a private prosecution might impose, and additional procedural checks (such as leave of a court before a private prosecution can be initiated in such circumstances) may be required. I have received very little evidence on this issue, and do not think it appropriate for me to make detailed suggestions as to the most appropriate mechanisms needed. But I recommend that when designing the legislative scheme of VMAPs, the Government needs to consider whether existing mechanisms are sufficient to prevent this form of double jeopardy, and if not, what would be the best way of handling the issue.

**Recommendation 4:**

I recommend that with regards to Monetary Administrative Penalties:

- Government should, introduce schemes for Fixed and Variable Monetary Administrative Penalties, for regulators and enforcers of regulations, that are compliant with the Hampton and Macrory Principles and characteristics. This can include national regulators as well as local regulatory partners;
- Appeals concerning the imposition of an administrative penalty be heard by a Regulatory Tribunal, rather than the criminal courts;
- Fine maxima for Fixed Monetary Administrative Penalties (FMAP) schemes should be set out and not exceed level five on the standard scale. FMAPs should also be scaled to differentiate between small and large firms; and
- There should be no fine maxima for Variable Monetary Administrative Penalties (VMAPs).

3.50 In order for these administrative penalties to be effective, it is important that prior to regulators expanding their toolkits, regulators should be compliant with the Hampton Principles and demonstrate an ability to comply with the Macrory Principles and characteristics. Compliance with the principles and characteristics will be considered for regulators who want to gain access to these sanctions prior to the new sanctions being awarded, including both national and local regulators. This role will likely fall to the Better Regulation Executive and some national regulators (who use local regulatory partners) to ensure that regulators gaining access to the expanded sanctioning toolkit are compliant and operate in a risk based manner.

3.51 Regulators who want to use administrative penalties should ensure the following:

- Clearly identify the persons within their organisation who are authorised to impose a Fixed and Variable MAP;
- Publish the way in which VMAPs will be calculated; and
- Regulators should not make any financial gains from the imposition of Monetary Administrative Penalties, but they should be entitled to some cost recovery.

3.52 In addition, the Government should consider whether additional provisions are needed to prevent the risk of double jeopardy from a private prosecution initiated for an offence that has been sanctioned by a VMAP.

## Appeal mechanisms and an independent Regulatory Tribunal

3.53 In my consultation document, I set out three models for the application of Administrative Monetary Penalties. The key differences in these models related to the mechanism for access to a fair and timely appeal.<sup>50</sup>

<sup>50</sup> *Regulatory Justice: Sanctioning in a Post Hampton World*, Consultation Document, Macrory, R., May 2006

## An independent tribunal as a route to appeal

- 3.54 It is important that any administrative penalty system where decisions are taken by public officials, acting as part of a Government department or agency carries with it the necessary protections for any person or business served with a penalty notice. Having access to an effective and quick appeal route is an absolute necessity when referring to administrative financial penalties. The Department for Constitutional Affairs' White Paper on *Complaints Redress and Tribunals* states that 'where mistakes occur we are entitled to complain and to have the mistake put right with the minimum of difficulty; where there is uncertainty we are entitled to expect a quick resolution of the issue'.<sup>51</sup>
- 3.55 The tribunal I recommend could serve as an appeals mechanism for all administrative sanctions including MAPs as well as other administrative sanctions. The Regulatory Tribunal would provide the regulated community with a chance to have its say before an independent body in cases where there is disagreement over the imposition or conditions of an administrative sanction. It would also hold regulators accountable for the imposition of an administrative sanction and ensure that regulators follow their own enforcement policies and procedures when imposing sanctions. I detail further accountability mechanisms in chapter five.
- 3.56 For those regulators who already operate schemes of Fixed and Variable Monetary Administrative Penalties with appeals being heard with an existing tribunal, I believe that these appeals can continue to be heard in the existing tribunal. There is no need to shift any of these cases to the Regulatory Tribunal, unless a sponsoring department and regulator agree that the Regulatory Tribunal would be more appropriate.

We believe that an independent specialist tribunal composed of members with specialist expertise is a good idea and would minimise the burden on the Magistrates' Court.

*Trading Standards Institute*

A tribunal would have the specialist skills and experience to deal with a new evidential test and procedure that would be required to make the MAP option work efficiently. MAPs should be viewed as an entirely separate sanction to prosecutions and the distinction could be blurred if appeals were to progress through the criminal courts.

*Office of Rail Regulation*

<sup>50</sup> *Transforming Public Services: Complaints, Redress and Tribunals*, DCA White Paper, July 2004, p3

## Why did I choose to create another tribunal?

- 3.57 The evidence presented to me consistently commented that there was a need to separate out those cases of regulatory non-compliance that would be better sanctioned outside of the criminal setting. It follows that if administrative sanctions are to be most effective, then it is necessary to remove appeals relating to these cases from the criminal courts. This would also avoid creating a hybrid system with no distinct separation between administrative and criminal sanctions.
- 3.58 Operating a hybrid system with appeals of both administrative and criminal sanctions going to a criminal court would raise some of the same issues that I have previously highlighted in my interim report when considering cases of regulatory non-compliance within a criminal setting.<sup>52</sup> These include:
- Low deterrence can sometimes be the outcome of a criminal prosecution as levels of fines can fail to remove the financial benefit arising from non-compliance.
  - Appeals of administrative sanctions would be heard alongside mainstream violent and anti-social crime cases.
  - Cases of regulatory non-compliance make up less than one percent of all cases heard in Magistrates' Courts making it difficult to provide specific training to Magistrates and legal advisors.<sup>53</sup>
- 3.59 I recognize that Magistrates' Courts in some areas already handle both criminal and civil matters, and as a matter of administrative simplicity it would be tempting to refer all appeals concerning MAPs back to the Magistrates' Courts. Given the proposed creation of the new unified tribunal system (see paragraph 3.67 below), I believe it would be a wasted opportunity not to incorporate a dedicated Regulatory Tribunal which would be better suited to handling these issues, and would clearly separate criminal and administrative processes. In my consultation report I suggested that there would be two advantages to a separate tribunal for appealing administrative sanctions. First, that the tribunal could be composed of members with both legal and specialist expertise in the subject matter, providing the tribunal with a fuller understanding of the issues. Second, a tribunal would not consider regulatory cases alongside cases of conventional crime which constitute the main workload of the criminal courts. A Regulatory Tribunal would also be a flexible and accessible appeal mechanism.
- 3.60 Overall, in cases of administrative sanctions, I believe that a tribunal would continue to provide sufficient procedural safeguards necessary to protect the needs of the regulated community and regulators. An independent tribunal would also allow for the differentiation and sanctioning of some cases of regulatory non-compliance outside of the criminal setting.

<sup>52</sup> *Regulatory Justice: Sanctioning in a post-Hampton World*, Consultation Document, Macrory, R., May 2006 p 54

<sup>53</sup> *Ibid* pp 89.

## Appeal route for an administrative sanction

- 3.61 Ultimately, it is for a regulator and sponsoring department to determine what the best appeal arrangements would be for its particular area of regulation provided that the minimum standards which I outline in this section are met. However, I would encourage all regulators who have an administrative sanctioning scheme to consider using the Regulatory Tribunal because it can be designed to be flexible enough to address regulatory issues in more than one particular regulatory field. I discuss this more in detail in the following section.

This would allow for such appeals to be heard in a timely manner and will help consistency, as the criminal and civil courts are already 'over-burdened'. The tribunals should be given adequate sentencing powers, in order that they are seen by regulators, consumers and legitimate business as being a worthwhile and punitive measure.

*Yorkshire and Humberside Trading Standards*

## Overall appeal process for FMAPs

- 3.62 The first stage of any appeal process in relation to FMAPs should be an internal review of the case carried out by the regulator. This would not involve the tribunal. Having access to an internal review process would give the regulated industry the opportunity to question the regulator's decision and present any information that the regulator may not have had access to at the time the sanction was originally imposed. Following an internal review, the regulator could either affirm its decision and uphold the sanction, or cancel and impose a lesser sanction if appropriate.
- 3.63 If the member of the regulated community is not satisfied with the outcome of the internal review, an appeal of that decision could be taken forward to the Regulatory Tribunal. The appeal could either be for a complete re-hearing of the issue where the member of the regulated community believes no sanction should have been applied in the first instance because the circumstances of the breach have not been made out (including any defences available for the offence in question) or that the regulator has acted unreasonably in imposing the FMAP. The appropriate grounds for appeal will be determined in legislation. A tribunal case could be conducted on the basis of papers alone if this was agreed to by both parties, or by an oral hearing. As the tribunal will be reviewing the application of administrative sanctions, it will apply the civil standard of proof.

## Overall appeal process for VMAPs

- 3.64 As VMAPs would be for more significant financial amounts, I believe that the regulator should give notice to a business that it intends to propose a VMAP, providing the business with an opportunity to make representations to the regulator for consideration. Following this process, a regulator may impose a VMAP by issuing a penalty notice.

- 3.65 If a business is not satisfied with the level of the VMAP or believes the VMAP should not have been imposed, it has the right of taking this matter to the Regulatory Tribunal for consideration. The appeal could either be a complete re-hearing, or pertain to a specific point of law and should take the form of an oral hearing. The appropriate grounds for appeal will be determined in legislation. Similar to the process outlined above for FMAPs, the tribunal would work on the civil standard of proof, as it is reviewing the application of an administrative sanction.
- 3.66 It would be up to the regulator and sponsoring department to consider what would constitute an appropriate panel and there are many models that exist. In general, I believe that the Regulatory Tribunal for VMAPs should consist of a panel of three made up of a legal expert, which could include members of the judiciary or lawyers, a relevant expert in the area of regulation before the tribunal, and a member from a relevant stakeholder group such as the industry or another relevant stakeholder.
- 3.67 Depending on the timing of legislation, the Regulatory Tribunal would either be a new, bespoke tribunal or would form part of the new First-tier Tribunal, proposed in the draft Tribunals, Courts and Enforcement Bill, which was published on 25 July 2006. The Bill sets out a new statutory framework for a unified tribunal system. The tribunal system will have two new, generic tribunals, the First-tier Tribunal and the Upper Tribunal. They are intended to be adaptable institutions, able to take on any existing or new jurisdictions. For those parties that are not satisfied with the outcome of an appeal to the Regulatory Tribunal, there would be a right of appeal on a point of law (and with permission) to the Upper Tribunal. The Tribunals Service, a new Department for Constitutional Affairs agency launched in April 2006, will provide common administrative support to the unified tribunal system.<sup>54</sup> The flexibility of the new unified tribunal system will ensure that the relevant panel of experts need only sit when there is a case to be heard in a particular regulatory area. It will also ensure a good geographical distribution so that cases can be heard in appropriate locations.

## Funding

- 3.68 Funding and set up costs for the Regulatory Tribunal should be provided by the sponsoring departments whose regulators are using the tribunal as part of their appeal for administrative sanctions including MAPs. It is important that any tribunal fees that might be introduced in no way inhibit the right of appeal against Monetary Administrative Penalty which I believe is inherent to a fair system.

<sup>54</sup> <http://www.tribunals.gov.uk/>

## Chapter Four

# My vision for contemporary sanctioning regimes – non-financial sanctions and alternatives for the criminal courts

**The previous chapter presented my recommendations for improving the effectiveness of criminal courts in addressing cases of regulatory non-compliance. It also presented my recommendations on the introduction of both Fixed and Variable Monetary Administrative Penalties. This chapter looks at non-financial sanctions such as Statutory Notices, Enforceable Undertakings and Undertakings Plus. It also presents recommendations for alternative sentencing in the criminal courts.**

### Introduction

- 4.1 I am aware that monetary penalties may not be effective in every instance and I want to ensure that regulators have access to a broad range of tools. This chapter sets out some reasons why financial penalties alone may not always achieve the best regulatory outcomes and presents some recommendations for sanctions that are less reliant on financial censure and include broader considerations such as rehabilitation.

### Why monetary penalties alone are not always sufficient

- 4.2 In my interim report, I showed that 96 percent of the sentences handed down against corporations in Magistrates' Courts were financial penalties.<sup>55</sup> Financial penalties, whether imposed as a result of a criminal prosecution or through an administrative system, may not always be the most appropriate sanction to bring a business into compliance. In some instances, the regulator need only 'persuade' the firm through advice or an informal warning letter, and move it into compliance by explaining the merits of the regulation or explaining what it is the firm would need to do in order to comply. In other instances, where the provision of advice and guidance has failed and where a prosecution or a financial penalty is not appropriate, the regulator may need access to other types of sanctions.

<sup>55</sup> The focus in this chapter is on the sentencing of businesses for regulatory non-compliance. Sentences for individual offenders not pertaining to regulatory non-compliance are not considered.

#### Box 4.1 Some limitations of financial penalties

A body of research has developed over the past two decades that has raised some of the limitations of relying on fines alone to change business behaviour.<sup>56</sup> I highlight some of the shortcomings that a strategy of enforcing by fines alone could include:

**Deterrence:** I have previously mentioned that unless the financial penalty is of the optimal amount, it may be the case that small financial penalties can be easily absorbed by a large company and become a part of doing business, for example, treating them like overhead costs, with limited impact on the day-to-day decision making on compliance made within a business. On the other hand, smaller firms, may not have the means to pay a fine that would be large enough to deter future lawbreaking.<sup>57</sup>

Getting the level of the fine right is essential to their effectiveness and I believe this will continue to be a challenge for both the courts and regulators. I believe regulators may be better placed, through administrative sanctions to determine the most effective level of financial penalty, which can be subject to review by the Regulatory Tribunal. The regulator can have access to information and consider all of the relevant details when determining the level of a VMAP. Courts may have a more difficult time as the judiciary is often reliant on the prosecution for providing the relevant information. I have heard evidence which suggests that in many instances, prosecutors fail to impart this information to the court.

**Spill over:** Fining a corporation may also fail to change business behaviour because the company can pass on the financial cost to third parties such as shareholders, employees, creditors and customers, and deferring responsibility away from company management. Shareholders experience losses resulting from fines through falls in the value of shares and reduced future dividends. The cost of a fine also spills over to consumers through increases in the prices for the firm's goods and services, and to employees through adverse effects on wages and staffing.<sup>58</sup>

**Discrimination/Unequal impact:** Fines tend to impact more upon small businesses whose operations are generally more vulnerable to monetary penalties.<sup>59</sup> The reliance on fining in the sanctioning of a business could also be perceived as representing discriminatory and unfair practice against individual offenders who arguably face far more serious sentences (such as imprisonment).<sup>60</sup>

<sup>56</sup> See for example – *Sentencing options against corporations*, B. Fisse, Criminal Law Forum 211, 1990; *Sanctions against corporations: Economic efficiency or legal efficacy?* Sydney University Transnational Corporations Research Project Occasional Paper No 13, 1986; *Sentencing: Corporate offenders*, New South Wales Law Reform Commission, 2003; *Principled Regulation: Federal, Civil and Administrative Penalties in Australia*, Australian Law Reform Commission, 2002

<sup>57</sup> *No Soul to Damn: No Body to Kill: an Unscandalised Inquiry into the Problem of Corporate Punishment*, Coffee, J., 79 Michigan Law Review 386 refers to this as the 'Deterrence Trap' – where the fine necessary to render future compliance the 'rational' choice for amorally calculating businesses is beyond the means of the business being punished.

<sup>58</sup> *Sanctions Against Corporations: Economic Efficiency or Legal Efficacy*, B.Fisse, 1986, p 13.

<sup>59</sup> Small businesses find it more difficult than large businesses to absorb a fine due to the constraints on their finances and credit. These constraints make it difficult for a small business to stay afloat through the payment period of a substantial fine.

<sup>60</sup> *Sentencing: Penalties*, Discussion Paper 30, Australian Law Reform Commission, 1987.

**Box 4.1** Some limitations of financial penalties (*continued*)

**Reflecting the harm caused:** The reliance on financial sanctions alone also suggests that the harm caused by corporate criminal regulatory breaches is financial. However, harm might also include physical, psychological or environmental damage and, financial sanctions alone, may not always result in the best outcomes.

**Lack of rehabilitation:** Lastly, financial penalties alone may not incentivise businesses to take appropriate measures to address procedures within the business that gave rise to the offence. Instead of taking the necessary steps to build long-term compliance corporate managers may decide to treat fines as recurrent business losses. This can be reinforced if non-compliance results in large financial gains and fines that are imposed do not adequately withdraw the financial benefit.

- 4.3 Non-financial administrative penalties could be used to deal with firms that want to comply but may have some gaps in their management system or are small firms with limited resources. They could also be appropriate for offenders who may be in severe economic difficulties and may not be able to pay even small fines. In some cases the offending business or individual might be able to, and have a desire to, undertake activities which aim to restore the harm that has been done.
- 4.4 For these reasons I have considered sanctions that look beyond the imposition of monetary penalties.

## Statutory Notices

- 4.5 In some instances of regulatory non-compliance, regulators will decide to issue a Statutory Notice. An example could be in instances where a company has failed to carry out, prepare, record and implement a suitable and sufficient risk-assessment addressing the risks that could arise from the use of workplace transport.
- 4.6 These notices require the recipient to do or refrain from a particular behaviour. They specify the steps a business must take in order to be compliant and the timescale for these changes. Depending on the statutory provision, a Statutory Notice may also include remediation provisions relating to the damage caused by the failure to comply with regulations. Failure to carry out the actions laid out in the notice may also be a criminal offence.
- 4.7 Although many regulators may have recourse to this sanction, the precise forms of Statutory Notices and their conditions of use vary between regulatory areas. My report *Regulatory Justice: Sanctioning in a post-Hampton World*, published in December 2005, identified examples of different types of Statutory Notices that businesses can be subjected to by the regulator.

**Box 4.2** Types of Statutory Notices

- Improvement Notices – demanding certain improvements to work practices while allowing time for the recipient to comply;
- Prohibition/Suspension Notices – prohibits an activity until remedial action has been taken in order to prevent serious harm from occurring;
- Work Notices – to prevent or remedy water pollution; and
- Enforcement Notices – served where it is believed that a breach of regulatory consent or licence has occurred. The notice specifies the steps to rectify the breach and the timescale for these changes, and, depending on the statutory provisions, may include remediation provisions relating to the damage caused by the breach.

Source: *Regulatory Justice: Sanctioning in a post-Hampton World*, Macrory, R., December 2005.

4.8 In the majority of cases, failure to comply with the terms of a Statutory Notice is an offence in its own right, punishable either by a fine or imprisonment. For example, if the terms of an Improvement/Prohibition Notice imposed by the Health and Safety Executive are not met, this is an offence that may be prosecuted. This demonstrates the seriousness of a notice, but may also deter a regulator from pursuing action against businesses that fail to comply with a notice. A regulator may view the stigma and potential imprisonment as a disproportionate response to the underlying breach.

An enforcement notice should be the preferred form of action over penalties. The enforcement notice system works well for business because there is an emphasis on prevention of injury or harm rather than on prosecution.

*Confederation of British Industry.*

### Scope for strengthening the Statutory Notices System

4.9 In my consultation report, I presented several ideas for strengthening the system of Statutory Notices. I elaborate on these in the following discussion. My recommendations could apply to both new and existing notices. Such a strengthened system of Statutory Notices should be used in a wider range of regulatory non-compliance.

### Notices that are fit for purpose

4.10 A number of regulators already have access to some kind of Statutory Notice, but there has been some innovation and development of the design of notices over time. New types of notices have been created and some regulators may benefit from updating their system of Statutory Notices to ensure that their system of notices is up to date and appropriate for a risk based approach to regulation. For example, in the area of consumer protection, Part Eight of the Enterprise Act 2002 gives Local Authority regulators access to Enforcement Orders, which are a type of Statutory Notice. Enforcement Orders are injunctions granted by the court to restrain breaches of specified law, but enforcers can accept agreed undertakings as an alternative to being taken to court. These replace and expand the scope of what were called 'Stop Now Orders' and are used in many areas of consumer protection such as in cases of giving customers written notification for cancelling contracts. This represents an example of an appropriate and effective Statutory Notice.

**Box 4.3** Statutory Notices

Statutory Notices need to be improved in the following ways:

- Statutory Notices should be made available as a tool for all regulators to use, in order to ensure consistency.
- Regulators should follow up Statutory Notices through a risk based approach, in order to ensure that Statutory Notices are complied with.
- An appeal mechanism should be made available through independent review and the tribunal system.
- Breaches of notices should be able to be sanctioned by the regulator through Monetary Administrative Penalties, in order to give them strength as a sanction.

**Failure to comply with a notice**

- 4.11 Failure to follow up notices to check that compliance has been reached can undermine Statutory Notices as a sanctioning tool, and could encourage reluctant businesses not to take them seriously. Furthermore, without follow-up, regulators are not in a position to evaluate the outcomes obtained by using notices. I believe it would be good practice for regulators, as part of evaluating their enforcement activities and outcome measurement to include some assessment of their notice system beyond just reporting on the number of notices issued. I also believe it is important for regulators to follow-up notices on a risk-adjusted basis.

If business gains the impression that such notices are not enforced, it will damage the credibility of the enforcement regime. Failure to do so would penalise the vast majority of business who have taken action and incurred expense to ensure they have complied.

*Small Business Service.*

- 4.12 Non-compliance with a Statutory Notice is usually a criminal offence, but as with other cases of regulatory non-compliance, I believe it would be helpful if regulators had greater flexibility in how to sanction the non-compliance with a Statutory Notice, such as applying a MAP rather than solely relying on criminal prosecution for non-compliance. It should remain at the discretion of the regulator whether it would be more appropriate to sanction the failure to comply with a Statutory Notice, in the particular circumstances of a case, with a MAP or a criminal prosecution, and their enforcement policy should indicate the factors that will guide their discretion.
- 4.13 Regulators may decide that non-compliance with a Statutory Notice always justifies prosecution because an intentional act is implied, or that this should be reserved, say, for repeated non-compliance. But I believe there will be circumstances where the use of a MAP will be a more appropriate and effective sanctioning tool to ensure compliance with a statutory notice. For example, where a business has clearly saved money by delaying compliance but the behaviour does not justify a criminal prosecution. Or where a business has complied with most of the requirements of a notice, with the knowledge that a regulator is unlikely to consider that the costs and time of a prosecution is justified to deal with a small proportion of outstanding issues.

- 4.14 Lastly, I suggest that regulators ensure that the notice itself is clear in its language and make those who receive such notices aware of the legal status of each notice and the consequences of not complying with the terms of the notice.

### Appeals of Statutory Notices

- 4.15 Most statutory provisions concerning Statutory Notices allow for the right of appeal against the service of the notice (including its requirements). As research undertaken for my review demonstrates the current appeals routes are varied – many provide for appeals to the Magistrates' Courts, but Health and Safety legislation, for example, provides for appeals to an Employment Tribunal.<sup>61</sup> Where a regulator decides to impose a VMAP in response to a breach of a Statutory Notice, any appeal of the VMAP would, in accordance with my recommendations, be to the Regulatory Tribunal rather than the criminal courts or other fora.
- 4.16 Strictly my terms of reference are concerned with sanctions, but I would recommend that Government consider whether any existing appeals against Statutory Notices would be more effectively and speedily handled by the Regulatory Tribunal rather than Magistrates' Courts. This may not be appropriate in all areas of regulation (it has been argued, for example, that the local knowledge possessed by local magistrates may be especially valuable for dealing with statutory noise nuisance appeals), but appeals against notices are essentially administrative in nature, and may raise complex technical issues where the more specialist make-up of the tribunal would provide a more effective forum.

#### **Recommendation 5:**

I recommend that for an improved system of Statutory Notices:

- Government should consider using Statutory Notices as part of an expanded sanctioning toolkit to secure future compliance beyond the areas in which they are currently in use;
- Regulators should systematically follow-up Statutory Notices using a risk based approach including an element of randomised follow-up;
- In dealing with the offence of failing to comply with a Statutory Notice, regulators should have access to administrative financial penalties as an alternative to criminal prosecution. This power should be extended by legislative amendment to existing schemes of Statutory Notices; and
- Government should consider whether appeals against Statutory Notices should be routed through the Regulatory Tribunal rather than the criminal courts.

<sup>61</sup> Health and Safety at Work Act 1974, s 24(2).

## Enforceable Undertakings

- 4.17 I have previously commented that the current system of regulatory sanctions lacks both financial and non-financial intermediate sanctions. Regulators have access to informal sanctioning through advice or warning letters, or extremely serious sanctions such as criminal proceedings, but there is a gap relating to intermediate sanctions. Regulators have limited sanctions for cases that are not serious enough to be prosecuted and too serious to just receive an informal warning. For this reason, I am suggesting the addition of some sanctions to fill this gap. As well as MAPs and, where appropriate, Statutory Notices, a further sanction, which I have called Enforceable Undertakings, should be introduced into the enforcement toolkit, for those instances where a non-financial intermediate sanction may be more suitable. I also make recommendations to combine both non-financial and financial administrative elements of a sanction, which I refer to as Undertakings Plus.
- 4.18 Enforceable Undertakings and Undertakings Plus introduce an intermediate sanction with elements of restoration into the enforcement process. If adopted in the UK, they could facilitate negotiations between regulator, business and, in appropriate cases, the victims of regulatory non-compliance. They represent a powerful alternative to traditional coercive, regulatory enforcement action, and have the potential of imposing fit-for-purpose sanctions which are more satisfying for both offender and the victims of non-compliance.

### What are Enforceable Undertakings?

- 4.19 Enforceable Undertakings (EUs) are a flexible sanction that enable regulators to tailor their enforcement response to individual circumstances taking industry considerations and resources, such as management capacity and willingness to restore harm, into account. They represent a valuable alternative to traditional regulatory enforcement action because they can address the needs of several parties involved in, or affected by, the wrongdoing as well as correcting and preventing breaches and their underlying causes.
- 4.20 EUs, in the form in which I am recommending them, are a sanction not currently available in the UK. Although some elements of EUs do exist in other contexts, their application across the regulatory landscape would be an extension of regulators' existing enforcement toolkits.<sup>62</sup>
- 4.21 EUs have proven successful abroad and I have discussed these experiences in more detail in chapter four of my interim report.<sup>63</sup> A report for the Australian Competition and Consumer Commission – cited by the Australian Law Reform Commission in its review of regulatory penalty schemes – concluded that Enforceable Undertakings provide a quicker and more cost-effective mechanism for resolution of regulatory non-compliance than court proceedings. The Commission also quoted businesses which observed that undertakings are a “nice way” of warning and giving the regulated business “another chance”. Businesses also stated that Enforceable Undertakings can encourage greater candour and promote compliance.<sup>64</sup>

<sup>61</sup> *Restorative Justice in Business Regulation? The Australian Competition and Consumer Commission's Use of Enforceable Undertakings*, Parker, C., *Modern Law Review*, Vol. 67, No. 2, 2004.

<sup>62</sup> The Competition Act 1998 s31A and the Enterprise Act 2002 s73 and s82

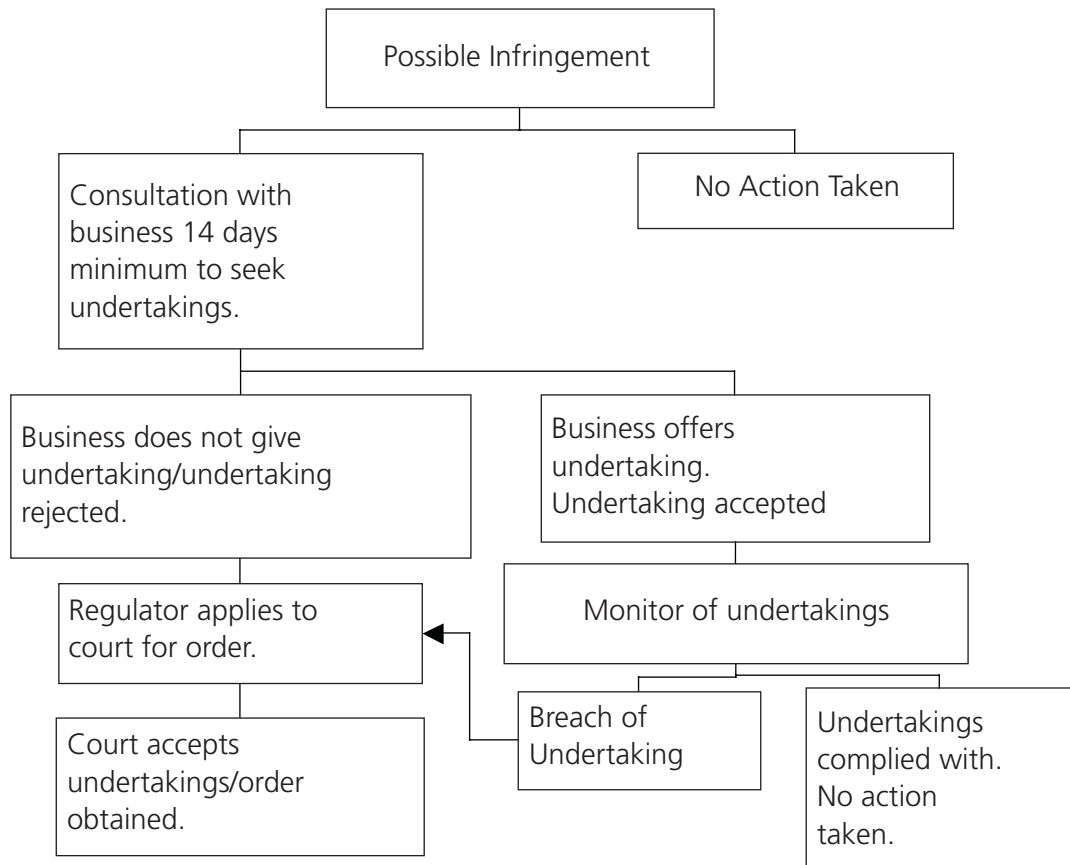
<sup>63</sup> *Regulatory Justice: Sanctioning in a post-Hampton World*, Consultation Document, Macrory, R., May 2006, p70

<sup>64</sup> *Principled Regulation: Federal, Civil and Administrative Penalties in Australia*, Australian Law Reform Commission, 2002, Chapter 16

**Box 4.4 Undertakings in lieu of Enforcement Orders**

1. Under Part Eight of the Enterprise Act 2002, the power is given to certain regulators to apply for Enforcement Orders from the court. Enforcement Orders are final orders given by a court to require the cessation of, or otherwise prohibit the infringement of certain legislation, where the infringement harms the collective interests of consumers.
2. The regulators that can use this power are General Enforcers (OFT, local weights and measures authorities, DETI), Designated Enforcers (bodies designated in a Statutory Instrument by the Secretary of State) and Community Enforcers (only enforcers from other EEA states).<sup>65</sup>
3. A business is usually given a period of at least 14 days consultation regarding such an action and may seek to make undertakings to the regulator during that time. These may be to rectify any infringement made by the business.
4. The regulator may accept or reject the undertakings made. If rejected, then the application for an Enforcement Order proceeds. If accepted, then the steps that the business makes to comply with the undertakings are monitored. If they are complied with then no further action will be taken.
5. If undertakings are not complied with then the regulator may apply to court for it to issue an Enforcement Order. The court may choose instead to accept the undertaking from the business. If the undertakings accepted by the court are breached after this then it is deemed to be a contempt of court. The process is outlined in Figure 4.1.

<sup>65</sup> DETI – Department of Enterprise, Trade and Investment in Northern Ireland

**Figure 4.1 Enforcement Orders in the UK**

Source: *Enforcement of Consumer Protection Legislation Guide on Part 8 of The Enterprise Act, OFT, March 2005.*

- 4.22 EUs are legally binding agreements between the regulator and business, under which the business agrees to carry out specific activities to rectify its non-compliance. An EU could include a commitment to future regulatory outcomes, including steps to ensure that a specific type of incident does not re-occur. EUs would be most effective when monitored closely by the regulator and where non-compliance with an EU is not tolerated.
- 4.23 EUs could be more effective in cases where a financial penalty or criminal conviction is likely to be absorbed by the business with a limited impact on the culture or management of the firm. They are also likely to be more effective in securing a change in businesses' behaviour when compared to warning letters or other means of persuasion currently available to the regulator. This is due to the way in which an EU is designed. Warning letters and advice are imposed by a regulator and specify what actions need to be taken by a business. The business may not have bought into the actions required. With EUs, it is the businesses who would apply for an EU and come up with their own list of conditions, and take ownership of the regulatory solution presented. Conditions that form part of the EU would be proportionate to the underlying breach and would hold business to account for their non-compliance.

- 4.24 Business responses to my call for evidence and consultation strongly supported the notion that there is a need for more flexible sanctions. EUs would allow for regulators to use a more flexible and individually tailored approach, which takes business considerations into account when determining how best to deal with cases of regulatory non-compliance. My recommendations here are very much in line with the Hampton ideas focusing on improving behaviour and moving firms into compliance through advice and persuasion.

Enforceable Undertakings focus strongly on behaviour change and damage restitution. The IoD has also been impressed by the Australian experience of using EUs.

*Institute of Directors*

EUs may work well not only as an alternative sanction but also as an additional sanction to our current regulatory tools. We particularly see the benefit of Enforceable Undertakings in larger organisations or major outbreaks of food borne disease or major food incidents. An Enforceable Undertaking Agreement would allow proportionality with the breach and the defendant's resources. Small duty holders may also be encouraged by the principal of agreeing a strategy that is clear, objective and measured. Enforceable Undertakings could provide scope and benefit to agree restorative and community elements. Enforceable Undertakings could also be a powerful tool to deliver sustained compliance. The Enforceable Undertaking option promotes openness of organisations and transparency of the enforcement process and fits well with the Agency's developing enforcement strategy.

*Food Standards Agency*

## How Enforceable Undertakings could work in the UK

- 4.25 Enforceable Undertakings should be available to regulators as an alternative to imposing a VMAP, or taking court action and prosecuting a business for regulatory non-compliance. It will be for individual regulators or their sponsoring departments, to determine which of the offences set out in their regulatory legislation, and in what circumstances an EU might be an appropriate sanctioning response. A key benefit of EUs is that the system offers the industry concerned the opportunity to demonstrate how it proposes to respond to a regulatory breach and to make open and binding commitments accordingly.
- 4.26 I believe that EUs should be a sanction that the regulator could consider in cases where they have the necessary evidence to bring an enforcement action. Regulators may prefer to accept an application for an EU in cases where they believe the EU will better deliver:
- the best regulatory outcomes which could include redressing the harm caused by the breach; and/or
  - the motivation for the necessary change in behaviour that could be brought about through an EU.
- 4.27 The specific actions required of a company that could be set out in Enforceable Undertakings include provisions for compensation, reimbursement or redress to affected parties. Actions may also include requirements that the offender does a service to the community, such as funding or implementing a compliance education program, and can also include a restorative element. I believe that once an Enforceable Undertaking has been agreed, there must be a consequence for the failure to comply with it.

- 4.28 If regulators have EUs as part of their toolkit, it will be important to make businesses aware that it is a sanctioning option. It would be helpful for regulators to provide guidance as to what might constitute an acceptable EU in order to avoid businesses offering too little. This could be included as part of a regulator's enforcement policy.
- 4.29 I do not intend to set out, in this report, the detail of exactly how Enforceable Undertakings would operate, as the details would be best left with by those responsible within Government for the implementation of such a sanction. However, I do believe there are some key features, based on the experience of this sanction in other jurisdictions that are necessary to ensure the effective operation of this new regime, which I outline in the section below.

## **Enforceable Undertakings in practice**

### *Application*

- A regulator's enforcement policy should indicate the type of circumstances in which they would consider accepting an EU rather than pursuing another sanction. In cases where a business has received notification that it is being prosecuted for an alleged breach of regulation, the business may decide to apply for an Enforceable Undertaking. When the regulator receives an application for an EU, legal proceedings connected with the alleged breach are put on hold. If the application for an EU is not accepted, prosecution will proceed.
- Where the regulator has decided to impose a VMAP on a business, and where the business may not have the financial resources to pay the administrative penalty, the business may decide to apply for an EU. When the regulator receives an application for an EU, proceedings connected with the breach and the imposition of the VMAP are put on hold. If the application for the EU is not accepted, the imposition of the VMAP will proceed.
- I suggest that business is not guaranteed a right to an Enforceable Undertaking; it would be granted at the discretion of the regulator.

### *Content*

- Enforceable Undertakings could take the form of a written agreement between the regulator and the business. This would clearly set out the specific action(s) for the business.
- The actions set out in the EU should be proportionate to and bear a clear relationship with the underlying breach. The time period within which compliance with actions is required should be defined.
- Regulators could also consider the impact on and, in some cases, consult third parties that have been affected by the regulatory non-compliance when deciding whether to accept the Undertaking.
- One of the conditions of an EU could include a financial element through a Monetary Administrative Penalty ("Undertaking Plus") *see further details below*.

*Process*

- Enforceable Undertakings would require an increased monitoring role for the regulator, as it will be involved in following up EUs to ensure that the conditions are carried through.
- Where a regulator has accepted an EU, the Undertaking should be made available publicly. This is important to secure public confidence in the regulatory enforcement system, but businesses who have agreed undertakings will also benefit since it will demonstrate that it is taking responsible action in relation to a breach.

*Non-compliance*

- There should be consequences for the business if it fails to comply with the EU. Having agreed and accepted the Undertaking as an appropriate response to specific regulatory non-compliance, if a business fails to comply with the conditions of an EU, the regulator could apply for a court order directing compliance with the undertaking or directing the payment of a fine.

**‘Undertakings Plus’**

4.30 A regulator may consider that while an undertaking offered by the business may be appropriate, the circumstances of the breach also require the payment of a financial penalty, and I think the system of EUs should be sufficiently flexible to incorporate this. This might be appropriate where, for example, the business has made a clear financial gain from non-compliance. The financial element of an Undertaking Plus would be based on the same principles as I described earlier in this chapter when discussing Fixed and Variable Monetary Administrative Penalties, and any revenue from the penalty would not go direct to the regulator. The Undertaking Plus would also be a voluntary but legally binding agreement. Both the financial element and the conditions of the EU would need to be agreed upon by both the company and the regulator. If a company did not agree with the level of the financial penalty, then it would choose not to enter into the EU and the regulator would decide what, if any enforcement action should be taken.

**Guidance in the enforcement policy**

4.31 Regulators would need to prepare guidance on when and under what circumstances EUs and Undertakings Plus might be considered and this should be reflected in and be part of the regulators’ enforcement policy. This policy, in turn, will be subject to the statutory Compliance Code.

**Recommendation 6:**

I recommend that the Government should introduce Enforceable Undertakings and Undertakings Plus (a combination of an Enforceable Undertaking with an administrative financial penalty) as an alternative to a criminal prosecution or the imposition of VMAPs for regulators that are compliant with the Hampton and Macrory Principles and characteristics.

**Box 4.5 Case study of EUs in Australia and USA****Australia**

In 2006, Black & Decker admitted a potential contravention of Australian law by selling a product with packaging which represented that it was made in Australia when it was, in fact, imported. After negotiation with the Australian Competition and Consumer Commission (ACCC) the company provided a court enforceable undertaking that it would (1) refrain from making misleading and false representations in regards to its products, (2) take remedial action in relation to stock held by retailers, and (3) implement a compliance programme to ensure future conduct did not contravene Australia law.

Source – ACCC Public Undertakings Register

**USA**

In June 2005, the Environmental Protection Agency reached an agreement with Saint-Gobain Containers Inc. to resolve Clean Air Act allegations. The agreement required Saint-Gobain to install state-of-the-art pollution control and monitoring equipment at a cost of approximately \$6.6 million. Saint-Gobain was also required to pay a civil penalty of \$929,000 and spend \$1.2 million for an environmental project to operate and maintain the new equipment. In addition, Saint-Gobain agreed to immediately comply with interim air pollution limits, obtain proper air permits, install pollution control equipment on its furnaces, and donate approximately \$1 million worth of emission credits generated by the emission reductions.

Source – *Compliance and Enforcement Annual Results 2005*, Environmental Protection Agency, Office of Enforcement and Compliance Assurance, November 2005

## Restorative Justice

- 4.32 Restorative Justice (RJ) is a philosophy that views harm and crime as violations of people and relationships. It is a holistic process that addresses the repercussions and obligations created by harm with a view to putting things right. When compared with current models of punishment, RJ requires a paradigm shift in thinking about responses to harm. RJ is different from retributive justice. It is justice that puts energy into the future, not into what is past. It focuses on what needs to be restored or repaid and what needs to be learned and strengthened in order for the harm not to re-occur.<sup>66</sup>

<sup>66</sup> *Introduction to Restorative Justice*, The Centre for Restorative Justice, Simon Fraser University, Vancouver, Canada – <http://www.sfu.ca/crj/intro/rj.html>

- 4.33 The basic principles of RJ are focused around harm and relationships such as the harm caused to individuals by injury at a workplace or a financial loss to a consumer because of mis-selling. Harms to the environment could include industrial spills or emissions into the environment. There are several definitions of RJ that I have come across although none is universally accepted. A frequently used and common definition of RJ which I have adopted in this Review is:

*Restorative Justice is a process whereby those most directly affected by a wrongdoing come together to determine what needs to be done to repair the harm and prevent a reoccurrence.*<sup>67</sup>

### Benefits of an RJ approach

- 4.34 **Outcomes** – The use of RJ has the potential to give good long-term outcomes for both victims and offenders. Victims show consistently greater levels of satisfaction in systems using Restorative Justice when compared to those relying on court-based justice, and many studies have strongly suggested that the re-offending rate of offenders is lower if they have undergone an RJ process.<sup>68</sup>
- 4.35 **Flexible response** – An RJ process is also flexible, as there is no pre-conceived notion of what ‘restoration’ is. It is a dynamic process reflecting the needs and capabilities of the stakeholders involved.
- 4.36 **RJ is focused on restoring the harm** – A restorative style approach will have a slightly different focus than the criminal justice system, which is more concerned with fault and punishment. In contrast, RJ is focused on the harm caused and on what can be done to make things right.

These positive aspects of RJ are reflected in the experience of its use in the UK within non-regulatory areas of the UK justice system. This has included work in areas such as Youth Justice and prisons.

### RJ in regulators’ sanctioning toolkits:

- 4.37 In my interim report I outlined the case for using RJ in regulators’ sanctioning toolkits as a further alternative to criminal prosecution, administrative fines or statutory notices. This case relied on evidence from Australia of the successful application of RJ to regulatory matters, discussed the use of RJ in the UK justice system, and put forward options for consultation.
- 4.38 Respondents to the consultation document on this review shared my positive outlook on the potential for Restorative Justice in this area.

<sup>67</sup> *Restorative Justice and Practices* – presented at ‘Restorative Justice in Action...into the Mainstream’, The 3rd International Winchester Restorative Justice Group Conference, 29th and 30th March 2006, London

<sup>68</sup> *The Effectiveness of Restorative Practices: A meta-analysis*, Latimer, J., Dowden, C., Muise, D., Canadian Department of Justice, 2005; *The positive effect of Restorative Justice on Re-offending*, Restorative Justice Consortium, January 2006

RJ used in conjunction with other enforcement tools may provide a good framework to proportionately match the breach, and involve and meet the needs of victims e.g. rehabilitation, workers retraining, reassurance and support, closure and public support. RJ would enable an organisation to do the right thing quickly. RJ may well result in improvements in health and safety outcomes in businesses as well as educate the organisation and managers.

Health and Safety Commission

There are many areas of regulatory non-compliance where restorative justice may well be appropriate. These will include Financial malfeasance, environmental damage and injury or risk to members of the public.

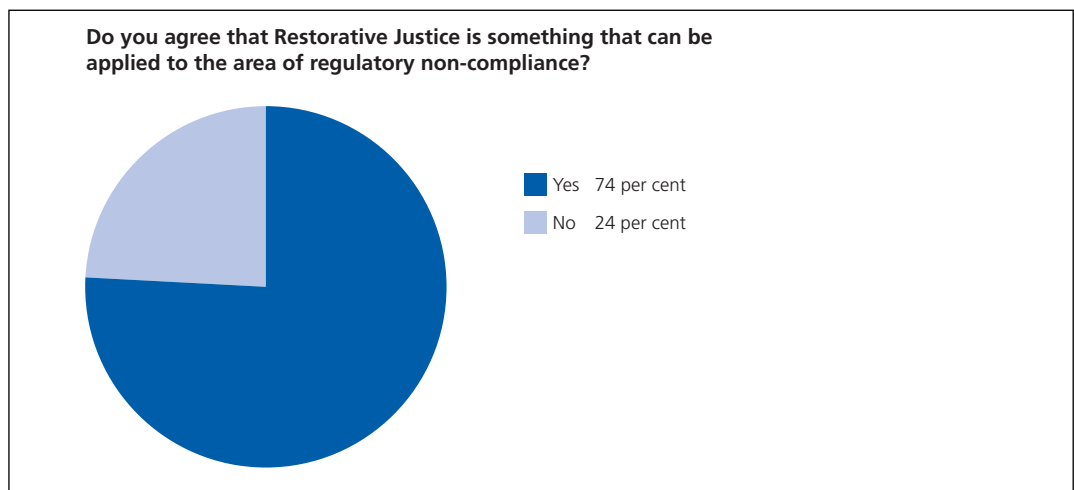
Trades Union Congress

We consider Restorative Justice (RJ) to be an innovative means of imposing sanctions on a particular business. RJ has the potential to educate where a strict financial penalty would not. It would also ensure a satisfactory outcome for the victims of regulatory non-compliance.

British Chamber of Commerce

4.39 Overall, 74 percent of respondents believed that RJ could be applied to the area of regulation, 24 percent believed that it could not be applied to this area. Furthermore the responses were favourable on the potential use of RJ in all three potential options for its use raised in the consultation document.

**Figure 4.2 Consultation Response to RJ proposals**



**Recommendation 7:** I recommend that Government introduce pilot schemes involving the use of Restorative Justice techniques in addressing cases of regulatory non-compliance. This might include RJ:

- as a pre-court diversion;
- instead of a Monetary Administrative Penalty; and
- within the criminal justice system – as both a pre or post sentencing option.

### Some considerations to make RJ effective as a regulatory sanction

4.40 RJ events can have very serious consequences for all stakeholders involved. Victims will often be very raw and sensitive about the physical, emotional, or financial harm that has been inflicted upon them. Offenders, on the other hand, will often be very nervous about facing those who they have harmed. Furthermore, the result of an RJ event will be an agreed remedy for the harm that has been caused. This agreement could amount to a significant burden on the offender, for example, financial compensation or a commitment to undertake unpaid work.

RJ Practitioners

4.41 Given the importance of these potential consequences, and the sensitivities on both sides that need to be respected, RJ must be carried out by trained experts. I understand that Skills for Justice, the standards setting body for the justice sector, will be publishing Occupational Standards by the end of this year and these will form the basis of any professional qualifications for such experts.

4.42 There is a good body of work on the use of RJ in the UK that provides many good points of learning that will provide safeguards for participants and give RJ the best chance of success. Any schemes introduced to implement RJ in the area of regulation should use this Best Practice guidance as the basis for designing RJ procedures.<sup>69</sup>

RJ Best Practice

4.43 Pilots could help capture for the regulatory system, the positive experience of RJ in other non-regulatory areas. Building on the Government's evidence-based approach to RJ policymaking I believe the best way to take forward the use of RJ in the area of regulation is through the use of pilots. The evidence from the use of RJ in the UK in non-regulatory areas, and the positive experience from Australia of the use of RJ in regulation show that there could be a use for RJ in regulatory sanctioning in the UK. I believe it would be good practice for a few pilot schemes to be undertaken to better develop RJ in the context of regulatory sanctioning.

Piloting RJ

<sup>69</sup> *Restorative Justice Guidance: Best practice for practitioners, their case supervisors, and line managers*, Home Office, December 2004.

## Alternative Sanctions in the Criminal Courts

4.44 Throughout this chapter, I have recommended a number of non-financial administrative sanctioning options to supplement the regulators' enforcement toolkit. Finally, in this last section, I look at expanding the sanctioning options available to the judiciary in cases of criminal prosecution.

### Introduction

4.45 In recent years, the criminal justice system in England and Wales has seen innovations in sentencing options for individual offenders beyond the traditional options of financial penalties or imprisonment. This is evident in the range of community sentencing options made available to judges in the Criminal Justice Act (CJA) 2003. Amongst these options are Unpaid work requirements, Curfew requirements, Supervision requirements, and Electronic Monitoring.<sup>70</sup> While these examples are not directly applicable to regulatory legislation, I mention them to demonstrate the flexibility in sanctioning of individuals.

4.46 There has been very little development in relation to the sanctioning of businesses for cases of regulatory non-compliance as the options I mentioned under the CJA 2003 are only available for individuals. I believe that there are existing tools that could be developed to effectively sanction the regulated community in cases that lead to a criminal conviction.

### My recommendations for alternative sentencing in criminal courts

4.47 I believe criminal courts should have more flexibility in the sanctions available to them in cases of regulatory non-compliance. I discuss several options that could be adopted in legislation by regulators and departments to better achieve increased compliance when sanctioning through a criminal prosecution in the section below.

<sup>70</sup> As defined in Section 199, 204, 213 and 215 of the Criminal Justice Act 2003.

**Box 4.6** Holistic use of alternate sanctioning in Australia

In November 2004, Vilo Assets Management was convicted by the Environmental Protection Agency (EPA) of the explosive discharge of over 6,500 litres of partially reacted bio-diesel. A number of people were injured and property on other sites damaged due to the incident. The company was ordered to pay \$20,000 towards an indigenous planting project within 30 days of the court order and to provide the EPA with proof of the payment within 45 days of that order. The business was prohibited from referring to the payment without also referring to the fact that they were ordered to do so by the court as a result of their regulatory non-compliance. The order also required Vilo to publish in the local and metropolitan media a notice about the offence and its impact in a manner specified by the court.

*Source – EPA media release November 2004 – Vilo Assets Management Pty Limited v EPA (Victoria) 2004*

## Profit Orders

- 4.48 Evidence has been presented in the course of both the Hampton Review and this review that clearly demonstrates that current levels of fines do not appear to reflect the gains from non-compliance with regulatory requirements in most cases.<sup>71</sup> As I discuss with regard to VMAPs and setting of the fines in Box 3.2, I believe that there are many factors that should determine the level of a financial penalty. These factors include whether the business has gained a financial benefit as a result of the non-compliance.
- 4.49 Fine levels imposed by the criminal courts should take into account any savings made by non-compliance, but in cases where the savings are clear (such as the failure to pay licence fees for a number of years) I believe that it would be preferable if the criminal courts had the power to impose a profits order that is separate from any fine imposed. The Profit Order would be a non-judgmental sanction in that it reflected solely the profits made from non-compliance, while the fine imposed would reflect the court's assessment of the seriousness with which they regard the breach. Thus it would be perfectly possible for a court to impose a substantial Profit Order where the savings were large, but impose a small fine because it considered the business had acted carelessly rather than with intent or recklessness. Identifying and removing the financial benefit from a regulatory breach is something I believe would strengthen enforcement and send a clearer signal to industry that it is not acceptable to make financial gain from non-compliance. It also seeks to provide a more level playing field for business and provides a deterrent for non-compliant businesses. Adding this level of differentiation and transparency and separating out financial benefits from punitive fines would ensure that businesses did not feel subject to large punitive sanctions unnecessarily and would guard against those types of accusations.

<sup>71</sup> *Reducing administrative burdens: Effective inspection and enforcement*, Hampton P., HM Treasury, March 2005, paragraph 17, page 6

**Box 4.7 A new sanctioning tool: Profit Orders**

Profit Orders would aim to ensure that the criminal offender should not gain from committing an offence and would seek to remove any financial gain that arose as a result of the non-compliance.

In effect, the Profit Order would separate the financial gain from the fine (the punitive sanction representing social and moral condemnation). Financial gains can include direct financial benefits as a result of non-compliance as well as deferred costs.

The Profit Order should reflect the actual gain made and should not be subject to any statutory limit. Nevertheless, in assessing both the fine and Profit Order imposed, the courts would be required to take into account the financial means of the offender.

- 4.50 To my knowledge, there is no similar scheme in operation in the UK at present, but there have been some attempts to remove the financial gains from wrongdoing. Most often, this takes the form of Confiscation Orders, which are made after conviction to deprive the defendant of the benefit that has been obtained from crime as set out in the Proceeds of Crime Act 2002. The Assets Recovery Agency uses the Proceeds of Crime Act 2002 to disrupt organised criminal enterprises and recover criminal assets.<sup>72</sup> It appears that Confiscation Orders have generally been used against individuals. Magistrates do not currently have access to Confiscation Orders and must refer cases up to the Crown Court to have access to this sanction. In addition, Confiscation Orders are strict in that they can only be used to capture acquisitive benefits such as profits that result from an offence. This benefit does not currently include provision for costs avoided, deferred or saved, which is a substantial part of the financial benefit obtained as a result of regulatory non-compliance.

<sup>72</sup> Proceeds of Crime Act 2002 – that Act deals with Confiscation Orders in Part 2 in relation to England and Wales, Part 3 for Scotland and Part 4 for NI.

**Box 4.8** Criminal Convictions and Confiscation Orders

When deciding how to sanction a business who has not complied with regulatory requirements, the regulatory authority should also consider the power of the court to make a Confiscation Order under the Proceeds of Crime Act 2002 in the event of a conviction. For offences committed up to 24 March 2003, the relevant legislation is the Criminal Justice Act 1988 (as amended).

When a defendant (including a corporate body) has benefited from an offence and the Prosecution asks the court to proceed, the court must make an Order for the offender to pay the amount by which they have benefited from the criminal conduct, or the available amount, whichever is the lesser.

In cases of offending by a corporate body, the starting point for calculating the defendant's benefit may be the gross turnover of the business during the period of the offence, i.e. deductions are not made for legitimate expenditure and so the amount of the Confiscation Order may be considerably greater than the net profit during the relevant period.

In deciding whether to prosecute an offender, the likelihood of a Confiscation Order being made in the event of a conviction is a public interest factor in favour of prosecution in the Code for Crown Prosecutors.

#### Box 4.9 Use of POCA in the regulatory context by UK Local Authorities

Evidence from UK Local Authorities shows that POCA (Proceeds of Crime Act 2002) has been successfully used to remove illegal profits from rogue traders such as counterfeiters. Three examples that have been submitted to the review are:

- **Counterfeit Goods** – The London Asset Recovery Team (RART) secured a confiscation order of £1,077,700 against an offender from Leyton working with Hackney Trading Standards Authority. The offender was also sentenced to 18 months' imprisonment after he was convicted of selling counterfeit goods, including well-known brands to various retail outlets across London.  
(see [http://cms.met.police.uk/met/news/convictions/forgery/1million\\_confiscation\\_order](http://cms.met.police.uk/met/news/convictions/forgery/1million_confiscation_order))
- **Counterfeit Goods** – Brent and Harrow Councils Trading Standards Departments secured the first confiscation order against a limited company. Trading Standards, with the Police and the London Regional Asset Recovery Team raided the premises of the offending company (a handbag wholesalers) and found over 1,700 counterfeit items which breached trademarks belonging to Louis Vuitton, Celine and Versace. The company's business records, accounts and computer hard drives were searched to determine the extent of the financial benefit from selling counterfeit goods. Following a successful prosecution, the company was ordered to pay £400,000 in August, this year.
- **Clocking Cars** – Northamptonshire County Council – A financial investigation by Northamptonshire Police established that the defendant had benefited to an amount of £180,507 and identified realisable assets amounting to at least £123,472. A confiscation order in the sum of £25,611 was made, together with an order for costs in the sum of £15,000 and compensation orders totalling £10,404. The Crown Court judge accepted the prosecutor's submission that in calculating the benefit he should make a confiscation order in respect of all 33 cars. The judge also accepted that method of calculating the benefit submitted by the prosecution (i.e. the Glass's Guide true mileage price for the vehicle less the Guide's lower mileage price) was appropriate. Two alternative methods were suggested by the defendant but application for leave to appeal was dismissed. The Court of Appeal found that the method adopted by the prosecutor was not unjust and indicated that the benefit may even have been aptly assessed by reference to the gross proceeds of the sale of the 'clocked' cars.

*Source: LACORS response to Macrory Review consultation*

- 4.51 It would be up to the prosecution to apply for a Profit Order. They will not be appropriate in all cases of regulatory non-compliance, but suitable where the profits or financial gains made are clear. It would be at the discretion of the court whether or not to impose such an order.

## Corporate Rehabilitation Orders (CROs)

- 4.52 Financial penalties represent the main sanction available to criminal courts in dealing with businesses who have not complied with regulatory obligations. Even where courts have access to a Profit Order as recommended above, the level of any financial penalty imposed will always take account of ability to pay which may account for some of the apparent low level of fines imposed on smaller businesses. In dealing with individual offenders, criminal courts now have access to a wide range of sanctions beyond fines and imprisonment, designed to bring home to the offender the consequences of the breach or secure rehabilitation. I believe that in dealing with regulatory breaches by businesses, the criminal courts should also have access to a more flexible range of sanctioning tools beyond the simple imposition of a financial penalty.
- 4.53 Corporate Rehabilitation Orders, as they are currently used in Australia, contain provisions to enable a court to require a company to undertake specific actions or activities during a specified period, such as one or two years. Corporate Rehabilitation Orders, as implied by their title, aim to rehabilitate the offender by ensuring tangible steps are taken that will address a company's poor practices and prevent future non-compliance. They involve a period of monitoring of the activities, policies and procedures of a business, with a view to organisational reform.<sup>73</sup>
- 4.54 Activities specified in the order could include training of personnel in regulatory related matters, the adoption and implementation of action plans to address regulatory non-compliance or taking steps to remedy the harm caused by regulatory non-compliance.
- 4.55 I believe a similar model could be introduced in the UK. Although I do not want to be too prescriptive in the models set out because different regulatory areas will have different needs, I do outline the way in which these could work in practice here in the UK.<sup>74</sup> CROs give criminal courts access to a sanction similar to Enforceable Undertakings.
- On conviction the company would be invited to put forward to the court a plan of action to remedy the matter which caused the harm. This could include a community project or a compliance audit;
  - The court, in consultation with the regulator would either approve that scheme or appoint its own experts (who would be paid by the company) to design a more robust plan;
  - The court would make its order;
  - The relevant regulator would monitor compliance with this order; and
  - Failure to comply with the order would lead to the company being brought back to court and sentenced in an alternative way, with the court taking into consideration, failure to comply with the CRO.

<sup>73</sup> *Sentencing: Corporate Offenders*, New South Wales Law Reform Commission, 2003.

<sup>74</sup> *Corporate Criminal Liability: The Problem of Sanctions*, M. Jefferson, *Journal of Criminal Law* 65, 2001.

- 4.56 Corporate rehabilitation is an effective means of rehabilitating an offending firm and reducing the likelihood of future harm. The imposition of this sanction goes beyond what a fine can achieve in this respect by identifying tangible steps that a company must take and binding that company to their implementation. In taking steps to solve a company's compliance problems (as opposed to simply fining) there is also a greater chance that the individuals responsible will be identified and be held to account for their offences. A CRO will often replace a fine imposed, but in appropriate cases courts should retain the discretion to impose a fine in addition to the order.

#### Box 4.10 Case study for Corporate Rehabilitation Orders

##### **US v World Air Conditioning Inc**

On October 30, 1997, US Federal Court found World Air Conditioning Inc. guilty of failing to report income in federal tax returns, obstruction of justice and mail fraud. The defendant was ordered to pay \$1.5 million in fines and several conditions of corporate probation, including co-operation with the IRS (Internal Revenue Service) and periodic reports of financial condition and periodic investigations of the company's records by independent experts were imposed on it.

*Source – US department of Justice press release October 1997*

##### **US v Royal Caribbean Cruises Ltd**

On September 17, 1998, Royal Caribbean Cruises Limited was sentenced to a \$1 million criminal fine for dumping oil and lying to the US Coast Guard. In addition the court imposed a period of corporate rehabilitation of five years, during which the conduct of the company will be closely monitored, with periodic reports to the court and the Government, detailing the company's environmental compliance and including the results of independent audits.

*Source – US Department of Justice press release September 17, 1998*

### **Community Projects**

- 4.57 The range of requirements that could form the elements of Corporate Rehabilitation Orders should be flexible, reflecting both the circumstances of the regulatory breach and the nature of the defendant. It could, for example, include a requirement for the business to complete an appropriate community improvement project within a specified period and for a specified value related to the underlying harm or benefit that has been caused or obtained by the offender. Community projects would enable the business community to take responsibility for its actions within a local community and restore the harm it may have caused to the community or individuals. The project symbolises the restitution of the loss to the community that corporate crime involves, and could be appropriate where the business does not have the ability to pay a large financial penalty.

- 4.58 Examples of community projects include funding and delivering an education campaign in a specific subject or funding and delivering a project in the built environment, such as a park or a garden, or making some donations to the local community of time or resource as our examples in Box 4.11. More generally, the projects should be:
- Carried out in addition to something the company is already legally obliged to do;
  - The firm should not be allowed to use the project for its own public relations purposes; and
  - The community project could be used where the defendant is not in a position to pay a high financial penalty.
- 4.59 International experience with such community requirements has been positive. Australian environmental and health and safety legislation provides broad powers to judges to order businesses to carry out specified projects to either restore the environment or improve health and safety respectively. Not only do the projects deliver tangible benefits to the local community where the offence was committed, but it has also engaged the business more so than a financial penalty would, for example, to ensure that future compliance is secured. This engagement would enhance the rehabilitative element of the sentence as the offender recognises the serious harm that has been caused.

#### Box 4.11 Examples of a Community Projects

Six bakeries convicted of price fixing in the US were excused from paying substantial portions of the fines imposed on condition that they provided baked goods to various organisations assisting the needy for one year. The court identified several reasons for making the order:<sup>75</sup>

**Avoidance of ‘Spill over’** – Imposing fines commensurate with the gravity of the offence would have bankrupted the bakeries. This would have caused a large spill over effect through creating widespread unemployment amongst the bakeries’ production-line employees.

**Reflecting non-financial aspect of the crime** – The community project required the firm to make symbolic restitution for their offences by doing something more onerous and thought-provoking than merely paying fines.

**Publicity** – The community project brought the offences to the attention of the public, thereby increasing deterrence without harming the needs of employees, consumers or communities that would otherwise be affected by a fine.

This example illustrates some of the added value that a community project can deliver in comparison to a simple fining approach.

In February 2002, Rosedale Leather pleaded guilty to one charge of air pollution after offensive odours from its tannery affected local residents. As part of the sentence handed down by the Magistrate’s Court the company was ordered to pay \$20,000 to a local community project to aid in the implementation of streetscape beautification works in the town of Rosedale.

*Source: EPA media release February 2002 (Rosedale Leather v EPA (Victoria) 2002)*

### Mandatory Compliance Audits

- 4.60 The power to compel companies to undertake an ‘audit’ is common in Australian states, especially in the area of environmental regulation.<sup>76</sup> This type of sanction is designed to remedy deficiencies in the business’ management and may be appropriate where systemic organisational change would help to better achieve future compliance. Bringing in external expertise could get the business the help it needs to identify how to improve its operations and meet its regulatory objectives.
- 4.61 A Mandatory Compliance Audit, by an accredited third party, ordered by the court, would identify the necessary changes to a business, to protect the public and also provide a framework to ensure that the changes would be made.<sup>77</sup> Audits by third parties would be systematic, documented and objective reviews of a business’ facilities, operations and product

<sup>75</sup> United States v Danilow Pastry Co (1983) 563 F Supp 1159 at 1166-1167.

<sup>76</sup> *Regulatory Justice: Sanctioning in a post Hampton World*, Discussion Paper, Macrory, R., December 2005.

<sup>77</sup> *Environmental Auditing: Entering the Eco-information highway*, Berlin, M., New York University Law Journal, p 2 1998.

lines.<sup>78</sup> The outcome of such a review would be an action plan of what corrective actions would be necessary to bring the business back into compliance.<sup>79</sup> The court could then direct the regulator to monitor the business to ensure it takes all of the necessary corrective action.

- 4.62 Mandatory audits have the potential to be wide ranging in their operation; in Australia they can be sought not only in relation to the premises and operation where the original offence was committed or brought to the regulator's attention, but to all sites and operations carried out by the defendant.<sup>80</sup> The scope of audits can also include an examination of both physical and managerial activities.<sup>81</sup>
- 4.63 I believe that as part of a Corporate Rehabilitation Order, the court should have discretion on whether such an audit is appropriate, seeking guidance from the regulator and its prosecutors on whether it is appropriate. The regulator could keep a list of accredited agents who could carry out the audit, with the costs of this met by the non-compliant business. If a business contested and a court agreed that the business did not have the means to pay, then such a sanction would not be appropriate.

#### Box 4.12 International Use of Mandatory Compliance Audits

In August 2002, the Environmental Protection Agency fined Shell Refining Australia limited for three separate incidents of oil discharges to Corio Bay beach. After a number of other cases of pollution were taken into consideration the EPA issued a clean up order and after discussion with the company initiated a number of independent environmental audits to identify and fix problems at the refinery.

*Source – EPA media release 2 August 2002 [Shell Refining (Australia) Pty Limited v EPA Victoria 2002]*

On 10 May, 2006, the US Environmental Protection Agency (EPA) brought a civil action for injunctive relief and civil penalties against AgriProcessors Inc. for numerous violations of federal environmental laws. The consent decree required the company to pay an administrative fine as well as undergo a Compliance Audit, carried out according to provisions set out in the consent decree, by an independent auditing firm. The purpose of the audit was to determine and achieve the firm's compliance with federal environmental legislation and was at the expense of the defendant. Provisions of the Compliance Audit included stipulations for a audit work plan, what the audit report should contain and the timing of when the audit report has to be submitted to the EPA.

*Source US Department of Justice – www.usdoj.gov*

<sup>78</sup> *Environmental Audit Privileges: The Need for Legislative Recognition*, O'Reilly, J.T., 19 Seton Hall Legis. J 119 – 120 1994.

<sup>79</sup> *Environmental Auditing: Entering the Eco-information highway*, Berlin, M., New York University Law Journal, 1998.

<sup>80</sup> *Guidelines for seeking environmental court orders*, NSW Environmental Protection Agency.

<sup>81</sup> *Environmental Audit Privileges: The Need for Legislative Recognition*, O'Reilly, J.T., 19 Seton Hall Legis. J 119, 120 1994.

## Publicity Orders

- 4.64 Reputation is an important asset to many businesses. When thinking about how to motivate firms to change their behaviour, reputational sanctions can have more of an impact than even the largest financial penalties. The use of reputational sanctions is already in practice in some areas of UK regulation as I outline in Box 4.14.
- 4.65 Publicity Orders are an effective means of deterring regulatory non-compliance as it can impact the public reputation of a business. A company's reputation and prestige is an important and valuable asset. The consequences of damaging a firm's reputation can potentially exceed the effect of a maximum fine that a court could impose.<sup>82</sup> A company that loses its reputation even for a short time can suffer significant damages to consumer confidence, market share and equity value.<sup>83</sup>
- 4.66 Publicity Orders can also make a business' behaviour more public and really hold it to account for its regulatory failures. The threat of this type of sanction may encourage firms contemplating not complying with regulatory objectives to re-consider, even if the non-compliance would generate significant financial benefit.
- 4.67 Adverse publicity could also trigger other non financial consequences such as interest from other regulatory agencies as well as consumers and they can be applied without limitations of a business' ability to pay.<sup>84</sup> Small and large firms with regard to their reputation could be sanctioned without the constraints that a financial sanction would impose which could be effective in some instances of regulatory non-compliance.

### Box 4.13 Example of Publicity Orders in the US

Under Federal Sentencing guidelines a judge may order a convicted company to publicise, at its own expense, its conviction and what steps it is putting in place to avoid future non-compliance. For example, the American Caster Corporation was found guilty of the illegal dumping of 250 deteriorating drums of solvents. The company's officers pleaded guilty to the charges and were ordered to take out a full page advertisement in the Los Angeles Times at a cost of \$15,000. In addition, the company also had to pay \$20,000 for the cleaning of the site and the president and vice president received a six month custodial sentence.

Source: As reported in New York Times, February 17th 1985 (Polluter Purchases Ad To Tell Of Its Illegal Toxic Dumping)

<sup>82</sup> *Scarlet letters for corporations? Punishment by publicity under the new sentencing guidelines*, Cowen, A., (1992) Southern California law Review 2387.

<sup>83</sup> *Reputation*, Formbrum, C., Harvard Business School Press, 1996.

<sup>84</sup> *The Regulatory Enforcement of Pollution Control Laws: the Australian Experience*, Abbot, C., Journal of Environmental Law (2005) Vol 17 No2 161-180.

**Box 4.14 Reputation as a motivation for regulatory compliance**

UK regulators already recognise and utilise policies of ‘naming, faming and shaming’ both good and bad practice. The Health and Safety Executive currently discloses details of its enforcement actions on its Web site which the CBI has said ‘puts peer pressure on those firms that have issues to address and threatens adverse impact on their reputation’.<sup>85</sup> In addition, the Financial Services Authority accompanies a penalty with a press release giving details of the non-compliance and the size of penalty as does the Environment Agency who issues press releases for successful prosecutions to local and national media.

**Recommendation 8:**

I recommend that the Government consider introducing the following alternative sentencing in criminal courts:

- Profit Order – Where the profits made from regulatory non-compliance are clear, the criminal courts have access to Profit Orders, requiring the payment of such profits, distinct from any fine that the court may impose;
- Corporate Rehabilitation Order – In sentencing a business for regulatory non-compliance, criminal courts have on application by the prosecutor, access to a Corporate Rehabilitation Order (CRO) in addition to or in place of any fine that may be imposed; and
- Publicity Order – In sentencing a business for regulatory non-compliance, criminal courts have the power to impose a Publicity Order, in addition to or in place of any other sentence.

- 4.68 I believe that the requirements of a CRO should be flexible, reflecting both the circumstances of the offence and the nature of the business and could include mandatory audits and the carrying out of community projects. The regulator would, under appropriate guidance from the court, be responsible for supervising the carrying out of the CRO.
- 4.69 For Publicity Orders, I believe that this type of order would enable a court, to order that a notice (with wording agreed by the regulator and the business) to be placed in an appropriate publication, such as a local or national newspaper, a trade publication or another appropriate media outlet such as radio or television, or in a company’s annual report within a specified period. The notice would state the background to the offence, the steps taken by the offender to prevent repetition and any remedial or compensatory measures taken by the offender. While some regulators have a strategy for ‘naming and shaming’, the recommendation on Publicity Orders differs in that they would be imposed by the court, an independent third party, and not by the regulator. This would ensure that the business has a received a fair and objective assessment of the offence.

<sup>85</sup> Evidence submitted to the Macrory Review, Spring 2006.

## Conclusion

- 4.70 Chapters three and four have gone through my main recommendations regarding the types of sanctions that I think should be available to regulators. These represent additional tools and are not meant to replace criminal prosecution as a regulatory sanction. The additional sanctions may be more appropriate in some cases that are currently prosecuted. They provide a range of administrative financial and non-financial options where criminal prosecution is not appropriate. Furthermore, I have also made recommendations for more flexible sanctions for cases of regulatory non-compliance that are sentenced within the criminal courts. The addition of these sanctioning tools to a regulator's and courts' toolkit will make them more effective when it comes to enforcement and this will strengthen the entire regulatory regime of advice, inspection and enforcement.
- 4.71 The next chapter focuses on transparency and accountability mechanisms that I believe are necessary for a well functioning and effective sanctioning system that includes financial and non-financial sanctions.

## Chapter five

# Transparency and Accountability

**The previous two chapters presented a blueprint for an effective sanctioning system that reinforces and is consistent with a risk-based approach to regulation. This chapter discusses the transparency and accountability frameworks that are necessary to support this blueprint.**

### Introduction

- 5.1 Regulators wield power over the regulated community and have been entrusted to act on behalf of the public to maintain and safeguard certain obligations or requirements. There is a strong culture of good governance within the UK regulatory system that acts as a check on these powers.
- 5.2 Some of my recommendations in the previous two chapters involve extending regulators' enforcement options, thereby giving some of them access to powers they have not previously held. Both regulators and industry have expressed some concern on how new powers of enforcement will be introduced and used in the coming years. However, some UK regulators, most notably the economic regulators, already use most of the sanctions that I have suggested should be part of an extended toolkit.<sup>86</sup> There is much good practice already in existence here, in particular strengthened transparency and accountability frameworks such as open board meetings.
- 5.3 Although standards of accountability and transparency amongst UK regulators in general are already high, I believe these systems must be developed further in order for a more flexible sanctioning system to be effective and credible. I detail some recommendations for these areas in the following discussion.

### Transparency

- 5.4 Transparency is something that the regulator must provide to external stakeholders, including both industry and the public, so they have an opportunity to be informed of their rights and responsibilities and of enforcement activity. However, it is also important for the regulator itself, to help ensure they use their sanctioning powers in a proportionate and risk based way.
- 5.5 I have set out recommendations relating to an increased level of transparency for regulators through:
  - The publication of an enforcement policy;
  - Publicly disclosing who enforcement actions have been taken against; and
  - Publishing information on the outcomes of enforcement action.

<sup>86</sup> These regulators include Financial Services Authority, OFGEM, OFT and Competition Commission

## Accountability

- 5.6 Regulators see their primary accountability to Ministers and elected officials whether in Parliament or at local level and this relationship is already strong. In addition, regulators are making some good progress on increasing their accountability to those who they regulate and those on whose behalf they are regulating. Some of my recommendations will strengthen the answerability of regulators to stakeholders further. I also propose that Ministers and Parliament should also look more closely at the enforcement and sanctioning activities of regulators, rather than focus mainly on financial accountability in order to provide a complete overview of a regulator's activities including enforcement.

## What do I mean by transparency?

- 5.7 Being transparent is necessary to ensure that business knows what consequences it could face for failure to comply with regulatory requirements. Transparency can be achieved in several different areas, for example transparency in procedural decision-making also ensures high standards when the regulator makes its enforcement decisions. Broadly speaking, regulators should be able to outline the process by which decisions are arrived at, the types of factors that may influence a regulator's enforcement decisions, and what types of enforcement action could be taken in what circumstances.
- 5.8 The culture of transparency is strong in those national regulators who have published enforcement policies available to the public and regulated communities. At present, however, the use of enforcement policies is patchy amongst UK regulators. Internal research I commissioned for my review showed that only 17 of the 60 national regulators surveyed had a publicly accessible enforcement policy.
- 5.9 Other agencies may have policies available for internal reference, but these are not easily available publicly. For local authority regulators, 96 percent have signed up to the Enforcement Concordat, which articulates general 'Principles of Good Enforcement'.<sup>87</sup> Although this is a good starting point, more specific guidance on its enforcement practice in particular regulatory areas should be produced beyond the Concordat by those local regulators who want to use an expanded sanctioning toolkit. Businesses should have a clear idea what they need to do in order to comply with regulations. In addition, where local authority regulators are enforcing on behalf of a national regulator, they should do so following the national regulators' policy guidelines.

<sup>87</sup> <http://www.cabinetoffice.gov.uk/regulation/documents/pst/pdf/concord.pdf#search=%22enforcement%20concordat%22>

## Transparency through enforcement policies

### What are enforcement policies?

5.10 An enforcement policy is a public document setting out what action the public, and the regulated community, can expect from a regulator when a regulatory breach has been identified. This will specify the range of enforcement options available to the regulator, when enforcement action is likely to be taken and in what circumstances. It should also talk about the regulator's policies for risk based enforcement, enforcement action in cases of conflicting regulations, the provision of advice and information it requests from business.

### Characteristics of a good enforcement policy

- 5.11 Enforcement policies must always retain a degree of flexibility, since I believe the choice of sanctioning response can never be a purely mechanical exercise. But if they are to be of real value to the regulated community, it is important that they are drafted with reference to the specific area of regulation to which they relate, rather than expressed in over-generalised terms, although I expect there would be some over-arching principles which would apply to all areas.
- 5.12 The language in an enforcement policy should not however be over-specific on what a business should expect when found in each and every potential type of breach. This would be arduous and bureaucratic and would bind a regulator's discretion too tightly leading to an overly rigid enforcement system that would not be beneficial for the regulator, the regulated community, or the public. Flexibility remains a cornerstone of a good enforcement system.

### Positive influence of published enforcement policies

- 5.13 **Consistent decision making** – public enforcement policies both facilitate and incentivise regulators to make decisions on a fair and consistent basis. They facilitate consistency by giving enforcers a reference point – applicable to all their enforcement activity – for how they should react to different circumstances. This delivers consistent decisions as regulators act in the knowledge that when formal enforcement proceedings are pursued this should happen in a manner consistent with the public policy. It would also require the regulator to explain and justify any significant departure from its public policy.
- 5.14 **Safeguards for stakeholders** – public enforcement policies provide a valuable safeguard for businesses against the misuse of regulators' powers. Likewise they provide reassurance for the public that decisions on enforcement are made consistent with public policy.
- 5.15 Given that some regulators already have experience in publishing enforcement policies I suggest the sharing of best practice here which could be co-ordinated by the Better Regulation Executive.

Each policy should:

- Have regard to the Principles of Good Regulation, the Enforcement Concordat, the Compliance Code (when established) and the Macrory Penalties Principles;
- Set out what a regulator may do to bring businesses into compliance without the need for taking punitive action;
- Explain the range of enforcement options available to the regulator;

- Explain the criteria upon which decisions are made when choosing what specific enforcement action to take in each case of non-compliance, including any aggravating or mitigating factors the regulator might take into account before applying a particular sanction;
  - Where a regulator has FMAP powers – outline the scheme for imposing these sanctions detailing, for example, relevant time limits, the scale of charges, and methods of paying FMAPs, and complaints and appeals procedures;
  - Where a regulator has VMAP powers – outline the calculation mechanism for deciding the appropriate fine including aggravating and mitigating factors that will impact on the level of VMAP, and give relevant details relating to payment of the VMAP;
  - Where a regulator has FMAP and/or VMAP powers – outline complaints and appeals procedures;
  - Where a regulator has access to Statutory Notices – outline the circumstances under which these might be appropriate and the consequences of non-compliance; and
  - Where a regulator has access to Enforceable Undertakings or Undertakings Plus – outline the scheme for entering into these agreements, for example, the relevant time limits, application process, types of conditions and consequences for non-compliance.
- 5.16 Enforcement policies should be clearly identified and readily accessible on the regulator’s own website. They may take the form of separate documents addressing each sanction individually provided that there is overall transparency about the regulator’s sanctioning options.
- 5.17 Enforcement policies once published should not be subject to constant change, but regulators should ensure that they are subject to periodic review, to ensure that in the light of experience they are fit-for-purpose and up-to-date. While I do not propose any formal assessment of regulators’ enforcement policies, actions taken by the regulator will be held against the policies when it reports on outputs and outcomes, which I discuss in the next section.

## Transparency through reporting outcomes

- 5.18 As I discussed in my interim report, I have found that most regulators, when reporting on enforcement activity or compliance, focus on the outputs of this activity, for example, the number of prosecutions or the number of Statutory Notices that have been issued. This information is important, but there is very little evidence on what the actual result, or outcomes, of these enforcement actions are. I think that regulators should be encouraged to measure and communicate their regulatory outcomes and objectives in addition to the outputs.
- 5.19 Reporting on these measures through existing reports to stakeholders or Parliament, would let the regulated community and the public know what activities the regulator is engaged in. It also is an indication of the effectiveness of the regulator in discharging their statutory duties, thereby holding them to account.

## Measuring outcomes

- 5.20 Appropriate outcome measures will vary in different areas of regulatory activity, but are essentially concerned with the expected consequences and goals of the regulator's enforcement activity rather than an account of the amount and type of enforcement activity it undertakes. In some cases, the regulatory requirements themselves may clearly identify a policy goal. In other cases, it may be appropriate to formulate an outcome that can be measured, such as the quantifiable reduction of pollution incidents or reduction in deaths and serious injuries. Evaluating the extent to which non-compliant businesses become compliant could also form an outcome measure. Determining the appropriate outcome measures and the methodology by which they should be measured are challenging tasks. However, it is only by measuring outcomes that regulators, the regulated community, and the public will begin to know what impact enforcement actions are having on regulatory outcomes and whether these have improved compliance. It will also highlight for the regulator if there needs to be any modification to its choice of enforcement actions in order to better meet regulatory objectives.
- 5.21 During the course of the review, it became apparent how little information is available on the effectiveness of sanctioning regimes. If Government accepts my recommendation, I would suggest that sponsoring departments and/or regulators use the opportunity of introducing new sanctioning tools to study and develop information, including commissioning independent research, relating to the sanctions and their effectiveness especially during the transition period. This will be very helpful to many within the regulatory sector.

The Office of Fair Trading has established an evaluation programme into how effective enforcement (and non enforcement) methods, such as information campaigns, are at changing business and consumer behaviour. It is also planning work on establishing appropriate performance measures in consumer regulation enforcement and market studies work. It will be working with academics and other competition authorities internationally to set baseline and success criteria that will enable a robust evaluation of performance and impact.

Source: <http://www.offt.gov.uk/NR/rdonlyres/F704C245-D32B-4E17-854D-715C23073A6D/0/AnnualPlan07.pdf>

- 5.22 Alongside providing the regulatory community with greater information, a focus on outcomes will also ensure that industry is better served. Regulators will need to demonstrate that their enforcement actions are having a measured impact. Simply publishing the number of enforcement actions, will no longer suffice as a demonstration of the effectiveness of a regulator in meeting its regulatory objectives. Business should be reassured because the regulator will need to go one step further in supporting its enforcement strategy. It will, for example, need to demonstrate that imposing administrative sanctions is improving regulatory outcomes compared with sanctioning by criminal prosecutions alone.

- 5.23 I do recognise that regulation is not an exact science and that regulatory outcomes are not the only measure of a regulator's success. Nonetheless I believe that measuring outcomes has been a neglected area of reporting within the regulatory community that is essential to the credible functioning of a modern regulatory system and I would like to see regulators strive towards achieving this.
- 5.24 Regulators and sponsoring departments should in their annual reports:
- Summarise the relevant regulatory output measures for the relevant period;
  - Summarise the relevant regulatory outcome measures during the relevant period; and
  - Comment on the relationship between the outcomes and the outputs.

## Transparency through publishing enforcement actions

- 5.25 When regulators make a decision to enforce and impose a formal sanction, I believe that this should be a matter of public record. This will:
- Ensure that the public knows that the regulator is taking action in cases where regulatory non-compliance has occurred;
  - Demonstrates to industry that the regulator will take action and is doing so against firms that do not comply; and
  - Publicly hold industry to account for its behaviour.
- 5.26 A number of regulators have made this part of their current practice and I think this is something that others should also adopt. For example, the HSE has a database of enforcement actions available on its website for prosecutions that the agency has taken forward and where Statutory Notices have been applied. I believe that disclosure of when and against whom enforcement action has been taken should not be isolated to criminal prosecutions but should also be used for other enforcement action such as administrative penalties, enforcement or improvement notices or any other formal sanction in order to be consistent and transparent in the approach to enforcement and publishing sanctions.
- 5.27 I believe that making public outcome measures, success in achieving them, and information concerning the number and types of enforcement sanction pursued provides one source of performance accountability of regulators. But I also believe that more formal channels of accountability should be strengthened and I discuss this in the section below.

## Accountability

- 5.28 A previous study of independent regulators found that, when asked to whom they are accountable, most national regulators suggested that it is to Ministers and Parliament.<sup>88</sup> This is an important mechanism of accountability, especially where the regulator is funded either in full or in part, by public money. Rigorous financial accountability mechanisms are a crucial part of a well-functioning, effective and credible regulatory system. There are currently a number of good accountability mechanisms in place including:
- All regulators have an accounting officer;
  - They have to produce annual accounts – available to everyone;
  - They can be audited by the National Audit Office or the Audit Commission;
  - They can be subject to value for money examinations by the National Audit Office; or
  - They can be called to appear before the relevant House of Commons or Lords select committee to answer for their actions.
- 5.29 Local authority regulators are accountable through their management structures to the Chief Executive and ultimately to the elected Councillors. All authorities will have a corporate complaints procedure to deal with complaints about the service and local authorities are also governed by the Local Government Ombudsman. All local authorities also have their own independent auditors plus a range of government inspectors and reporting requirements to central Government.
- 5.30 Whilst accountability to Parliament and Ministers is important, it is equally important that regulators are clearly answerable to those that they regulate, and those on whose behalf they are regulating. Such accountability would assist in reassuring the regulated community that non-compliance is dealt with effectively. My recommendations on improved transparency will serve to strengthen regulators' accountability to the public and the regulated community through the publication of their enforcement policies and outcomes of their enforcement actions.
- 5.31 Many regulators are making real progress in their efforts to become more answerable to their stakeholders. Some examples of these include:
- Corporate plans (sets out priorities and details of how these will be achieved);
  - Open meetings;
  - Accessible and affordable appeal mechanisms;
  - Open consultation exercises and feedback;
  - Publication of board agendas, papers and minutes where appropriate;
  - Regulatory impact assessments presented alongside proposed legislation; and
  - Comprehensive and easy to use websites.

<sup>88</sup> *Independent Regulators*, Better Regulation Task Force, October 2003, page 22,

## **The Better Regulation Executive (BRE)**

- 5.32 Many of my recommendations may pose a challenge to regulators and I believe the BRE is the right body to facilitate the introduction of many of my recommendations, given its oversight of the better regulation agenda.
- 5.33 The Better Regulation Executive is the central Government body that promotes delivery of the Government's regulatory reform agenda. As such, it plays a key role in working with Government departments and regulators to improve performance on better regulation, embedding the principles of better regulation and identifying areas of best practice. This work should continue and be extended to include the implementation of the extended sanctioning toolkit.
- 5.34 The Better Regulation Executive should facilitate a working group of regulators and sponsoring departments to share best practice in enforcement approaches, the application of sanction options, development of outcome measures and transparency in reporting. Regulators and sponsoring departments should work with the Executive to include outcome measures as part of their overall framework of performance management.
- 5.35 This working group would consist of regulators, departments, industry representatives where appropriate, and BRE staff with an interest and expertise in enforcement related issues. Its aims could be to share best practice on many issues relating to enforcement including risk-assessment, designing appropriate sanctioning schemes and providing support and guidance to enforcers more generally on the better regulation agenda. It could also assist regulators and departments in the development of regulatory outcome measures and enforcement policies.
- 5.36 The working group would exist to facilitate the exchange of best practice and assist regulators and sponsoring departments in developing expertise and competence in the extended range of sanctions. It could work alongside other expert groups such as the Whitehall Prosecutors Group and the Joint Regulators Group.

## **Accountability for specific enforcement decisions**

- 5.37 My proposals envisage that regulators will have a wider range of sanctioning responses to particular instances of regulatory breach, but that their enforcement discretion is exercised in the context of strengthened overall transparency and accountability. However, it is also important to consider what protective mechanisms exist to deal with allegations of abuse or poor practice in individual cases.
- 5.38 Where a regulator imposes an administrative penalty, I have proposed a right of appeal to a regulatory tribunal in order to provide a speedy and cost-effective protection for those who feel that the imposition of a sanction is unjustified, or the circumstances do not amount to a breach. The tribunal could also censure the regulator where there had been abuse or poor practice thereby also holding the regulator to account.

### **Third parties can improve accountability**

- 5.39 Third parties such as non-governmental organisations, victims or consumers can provide an important challenge and accountability function. They act to ensure that regulators are carrying out their public duties with due care. If a regulator is not seen to be carrying out its public duties, then third parties can challenge the regulator and hold the regulator to account for its actions. I outline some of these mechanisms below.
- 5.40 Judicial review is a check on the lawfulness of actions and decisions of public bodies, examining the way in which a decision has been made.
- 5.41 The expanded toolkit I recommend in this review will not change recourse to judicial review for third parties. However, given that my recommendations will improve the transparency of regulators' enforcement procedures and policies, I envisage this in turn will reduce the need for regulatory cases to be referred to the Administrative Court.
- 5.42 Finally there is the option of bringing a private criminal prosecution, which individuals may do in most areas of regulation even where the regulator has decided not to commence prosecution. Although the powers are rarely exercised in the regulatory field, I believe the right of private prosecution represents a valuable public safeguard. Mechanisms already exist to prevent abuse and vexatiousness, but I have recommended that in the design of any scheme for VMAPs the Government ensure that businesses are protected from double jeopardy.

### **A further role for Parliament**

- 5.43 As I mention above, regulators are currently accountable to Ministers and Parliament. However, I have some specific suggestions I believe will strengthen these relationships. Many of my recommendations in this area have been previously mentioned by other reports or reviewers and I want to add my endorsement for these. I fully recognise that these recommendations will be for Parliament rather than Government to consider, and I have therefore not formulated them as formal recommendations. Nevertheless, I hope that they will be addressed by Parliament in the context of my other proposals.

## Departmental Select Committees

- 5.44 Departmental Select Committees are the parliamentary bodies responsible for scrutiny of each Government department. Their role is to examine ‘the expenditure, administration and policy’ of the relevant department and its ‘associated public bodies’ and they are the leading bodies assessing the work of independent regulators with sponsoring departments. They serve to challenge and consider annual reports and specific ad hoc issues which are deemed of importance. Departmental Select Committees are widely perceived amongst the regulatory community to be the most important body holding regulators to account.
- 5.45 However, as highlighted in a report by the House of Lords Select Committee on the Constitution, this scrutiny function could be improved further.<sup>89</sup> In the first instance, I would hope that Departmental Select Committees could systematically review the enforcement performance of regulators sponsored by the departments which they scrutinize. My recommendation that regulators publish outcome measures should facilitate this process. To facilitate the scrutiny process by Select Committees, the Better Regulation Executive could, through the Enforcement Working Group I have recommended, work with regulators to create some models of good practice on reporting regulatory outcome measures and enforcement activity, which may make the material more intelligible and user-friendly.

## Select Committee on the regulatory system

- 5.46 Departmental Select Committees work on issues relevant to their specific government department. While this sector specific scrutiny is appropriate in many instances, the cumulative impact of regulatory issues is difficult to capture under such governance arrangements. Both the Hampton Review and my own review have demonstrated that, despite very different legislative structures and institutional arrangements, there are many common issues and challenges in the regulatory field that cut across sectoral boundaries. I support the view of the House of Lords Select Committee in recommending that a joint Parliamentary Select Committee be created to focus on overarching regulatory issues. This recommendation was also endorsed by the Hampton Review.<sup>90</sup>
- 5.47 Such a committee could make a substantial contribution on the evaluation of the extended sanctioning toolkit, and issues pertaining to the regulatory system as a whole. It would not duplicate the work of Departmental Select Committees in examining individual regulators, but would assist in investigating both good and bad practice across the regulatory spectrum, and, in the context of my report, help assess the effectiveness of different sanctioning approaches.
- 5.48 The Parliamentary Select Committee should preferably be a joint committee of both Houses. The functions of this committee could include the right to be consulted over proposals to confer statutory powers and enforcement powers on a new or existing regulator with enough time for its comments to be taken into account during pre-legislative scrutiny.

<sup>89</sup> *The Regulatory State: Ensuring its Accountability*, House of Lords Select Committee, May 2004.

<sup>90</sup> *Reducing administrative burdens: Effective inspection and enforcement*, Hampton, P., HM-Treasury, March 2005. p77 at 4.119.

- 5.49 This committee could also take on additional functions, which fall outside of my remit, but I suggest some options for Parliament to consider.
- Having regard to issues such as the potential duplication or overlap of regulatory activities, the clarity of the hierarchy of regulatory objectives with specific attention to the development of a 'whole of Government' view of regulation;
  - Identify and promote good practice in its role as the Parliamentary counterpart of the Better Regulation Executive within the Cabinet Office;
  - Monitor the consistency and effectiveness of regulators in complying with the Principles of Good Regulation, the Compliance Code (when established) and my Penalties Principles; and
  - Focus on annual reports of regulatory bodies with a view to maintaining the consistency and co-ordination of Parliamentary scrutiny.
- 5.50 I believe it is important for such an over-arching committee to exist in order to institutionalise this scrutiny function over regulators and sponsoring departments across a wide number of regulatory fields. The business community usually interacts with several regulators. At present, the accountability mechanisms that exist are often narrow and sectoral in scope, and therefore have difficulty in assessing the wider consequences of regulatory requirements and their enforcement, both for those that are regulated and society as a whole.

**Recommendation 9:**

I recommend that to ensure improved transparency and accountability:

- The Better Regulation Executive should facilitate a working group of regulators and sponsoring departments to share best practice in enforcement approaches, the application of sanction options, development of outcome measures and transparency in reporting. Regulators and sponsoring departments should work with the Executive to include outcome measures as part of their overall framework of performance management.
- Publish Enforcement Activities – Each regulator should publish a list on a regular basis of its completed enforcement actions and against whom such actions have been taken.

- 5.51 To further emphasise the importance of transparency and accountability I refer readers back to chapter two where I reinforce two of the characteristics I mentioned. Regulators should:
- Publish an enforcement policy – this policy should be drafted in consultation with both the regulated community and wider stakeholder groups where appropriate.
  - Outcome measures – regulators alongside sponsoring departments should work, in consultation with stakeholders to determine meaningful outcome measurements which can assist in the achievement of regulatory objectives. These outcome measures and the extent to which they have been achieved should be reported in the regulator's annual report.
- 5.52 Where I suggest publishing enforcement activities, this can be in the form of a database on a website, through a press release, or other appropriate means for the dissemination of such information, in accordance with the relevant data protection rules. This can further promote the risk based approach to regulation as there would be more information on compliant and non-compliant businesses and this would better inform risk assessment frameworks. The increased information on compliant and non-compliant businesses will further promote transparency, by providing regulators with more information to take targeted enforcement actions on business that break the rules and allowing good businesses a light touch.

## Chapter six

### Summary of recommendations

**This chapter is a summary of my recommendations.**

#### Introduction

- 6.1 This chapter summaries my recommendations that have appeared in the previous five chapters of this report. I want to highlight that reforms to the sanctioning regimes are an essential feature of a risk based approach to regulation envisaged by Philip Hampton in his report. Having an effective and credible sanctioning system should result in the need for less routine inspections on compliant businesses and allow regulators to focus attention on those businesses who fail to comply with the law. Most breaches identified in a risk based system, should face penalties that are quicker and more proportionate to the offence, while there will continue to be tough criminal sanctions for those offenders who persist in rogue trading activity.
- 6.2 The recommendations in this report suggest that regulators should have access to a more flexible sanctioning toolkit. It is important that only regulators who are following the risk based approach should gain access to these sanctions. That is why I have qualified many of my recommendations with a need for regulators to demonstrate that they are compliant with both the Hampton and Macrory Principles. The Regulators' Compliance Code takes Hampton's seven principles, which support a risk based approach to regulation (such as inspections being risk based, regulators sharing data between them, sanctions being proportionate and meaningful) and puts them on a statutory footing under Part Two of the Legislative and Regulatory Reform Act 2006). Regulators will have a statutory duty to have regard to the Compliance Code as it relates to their enforcement activity. The government intends to issue the Code and accompanying guidance after further consultation with regulators and the regulated community and after necessary Parliamentary scrutiny (as laid out in the Act).
- 6.3 The Better Regulation Commission have recently published a report on risk, entitled *Risk, Responsibility and Regulation – Whose risk is it anyway?* Recommendation Four of this report has commented on the need to identify what are the principle risks regulators are protecting against and what regulatory outcomes regulators are trying to achieve. This is very much in line with my own thinking and I have also recommended that regulators look beyond outputs to also consider measuring outcomes. Outcome measures will represent a challenge for regulators to identify and determine, but I believe that this is something that Government should strive towards.

### Summary of recommendations

#### Chapter One

1. I recommend that the Government initiate a review of the drafting and formulation of criminal offences relating to regulatory non-compliance.

#### Chapter Two

2. I recommend that in designing the appropriate sanctioning regimes for regulatory non-compliance, regulators should have regard to the following six Penalties Principles and seven characteristics.

## Six Penalties Principles

A sanction should:

1. Aim to change the behaviour of the offender;
2. Aim to eliminate any financial gain or benefit from a non-compliance;
3. Be responsive and consider what is appropriate for the particular offender and regulatory issue, which can include punishment and the public stigma that should be associated with a criminal conviction;
4. Be proportionate to the nature of the offence and the harm caused;
5. Aim to restore the harm caused by regulatory non-compliance, where appropriate; and
6. Aim to deter future non-compliance

## Seven characteristics

Regulators should:

1. Publish an enforcement policy;
2. Measure outcomes not just outputs;
3. Justify their choice of enforcement actions year on year to stakeholders, Ministers and Parliament;
4. Follow-up enforcement actions where appropriate;
5. Enforce in a transparent manner;
6. Be transparent in the way in which they apply and determine administrative penalties; and
7. Avoid perverse incentives that might influence the choice of sanctioning response.

## Chapter Three

3. I recommend that in order to increase the effectiveness of criminal courts for regulatory offences, the following actions should be implemented:
  - The Government should request the Sentencing Guidelines Council prepare general sentencing guidelines for cases of regulatory non-compliance;
  - Prosecutors should always make clear to the court any financial benefits resulting from non-compliance as well as the policy significance of the relevant regulatory requirement;
  - Prosecutions in particular regulatory fields be heard in designated Magistrates' Courts within jurisdictional areas, where appropriate; and
  - Regulators provide specialist training for prosecutors and discuss with the Judicial Studies Board (JSB) contributing to the training of the judiciary and justices' clerks.

4. I recommend that with regards to Monetary Administrative Penalties:
- Government should, consider introducing schemes for Fixed and Variable Monetary Administrative Penalties, for regulators and enforcers of regulations, that are compliant with the Hampton and Macrory Principles and characteristics. This can include national regulators as well as local regulatory partners;
  - Appeals concerning the imposition of an administrative penalty be heard by a Regulatory Tribunal, rather than the criminal courts;
  - Fine maxima for Fixed Monetary Administrative Penalties (FMAP) schemes should be set out and not exceed level five on the standard scale. FMAPs should also be scaled to differentiate between small and large firms; and
  - There should be no fine maxima for Variable Monetary Administrative Penalties (VMAPs).

## Chapter Four

5. I recommend that for an improved system of Statutory Notices:
- Government should consider using Statutory Notices as part of an expanded sanctioning toolkit to secure future compliance beyond the areas in which they are currently in use;
  - Regulators should follow-up Statutory Notices using a risk based approach including an element of randomised follow-up;
  - In dealing with the offence of failing to comply with a Statutory Notice, regulators should have access to administrative financial penalties as an alternative to criminal prosecution. This power should be extended by legislative amendment to existing schemes of Statutory Notices; and
  - Government should consider whether appeals against Statutory Notices should be routed through the Regulatory Tribunal rather than the criminal courts.
6. I recommend that the Government should consider introducing Enforceable Undertakings and Undertakings Plus (a combination of an Enforceable Undertaking with an administrative financial penalty) as an alternative to a criminal prosecution or the imposition of VMAPs for regulators that are compliant with the Hampton and Macrory Principles and characteristics.
7. I recommend that Government introduce pilot schemes involving the use of Restorative Justice techniques in addressing cases of regulatory non-compliance. This might include RJ:
- as a pre-court diversion;
  - instead of a Monetary Administrative Penalty; and
  - within the criminal justice system – as both a pre or post sentencing option.
8. I recommend that the Government consider introducing the following alternative sentencing in criminal courts:
- Profit Order – Where the profits made from regulatory non-compliance are clear, the criminal courts have access to Profit Orders, requiring the payment of such profits, distinct from any fine that the court may impose;

- Corporate Rehabilitation Order – In sentencing a business for regulatory non-compliance, criminal courts have on application by the prosecutor, access to a Corporate Rehabilitation Order (CRO) in addition to or in place of any fine that may be imposed; and
- Publicity Order – In sentencing a business for regulatory non-compliance, criminal courts have the power to impose a Publicity Order, in addition to or in place of any other sentence.

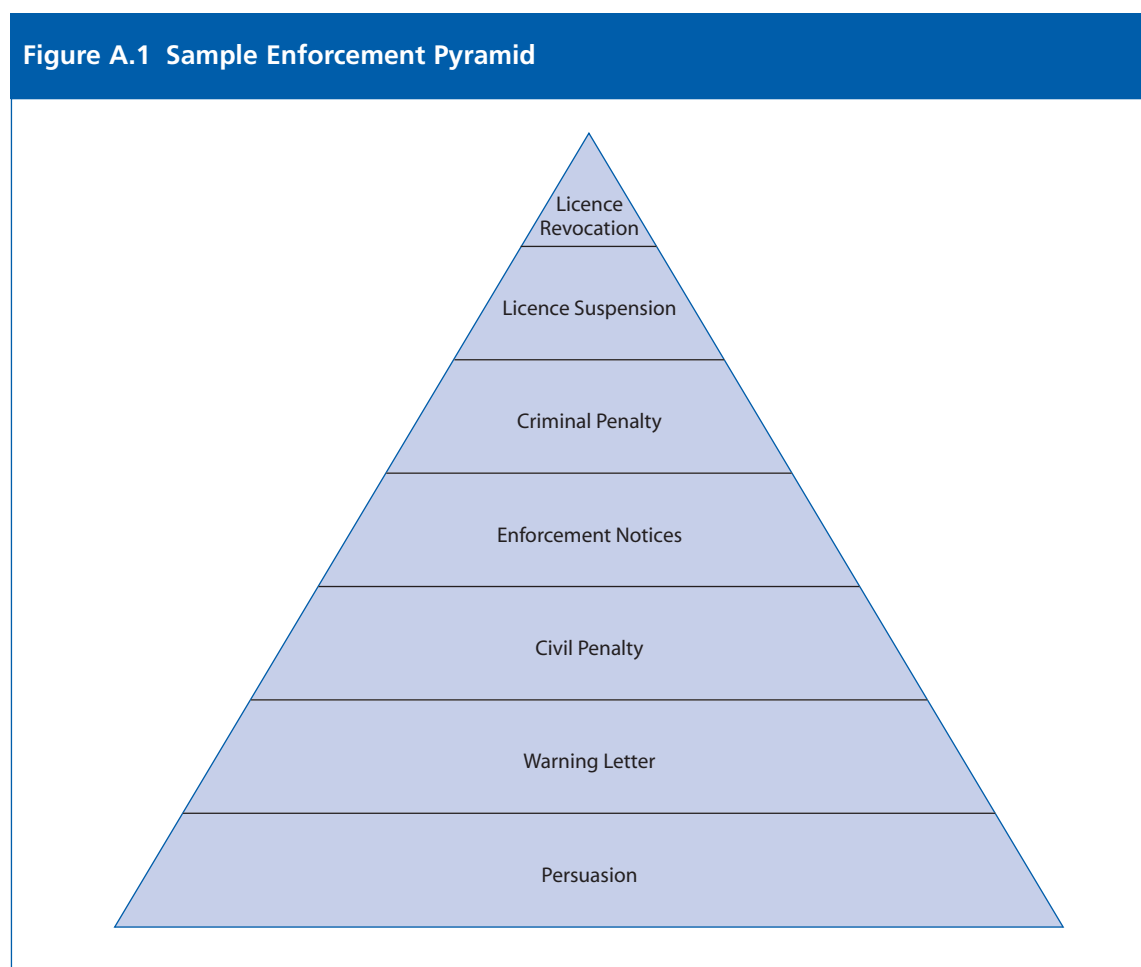
## Chapter Five

9. I recommend that to ensure improved transparency and accountability:
  - The Better Regulation Executive should facilitate a working group of regulators and sponsoring departments to share best practice in enforcement approaches, the application of sanction options, development of outcome measures and transparency in reporting. Regulators and sponsoring departments should work with the Executive to include outcome measures as part of their overall framework of performance management.
  - Publish Enforcement Activities – Each regulator should publish a list on a regular basis of its completed enforcement actions and against whom such actions have been taken.

## Annex A

### Sample Enforcement Pyramid

**A.1** The sample 'enforcement pyramid' below, illustrates the range of sanctioning and penalty powers exercised by regulators. The sample enforcement pyramid does not correspond to the sanctioning powers of any particular regulator, but is a generalised model. Individual regulators have specific and different sanctioning options, depending on the powers provided by the underlying legislation.



**A.2** The enforcement pyramid indicates a range of sanctioning options starting at the least severe at the base of the pyramid. As one moves towards the apex, the enforcement actions increase in severity. Regulators usually choose which level of the pyramid to commence their enforcement action depending on the nature of the offence, the seriousness of the consequences, and the level of intent of the offender.

## Annex B

### The Review's Work

#### The Review

- B.1** The terms of reference for the review were set in September 2005 in agreement with the then Chancellor of the Duchy of Lancaster, John Hutton:
- to set out general principles for the use of penalties in the enforcement of regulation; and to consider
- a.** how sanctions can be changed to ensure that they act as an effective deterrent and eliminate all of the economic benefits of non-compliance;
  - b.** how administrative penalties might best be used to eliminate economic gains and speed up the penalty process;
  - c.** how measures can be taken to enhance consistency between and within penalty regimes;
  - d.** the role of alternative sanctions for regulatory offences such as restitutive and restorative justice;
  - e.** whether there is a role for a regulatory tribunal in the regulatory system; and
  - f.** to make general recommendations on the use of regulatory penalties and specific recommendations for change where that is thought appropriate.
- B.2** The review covers regulatory authorities in England and activity in Scotland, Wales and Northern Ireland where this is carried out by bodies also covering England.

#### The Reviewer

- B.3** Richard Macrory is a Barrister and Professor of Environmental Law at University College London. He holds an MA in Jurisprudence from Oxford University and is a Barrister at Laws, Grays Inn, London, UK. Professor Macrory has held several academic appointments at international academic institutions including Imperial College, Linacre College, University of Oxford, University College London, City University, and University of Melbourne (Australia).
- B.4** Professor Macrory has served as a specialist advisor in Environmental Law to the House of Commons Select Committee on Environment, specialist advisor for the House of Lords Select Committee on the European Communities inquiry into enforcement and implementation of EEC legislation and as a Board member of the Environment Agency.

## Annex C

### The Regulators

This Annex lists all the regulators in the scope of my review, and some notable exceptions. My review follows on from the work of the Hampton Review.<sup>1</sup> For this reason, the scope of my project is, with a few notable additions, very similar to that taken in its forerunner.<sup>2</sup>

#### Different Types of National Regulators

- C.1** The review identified a total of 56 national regulators within its scope, in addition to the regulatory services of local authorities. These national regulators range from very large bodies with a wide range of powers, like the Environment Agency, to small, highly specialised regulators, like the Adventure Activities Licensing Authority.
- C.2** The national regulators in scope can be categorised into four main groups:
- Core Departmental functions;
  - Non-Ministerial Departments;
  - Non-Departmental Public Bodies (NDPBs); and
  - Executive Agencies.
- C.3** The different types of bodies have different legal status, and there are therefore varying constraints on institutional reform.
- C.4** Secretaries of State can change or move *core Departmental functions* administratively, because they are part of the normal Departmental structure. Examples include the DTI's Companies Investigations Branch.
- C.5** Office-holders, boards or commissioners with specific statutory responsibilities head *non-Ministerial Departments*. Their staff are civil servants. The precise nature of their relationship with Ministers varies according to their individual policy and statutory framework. Their structure keeps the day-to-day administration of the particular activity separate from Government, but allows Government input in the wider policy context. Their establishing statutes set out how much their structure can be changed by administrative means. Examples of non-Ministerial Departments include the Food Standards Agency and the Forestry Commission.
- C.6** A *Non-Departmental Public Body* is not part of a government department, and carries out its functions at arm's length from central Government. Ministers are responsible to Parliament for the activities of NDPBs sponsored by their Department and, in almost all cases, Ministers

<sup>1</sup> *Reducing Administrative Burdens: Effective inspection and enforcement*, Hampton, P., HM Treasury, March 2005.

<sup>2</sup> The scope of the penalties review covers a wider range of local authority regulation than Hampton, and also covers the work of the Office of National Statistics. In addition, since the Hampton Review published its final report, some regulators have been merged into other bodies, and some organisations are no longer in scope as their responsibilities have shifted into new organisations. This includes:

- the Horticultural Marketing Inspectorate has merged into the Rural Payments Agency;
- the new Marine Fisheries Agency has taken responsibility for the work of the Sea Fisheries Inspectorate;
- the Gambling Commission has taken over the work of the Gaming Board for Great Britain; and
- the new Pensions Regulator has taken over the work of the Occupational Pensions Regulatory Authority.

make the appointments to their boards. Departments are responsible for funding and ensuring good governance of their NDPBs. NDPBs tend to be set up through statute, and most need primary legislation to alter their institutional framework. Examples include the Environment Agency and the Health and Safety Commission/Executive.

- C.7** An *Executive Agency* is a body that has been set up to carry out a particular service or function within Government and has a clear focus on delivering specific outputs. As with NDPBs, Ministers are ultimately responsible for the work of Executive Agencies. Departments are responsible for funding and ensuring good governance of their NDPBs. Executive Agencies, unless explicitly created by statute, can be reformed without primary legislation. Examples include the Rural Payments Agency and the Meat Hygiene Service.
- C.8** Some national bodies we are considering do not fit into the categories above. The Civil Aviation Authority is a public corporation and the Financial Services Authority is a statutory industry body.

## UK National Regulators in Scope

- C.9** Core departmental functions considered within scope:
- Animals (Scientific Procedures) Inspectorate (HO)
  - Drinking Water Inspectorate (Defra)
  - Egg Marketing Inspectorate (Defra)
  - Employment Agency Standards Inspectorate (DTI)
  - Fish Health Inspectorate (Defra)
  - Global Wildlife Division, including Wildlife Inspectorate, and Wildlife Licensing and Bird Registration Service (Defra)
  - Marine Fisheries Agency, formerly the Sea Fisheries Inspectorate, and Fisheries Directorate (Defra)
  - Pharmaceutical Price Regulation Scheme (DH)
  - Plant Health and Seeds Inspectorate (Defra)
  - Plant Varieties and Seeds Division (Defra)
  - State Veterinary Service (Defra)
- C.10** Non-Ministerial Departments considered within scope:
- Charity Commission for England and Wales
  - Food Standards Agency
  - Forestry Commission
  - Office of Fair Trading
  - Office of Rail Regulation

**C.11** Non-Departmental Public Bodies considered within scope:

- British Hallmarking Council (DTI)
- British Potato Council (Defra)
- Coal Authority (DTI)
- Competition Commission (DTI)
- Disability Rights Commission (DWP)
- English Heritage (DCMS)
- Environment Agency (Defra)
- Equal Opportunities Commission (DCLG)
- Health and Safety Commission / Executive (DWP)
- Hearing Aid Council (DTI)
- Housing Corporation (DCLG)
- Football Licensing Authority (DCMS)
- Gambling Commission, formerly Gaming Board for Great Britain (DCMS)
- Gangmasters Licensing Authority (Defra)
- Home Grown Cereals Authority (Defra)
- Human Fertilisation and Embryology Authority (DH)
- Information Commissioner's Office (DCA)
- National Bee Unit of the Central Science Laboratory (Defra)
- Natural England (Defra)
- The Pensions Regulator, including former Occupational Pensions Regulatory Authority (DWP)
- Sea Fish Industry Authority (Defra)
- Security Industry Authority (HO)
- UK Sport (DCMS)

**C.12** Executive Agencies considered within scope:

- Companies House (DTI)
- Driving Standards Agency (DfT)
- Insolvency Service including DTI Companies Investigation Branch (DTI)
- Maritime and Coastguard Agency (DfT)
- Meat Hygiene Service (Food Standards Agency)
- Medicines and Healthcare Products Regulatory Agency (DH)

- National Weights and Measures Laboratory (DTI)
- Patent Office (DTI)
- Pesticides Safety Directorate (Defra)
- Rural Payments Agency, including Horticultural Marketing Inspectorate, and Agricultural Wages Inspectorate (Defra)
- Vehicle Certification Agency (DfT)
- Veterinary Medicines Directorate (Defra)

**C.13** Other bodies considered within scope:

- Adventure Activities Licensing Authority (funded by DfES)
- Civil Aviation Authority Safety Regulation Group, Aviation Regulation Enforcement Department and Consumer Protection Group (sponsored by DfT)
- Financial Reporting Council (DTI)
- Financial Services Authority
- The Independent regulator for Community Interest Companies (DTI)

**C.14** Economic Regulators considered for comparative purposes only:

- Office of Communications (Ofcom)
- Office of Gas and Electricity Markets (Ofgem)
- Office for Standards in Education (Ofsted)
- Postal Services Commission (Postcomm)
- The Water Services Regulation Authority (Ofwat)

## Notable UK National Regulators out of Scope

**C.15** The following notable Non-Ministerial Departments are considered out of scope:

- HM Revenue and Customs
- Serious Fraud Office

**C.16** The following notable Non-Departmental Public Bodies are considered out of scope:

- Adult Learning Inspectorate (sponsored by DfES)
- Audit Commission (DCLG)
- Commission for Racial Equality (HO)
- Commission for Social Care Inspection (DH)
- Healthcare Commission (DH)

**C.17** The following notable Public corporations considered out of scope:

- Civil Aviation Authority Economic Regulation Group (sponsored by DfT)

**C.18** Since the Review's interim report the number of national regulators within scope has reduced from 60 to 56. This is due to mergers that have been completed as part of the recommendations of the Hampton Review. Mergers completed since the start of the review in September 2005 are :

- Wine Standards Board (Defra) has merged into the Food Standards Agency
- DTI Companies Investigation Branch has merged into the Insolvency Service (DTI)
- The electrical safety inspection functions of the Engineering Inspectorate transferred to HSE, abolishing the Engineering Inspectorate.
- English Nature and the Rural Development Service were merged, along with the Countryside Agency, into Natural England.

**C.19** One body has emerged that would have been considered to be within the scope of the review, had it existed at the outset. This is:

- The Commission for Equality and Human Rights

## Local Authority Regulators in Scope

**C.20** Regulatory functions not carried out at national level are carried out by local authorities with one exception – fire safety – considered separately below. Local authority enforcement considered within the scope of the review includes:

- Environmental Health
- Planning
- Building Control
- Licensing
- Trading Standards and related services

**C.21** Local authorities are responsible for a large proportion of the enforcement of UK regulation. Local authority enforcers in the scope of the Hampton Review carried out approximately 2 million inspections in 2003-04, this compares to 600,000 inspections by national regulators.<sup>3</sup>

**C.22** In general, local authority regulators follow guidance from a national regulator or Government Department. For instance, the Food Standards Agency works with local authorities on food safety and food standards work, and the Office of Fair Trading works with local authorities on trade practices work. Within this framework local authorities retain considerable discretion in the way regulations are enforced within the authority's area.

**C.23** In total there are 468 local authorities in the UK who all have responsibilities for the enforcement of regulation.

<sup>3</sup> *Reducing Administrative Burdens: Effective inspection and enforcement*, Hampton, P., HM Treasury, March 2005, p. 11.

## Composition of Local Authorities

- C.24** For the purposes of regulatory services, English local government bodies can be divided into three types:
- **Counties** – like Lancashire, East Sussex and Devon. Counties are made up of a number of district areas. The smallest county is Shropshire, with a population of 287,900, and the largest is Kent, with a population of 1.4 million.
  - **Districts** – smaller areas within counties. Examples include Copeland (Cumbria), Mid Sussex, and Richmondshire (North Yorkshire). The smallest district is Purbeck (Dorset), with a population of 45,100. The largest is Northampton, with a population of 194,800.
  - **Unitary authorities** – these can be London boroughs, metropolitan boroughs (usually parts of former metropolitan counties), or new-style unitary authorities. Examples include Sefton (a metropolitan borough), Wandsworth (a London borough), Medway and Herefordshire (new-style unitary authorities). Unitary authorities vary considerably in size, from Rutland with only 36,500 people to the city of Birmingham, with 992,400.
- C.25** In Scotland, Wales and Northern Ireland, all local authorities are unitary. In Scotland, Orkney is the smallest authority, with a population of 19,200, and Glasgow is the largest, with a population of 577,400. Wales' smallest authority is Merthyr Tydfil (55,100), and its largest is Cardiff (316,800).<sup>4</sup>
- C.26** In two-tiered authorities (where there are District Councils within a County Council) responsibility for enforcing regulation is split between the County Council and the District Councils. For instance, District Councils are responsible for Environmental Health services with County Councils having no role in this area. In Trading Standards this picture is reversed, with County Councils taking full responsibility for the enforcement. In Unitary Authorities the jurisdiction covers the full range of local authority enforcement work in the relevant geographical area.

## Fire Authorities

- C.27** Fire safety and fire safety inspections are run separately to local authorities' regulatory services by local fire authorities. This enforcement activity is also within the scope of the review.

<sup>4</sup> All population data is for 2004.

## Acknowledgements

- 1 My team and I have carried out various consultations with key stakeholders, through a series of meetings, seminars, and focus groups. We also undertook visits both in the UK and overseas.
- 2 I would like to thank the following organisations and individuals for their contribution over the course of my review:
  - Carolyn Abbot, University of Manchester
  - Administrative Review Council, Australia
  - American Chemistry Council
  - American General Council
  - AMICUS
  - Asda
  - Association of British Travel Agents
  - Association of Master Bakers
  - Attorney-General's Department, Australia
  - Australian Competition & Consumer Commission
  - Australian Law Reform Commission
  - Australian National University Regulatory Institutions Network
  - Australian Securities & Investment Commission
  - Robert Baldwin, London School of Economics and Political Science
  - Birmingham City Council
  - Julia Black, London School of Economics and Political Science
  - Boots Group Plc.
  - John Braithwaite, Australian National University
  - British Bankers' Association
  - British Chamber of Commerce
  - British Embassy, Berlin, Germany
  - British High Commission, Canberra, Australia
  - British High Commission, Ottawa, Canada
  - British Retail Consortium
  - The Brookings Institution, Washington, D.C., USA
  - Bundesverband verbraucherzentrale (Federation of German Consumer Organisations)
  - Cattles Plc.

- Centre for Corporate Accountability
- Charity Commission
- Chartered Institute of Environmental Health
- Chemical Industries Association
- Citizens Advice Bureau
- Civil Aviation Authority
- Commission for Judicial Appointments
- Companies House
- Competition Appeal Tribunal
- The Confederation of British Industry (CBI)
- Conwy County Borough Council Public Protection Services
- Co-Operative Group
- Council of Civil Service Unions
- Council on Tribunals
- Department for Communities and Local Government (DCLG)
- Department for Environment Food and Rural Affairs (Defra)
- Department for Transport (DfT)
- Department for Works and Pension (DWP)
- Department of Constitutional Affairs (DCA)
- Department of the Environment and Heritage, Australia
- Department of Trade and Industry (DTI)
- Derby County Council
- Doncaster Metropolitan Borough Council
- Dundee City Council
- East Sussex County Council
- Environment Agency
- Environmental Industries Commission
- Environmental Law Institute, Washington, D.C., USA
- Janice Evans, Independent Restorative Justice Practitioner
- Fair Process Ltd.
- Federation of German Industries (BDI)
- Federation of Small Businesses
- Financial Reporting Council

- Financial Services Authority
- Food Standards Agency
- Forum of Private Business
- Freshfields Bruckhaus Deringer
- Friends of the Earth
- Gangmasters Licensing Authority
- Government Accountability Office, Centre for Economics (Applied Research and Methods) Washington, D.C., USA
- General Medical Council
- General Optical Council
- Georgetown Environmental Law & Policy Institute, Washington, D.C., USA
- German Federal Institute of Risk Assessment (BfR)
- German Federal Ministry of Justice
- German Federal Office of Consumer Protection and Food Safety (BVL)
- Glasgow City Council
- Peter Grabosky, Australian National University
- Cosmo Graham, University of Leicester
- Greater Manchester Hazards Centre and Hazards Campaign
- Greenpeace
- Guildford County Council
- Neil Gunningham, Australian National Research Centre for Occupational Health & Safety Regulation
- Haemolytic Uraemic Syndromes Help (HUSH)
- Hampshire County Council
- Keith Hawkins, Oriel College, Oxford
- Health and Safety Executive/Commission
- Hearing Aid Council
- HM Courts Service
- HM Revenue and Customs
- HM Treasury
- Home Office
- Huntswood Consulting
- Hessen Administration for Soil Management and Geo Information (HVBG)

- Bridget Hutter, Centre for Analysis of Risk and Regulation, London School of Economics and Political Science
- INEOS Vinyls UK Ltd.
- Institute of Chartered Accountants
- Institute of Criminology, Australia
- Institute of Directors (IoD)
- Judicial Studies Board
- Justices' Clerks' Society
- King's College London
- Kirklees Council
- Law Commission
- Law Society
- Local Authorities Coordinating Office on Regulatory Services (LACORS)
- Local Authority Building Control (LABC)
- Local Government Association (LGA)
- London Borough of Camden
- London Borough of Hellington
- London Hazards Centre
- London Probation
- Magistrates' Association
- Maldon Council
- Medicines and Healthcare products Regulatory Agency (MHRA)
- Middlesbrough Council
- Nacro
- National Consumer Council
- National Security Inspectorate
- National Weights and Measures Laboratory
- Newham Youth Offending Team
- NHS Counter Fraud and Security Management Service
- New South Wales Land and Environment Court, Australia
- Office of Communications (Ofcom)
- Office of Fair Trading (OFT)
- Office of Gas and Electricity Markets (Ofgem)

- Office for National Statistics (ONS)
- Office of Rail Regulation (ORR)
- Office of the Scottish Charity Regulator
- Anthony Ogus, University of Manchester
- Ontario Energy Board, Canada
- Ontario Ministry of Labour, Canada
- Ontario Ministry of Natural Resources, Canada
- Ontario Securities Commission, Canada
- Organisation of Economic Co-operation and Development (OECD)
- The Pensions Regulator
- Pesticides Safety Directorate
- Philip Thomas, City University
- Postal Services Commission (Postcomm)
- Public and Commercial Services Union
- Quakers
- Queen's University, Belfast
- Radio, Electrical & Television Retailers Association (RETRA)
- Rail Safety and Standards Board (RSSB)
- Restorative Justice Consortium
- Restorative Solutions
- Rio Tinto Plc.
- Mark Rowland, Chairman, Care Standards Tribunal
- Royal Borough of Windsor and Maidenhead
- Royal Society for the Prevention of Accidents (RoSPA)
- Rural Development Service
- Scottish Environment Protection Agency (SEPA)
- Scottish Executive
- Sheffield Chamber of Commerce & Industry
- Shepway District Council
- Sidley Austin LLP
- Simon Jones Memorial Campaign
- Andrew Simester, University of Nottingham
- Small Business Service

- The Society of Chief Officers of Trading Standards in Scotland (SCOTSS)
- State of Vermont Environmental Court, USA
- Suffolk Council Trading Standards
- Hearn Taylor Associates
- Thames Valley Police
- Three Rivers District Council
- Trade Unions Congress (TUC)
- Trading Standards Institute
- The Treasury, Australia
- The Tribunal Service
- Treasury Solicitors Department
- United Kingdom Environmental Law Association (UKELA)
- University College London (UCL)
- U.S. Department of Justice
- U.S. Environmental Protection Agency
- U.S. Small Business Administration
- Vale Royal District Council
- Vehicle and Operator Services Agency (VOSA)
- Washington College of Law, Washington D.C., USA
- The Water Services Regulation Authority (Ofwat)
- Waverley Borough Council
- West Lindsey District Council
- Which?
- Wilkinson
- Gerd Winter, University of Bremen
- WorkCover New South Wales, Australia
- WRc plc
- Yorkshire & Humber Chambers of Commerce
- Yorkshire Water

## Annex D

### Submissions

D1. The following individuals and organisations made submissions to the review:

- Amicus
- Association of Convenience Stores
- Babergh District Council
- Better Regulation Commission
- Birmingham City Council
- Julia Black, London School of Economics and Political Science
- Brian Williams, De Montford University
- Brighton Magistrates' Court
- British Cement Association
- British Chambers of Commerce
- British Potato Council
- British Retail Consortium
- Buckinghamshire County Council
- Cambridge City Council
- Camelot
- Cardiff Magistrates' Court
- Cattles plc.
- Central England Trading Standards Authorities (CEntSA)
- Charity Commission
- Chartered Institute of Environmental Health
- Chemical Industries Association
- Citizens Advice Bureau
- Companies House
- Competition Commission
- Consumer Council for Water
- Conwy County Borough Council Public Protection Services
- Co-Op Group
- Council of HM Circuit Judges
- Council on Tribunals
- Department for Communities and Local Government (DCLG)
- Department for Environment Food and Rural Affairs (Defra)
- Department of Constitutional Affairs (DCA)

- Department of Health (DH)
- Department of Trade and Industry (DTI)
- East of England Trading Standards
- Eastleigh Council
- Enfield Borough Council
- Engineering Employers Federation (EEF)
- Environment Agency
- Environment and Heritage Service
- Environmental Industries Commission (EIC)
- Environmental Services Agency
- Federation of Small Businesses
- Financial Reporting Council
- Financial Services Authority
- Food Standards Agency
- Foodaware
- Gangmasters Licensing Authority
- Gateshead Council
- General Optical Council
- Glasgow City Council
- Graham Bouckley
- Health and Safety Commission
- Health and Safety Executive (HSE)
- Huntswood Consultancy
- Institute of Directors (IoD)
- Justices' Clerks' Society
- Law Society
- Local Authority Building Control (LABC)
- Local Authorities Co-ordinating Office on Regulatory Services (LACORS)
- Local Government Employers
- London Borough of Camden
- London Hazards Centre
- Magistrates' Association
- Manchester City Magistrates Court

- Medicines & Healthcare products Regulatory Agency (MHRA)
- National Consumer Council
- National Union of Farmers
- National Weights and Measures Laboratory
- Network Rail
- NHS Counter Fraud and Security Management Service (CFSMS)
- North East Trading Standards Association
- Office for National Statistics
- Office of Communications (Ofcom)
- Office of Fair Trading (OFT)
- Office of Gas and Electricity Markets (Ofgem)
- Office of Rail Regulation (ORR)
- Office of the Deputy Prime Minister (Planning)
- Office of the Scottish Charity Regulator (OSCR)
- Anthony Ogus, University of Manchester
- Pennon Group Plc.
- Pesticides Safety Directorate
- Peter Howsam, Cranfield University
- Postal Services Commission (Postcomm)
- PricewaterhouseCoopers
- Professional Contractors Group
- Radio Electrical and Television Retailers Association (RETRA)
- Rail Safety & Standards Board
- Restorative Justice Consortium
- Scottish Environment Protection Agency (SEPA)
- Scottish Trades Union Congress (STUC)
- Security Industry Authority
- Simon Jones Memorial Campaign
- Small Business Council
- Small Business Service
- South West England Coordination of Trading Standards (SWERCOTS)
- Suffolk County Council
- The Confederation of British Industry (CBI)

- The Society of Chief Officers of Trading Standards in Scotland (SCOTSS)
- The Water Services Regulation Authority (Ofwat)
- Trades Union Congress (TUC)
- Trading Standards East Midlands
- Trading Standards in Scotland (SCOTSS)
- Trading Standards Institute
- Trading Standards South East
- United Kingdom Environmental Law Association (UKELA)
- US Department of Justice
- US Environmental Protection Agency
- Wrexham Council
- Karen Yeung, St Anne's College, Oxford University
- Yorkshire and The Humber Regional Trading Standards Group
- Yorkshire Water

## Annex E

### Acronyms and Abbreviations

ACCC	Australian Competition and Consumer Commission
ALRC	Australian Law Reform Commission
AMP	Applied Monetary Penalties
ARA	Assets Recovery Agency
BRC	Better Regulation Commission
BRE	Better Regulation Executive
BRTF	Better Regulation Task Force
BVL	Bundesamt für Verbraucherschutz und Lebensmittelsicherheit
CBI	Confederation of British Industry
CC	Competition Commission
CEO	Chief Executive Officer
CJS	Criminal Justice System
CPS	Crown Prosecution Service
CRO	Corporate Rehabilitation Orders
DCA	Department of Constitutional Affairs
DCLA	Department for Communities and Local Government
DCMS	Department of Culture, Media and Sport
Defra	Department for Environment, Food and Rural Affairs
DfES	Department of Education and Skills
DfT	Department of Transport
DH	Department of Health
DPP	Director of Public Prosecutions
DTI	Department of Trade and Industry
DWP	Department of Work and Pensions
EASI	Employment Agency Standards Inspectorate
EEC	European Economic Community
EPs	Environmental Penalties
EPA	Environmental Protection Agency
EU	European Union
EUs	Enforceable Undertakings
EWCA	England and Wales Court of Appeal
FAO	United Nation's Food and Agriculture Organization
FMAP	Fixed Monetary Administrative Penalties
FSA	Financial Services Authority
FSMA	Financial Services and Markets Act
GOC	General Optical Council
HO	Home Office
HSC	Health and Safety Commission
HSE	Health and Safety Executive
HSWA	Health and Safety at Work etc. Act 1974
IC	Information Commissioner's Office
IMPEL	Implementation and Enforcement of Environmental Law
IoD	Institute of Directors
IR	Inland Revenue (now HM Revenue & Customs)
LABC	Local Authority Building Control

LACORS	Local Authorities Coordinating Office on Regulatory Services
LGA	Local Government Association
MAP	Monetary Administrative Penalties
MHRA	Medicines and Healthcare products Regulatory Agency
NDPB	Non-Departmental Public Body
NHS	National Health Service
NSW	New South Wales, Australia
OECD	Organisation for Economic Co-operation and Development
OFGEM	Office of Gas and Electricity Markets
OFT	Office of Fair Trading
OFWAT	The Water Services Regulatory Authority
ONS	Office for National Statistics
ORR	Office of the Rail Regulator
OSHA	Occupational Safety and Health Administration (USA)
POCA	Proceeds of Crime Act 2002
POSTCOMM	The Postal Services Commission
RETRA	Radio, Electrical and Television Retailers
RJ	Restorative Justice
ROSPA	Royal Society for the Prevention of Accidents
RSPCA	Royal Society for the Prevention of Cruelty to Animals
RSSB	Rail Safety and Standards Board
SBS	Small Business Service
SCOTSS	Trading Standards in Scotland
SEPA	Scottish Environment Protection Agency
SI	Statutory Instruments
SIA	Security Industry Authority
TUC	Trades Union Congress
UCL	University College London
UKELA	United Kingdom Environmental Law Association
VMAP	Variable Monetary Administrative Penalties
VOSA	Vehicle and Operative Services Agency
WLR	Weekly Law Reports

## Annex F

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