

## **CBI RESPONSE TO THE 'REGULATORY JUSTICE: SANCTIONING IN A POST-HAMPTON WORLD' CONSULTATION DOCUMENT**

**August 2006**

1. The CBI welcomes the opportunity to respond to the 'Regulatory Justice: sanctioning in a post-Hampton world' consultation document and re-emphasise some of the points that we made in our response to the Review's December 2005 discussion paper. The CBI would like to stay involved in the work of the Review team as the Review progresses.
2. The Confederation of British Industry (CBI) is the national body representing the UK business community. It is an independent, non-party political organisation funded entirely by its members in industry and commerce and speaks for some 240,000 businesses that together employ around a third of the UK private sector workforce. The CBI's membership includes 80 of the FTSE 100, some 200,000 small and medium-sized firms, more than 20,000 manufacturers and over 150 sectoral associations.

### **Introduction**

3. Business wholeheartedly supports the philosophy of a risk-based approach to regulation and regulatory compliance and enforcement. A risk-based approach must mean that the regulatory environment is focused on ensuring compliance. Inspections should take place only when justified, and not as a matter of arbitrary routine, and ultimately, sanctions should be targeted at, and be an effective deterrent to, those considering deliberate illegal activity. Inherent in an effective and respected penalty system should be all the components of open justice, not least proper standards of proof, equitable defences, a full and transparent appeals mechanism and appropriate separation of powers, as between judge and jury. Businesses should not face the risk of unsubstantiated damage to their reputation until, and unless, proven guilty. There should be a public commitment by enforcers that they will encourage compliance in a positive way and only use penalties when absolutely necessary.



4. The Macrory Review is part of the agenda established by the recommendations in the Hampton Review report and will gain the support of responsible and compliant businesses if, and only if, it delivers: a risk-based and light-touch approach to regulation and enforcement, as recommended by Hampton, coupled with a culture change resulting in regulators capable of delivering a common and business-friendly 'culture'. In short, regulators must adopt a joined-up and consistent approach to enforcement decisions and inspection, and encourage compliance in a positive way.
5. There remains a general concern among CBI members that the current Review is 'putting the cart before the horse' by looking at ways of changing and adding to the current penalty system, rather than concentrating in the first place on how the structures already in place can be improved. It is important that the review of the penalty system is part of, and fits in with, the overall Hampton agenda. Changes to the penalty system should therefore not be made until other Hampton reforms have been implemented and taken effect, for example the Local Better Regulation Office and the new Compliance Code.
6. CBI members have also expressed a concern that the consultation paper does not provide enough detail on how the proposed changes to the penalty system will work in practice. For example, lack of clarity regarding when and how new sanctions would apply and standards of proof, could easily lead to further inconsistencies in the penalty system. The language used, for example in the sections regarding restorative justice and enforceable undertakings, is complex and there seems to be extensive overlap between these two sections of the consultation document. At what stage of the review will the practicalities and details of the proposed, 'modernised' penalty system be worked out? CBI members are keen to be kept informed and involved in this process.
7. The CBI's response to the Review's December 2005 discussion paper expressed our concerns about the balance of interests on the Review team. Seeing that a majority of responses to the discussion paper came from regulators, we feel obliged to caution against any bias in the final recommendations of the Review team. It is essential for the credibility of the future penalty system that equal consideration is given to issues of concern for both regulators and regulated organisations.

**The Hallmarks of a Good Penalty System According to CBI Members: or what it will take to create a penalty system that corresponds to the 'Hampton view'**

8. What business wants are clarity and certainty and a regulatory and enforcement regime that is effective, efficient and joined-up and works to high standards of consistent delivery.
9. The CBI agrees with, and would like to see the application in practice of, the five principles of good regulation set out by the Better Regulation Task Force (now the Better Regulation Commission) in its "Principles of Good Regulation leaflet" (first published in 1998 and revised in 2000). We think that these principles should inform the work of those involved in regulatory reform and be used as benchmarks for assessing whether progress has been made in improving the regulatory environment.

10. Therefore, the CBI believes that the following, and interrelated, guiding principles should inform recommendations for improving the penalty system:

➤ **Proportionality**

The consultation document states that the Review was set up ‘to examine the system of regulatory sanctions to ensure that these were consistent and appropriate for the risk-based approach to regulation set out in the Hampton Review’. Employing a risk-based approach to regulation would be one step towards ensuring proportionality in regulators’ use of the penalty system.

The CBI supports a risk-based approach to regulation in general. For such an approach to work within the framework for the penalty system, it is necessary that regulators and inspectors can distinguish hazard from well-managed risk. To do this, regulators and inspectors must have an understanding of the businesses they are regulating.

The Hampton Review importantly pointed out that carrying out risk assessments allows regulators to take proper account of the nature of businesses. Information gained through risk assessments should support regulators in their decisions regarding inspections and data requirements and help them direct resources to where they can do most public good. This could end unnecessary inspections of less risky businesses. Consequently, resources not used on unnecessary actions could instead be used to improve services aimed at enhancing compliance, for example, advice and information services and working with business to explain in practical terms what they need to do to be compliant.

Regulations must be policed cost-effectively. The Hampton interim report stated that the total annual budget of the regulators covered by the Hampton Review is £4.3 billion, most of which comes from government. As with all government spending on tax-funded public services, a top priority should be value for money. It is essential that public funds be spent effectively, with real, lasting improvements in services delivered. So, ensuring that enforcement activities are proportionate would also contribute to securing better value for money.

It is also important to ensure that appropriate resources are made available to inspectors in order for them to make the systems within which they operate work effectively. The CBI would like to see an appropriately resourced enforcement service with a professional structure that attracts high-calibre staff and increased efforts to ensure that resources are used effectively.

In certain areas, for example some areas of environmental regulation, companies pay to be regulated. As these companies are the ‘customers’ of regulators, they expect a high quality service. For example, the cost of obtaining an environmental permit for a complex chemicals installation is well over £100,000, followed by a £30,000-£40,000 annual charge.

In addition, and fundamental to making a risk-based approach to regulation work, is the understanding that inherent in such an approach is the acceptance that, from time to time, things will go wrong. Hence, there must be sufficient political will to see this approach through. Where a situation arises, for whatever reason, at a company that has been considered 'low-risk' and has not been inspected for some time as a consequence, there will inevitably be public pressure on regulators and the Government to 'do something'. Business would like some assurance that in such a scenario the risk-based approach to regulation will not be abandoned.

### ➤ **Targeting**

If enforcement activity is risk-based and inspection takes place only when justified, it should be possible to target resources at dealing with persistent, and deliberate, offenders rather than normally compliant businesses that may on occasion unintentionally fail to comply.

One of the main difficulties that has not yet been addressed by the Review is how to distinguish between deliberate non-compliance and gross negligence or intentional and unintentional breaches of the law. CBI members would like an explanation of how, in practice, regulators will make this distinction.

The regulatory regime must be an effective deterrent to those considering illegal activity. This is important for ensuring fair competition and efficient operation of open markets. Rogue traders, who intentionally set out to flout the law, should be punished and deterred from future illegal activity. However, it is important for the credibility of the penalty system that normally compliant and responsible businesses that may on occasion unintentionally fail to comply, or breach technical regulations, do not become 'soft targets' for enforcement activities.

There is a feeling among responsible and compliant business that, because of lack of resources and expertise or knowledge of industry within regulators, enforcement officers fail to identify who the rogues in each sector are. Instead, responsible businesses that report incidents and accidents as prescribed by regulations, are targeted and penalised. For example, statistics from the Health and Safety Executive show that 80% of reported accidents result in prosecution. However, there is no evidence that those companies that fail to report, which is an offence in itself, are punished.

### ➤ **Transparency**

The aim of regulation should be prevention of harm. Consequently, transparency in the penalty system must mean that regulated businesses have access to information and practical advice and guidance. These are key parts of ensuring compliance and the use of these 'tools' should always be the first step in regulators' work to encourage business to comply with regulation.

A commitment to securing compliance through education and discussion with business would be in line with the Hampton principles. However, this is one of the areas where there seems to be most need for improvement by all regulators.

Information and guidance on requirements for complying with regulations and how this translates into practical terms has to be made available to business seeking it. CBI members have reported that responses from regulators to queries can be very slow and sometimes an adequate answer is never obtained. For the system to work, business must have a guarantee that where advice is sought for specific applications, adequate responses will be provided within a reasonable time-frame and that firms will not be subject to retrospective judgement in cases where advice has not been available.

This is especially important where regulators are adopting a principle-based approach to regulation. When operating within a principle-based regime, firms require clear and definitive guidance on what behaviour is, or is not, acceptable. Regulators must be prepared to provide such guidance.

In addition, there must be greater recognition of discussion and involvement with business as essential parts of an efficient and effective regulatory enforcement strategy. This would encourage compliance, as firms could be allowed to explain to regulators how they have assessed risks and why their assessment might be appropriate for the situation. The reasons why a company has failed to comply and follow guidance have to be given due consideration. It would also allow regulators to tap into the wide-ranging pool of expertise that exists in companies about how to deal with regulated areas of business.

Firms and regulators should be able to decide together what the optimum way of handling risk is. The aim should always be to strive for optimum risk management action and regulators must have discretion to use different options and available 'enforcement tools', including the option not to prosecute. This option would be especially important when enforcement officers are dealing with unintentional non-compliance and settling the case through negotiation will ensure better risk management. Companies that need advice should not fear that by seeking it, they would attract enforcement activity or a penalty such as an administrative fine.

Enforcement officers should also be encouraged to work constructively with business to give them a period of time to achieve compliance standards, an approach that would be consistent with the Hampton Review ethos. Prosecution should never be the automatic consequence of compliance failure. The option to prosecute should, as far as possible, be reserved for use against rogues who engage in deliberate illegal activity.

According to the consultation document, the principal purpose of the Review is not a blanket strengthening of penalty regimes. In keeping with the spirit of this statement, the CBI would argue that there must be positive incentives and rewards for good behaviour to encourage businesses to comply with regulations. Positive incentives and rewards would complement an enforcement regime where regulators provide advice and information on compliance requirements to business.

The Hampton Review stated that regulators lack effective tools to punish persistent offenders and reward compliant behaviour by business. Unfortunately, the Macrory Review seems to have placed its emphasis on the former issue and left out the discussion about positive incentives to encourage compliant behaviour.

The CBI would encourage the Review team to take forward work in this area, both with regard to the extent of individual incentives, for example reduction in regulatory charges, and to the range of incentives that might be deployed, for example, fewer inspections together with lower charges.

### ➤ **Consistency**

Consistency in terms of approach and decisions by regulators is key to the effectiveness of and trust in a regulatory regime. CBI members repeatedly report incidents of inconsistent enforcement decisions by the same regulator and inconsistency between national and local level. Different individuals seem to take different approaches to enforcement. Such inconsistency is unacceptable in a penalty regime as it fosters lack of trust in the system. There is also a need for clarification in terms of when and where penalties will be used.

Another key point is clarity and consistency with regard to interpretation of legislation and regulation. It is a concern for businesses that they in many cases receive contradictory or vague information from regulators, sometimes from different officials within the same regulator, regarding how regulations should be translated into practical terms. This leaves companies uncertain as to what actions they need to take to comply with regulations and their legal standing.

### ➤ **Accountability**

Business wants to see the application of sound principles of justice. These include proper defence rights based on established due diligence principles, a robust right to appeal and risk assessment in cases where sanctions are used against a business.

For each penalty there must be a comprehensive and meaningful appeals process. Existing appeals mechanisms are frequently insufficient on their own to address businesses' concerns about regulatory decision-making. The magnitude of management time and costs required to launch an appeal in comparison to the size of the penalty sometimes dissuade business from mounting an otherwise justifiable challenge to regulators' decisions. In addition to financial cost, the risk to a firm's reputation must also be taken into consideration. Reputation is extremely important to all responsible businesses and there must be a guarantee that businesses launching an appeal do not risk unsubstantiated damage to their reputation until, and unless, proven guilty.

CBI members have also expressed concern that in some cases there is no clear separation of powers in terms of who drafts regulations and who enforces them. In cases where regulators are given the powers to both draft regulations and related guidance for enforcement and act as the enforcer, they have quite significant scope to interpret the law in ways that fit their purposes but may not necessarily coincide with the ultimate aim of preventing harm.

To avoid such situations, the CBI believes that it is a key responsibility of Central Government to issue clear guidance to all regulators on the interpretation of legislation and its objective, for example, in terms of social and environmental objectives.

## **Answers to Specific Consultation Questions**

### **1. Do you agree that criminal prosecution and the criminal courts should be reserved for the truly egregious offenders or where regulatory breach leads to severe actual or potential external consequences?**

1. Yes, and the CBI has submitted evidence on this particular point to the Home Office with reference to the creation of an offence of Corporate Manslaughter.

### **2. Do you agree with the vision that is laid out in Figure 1.3 of a contemporary regulatory enforcement toolkit?**

1. The view among CBI members is that the Macrory Review should concentrate, in the first place, on how the penalty structures already in place can be improved and brought into line with the 'Hampton ethos' and not on how to add to the current penalty regime.
2. The penalty system, as it stands, does not necessarily target rogue traders who are unlikely to respect any system of enforcement. It is important that enforcement officers have a range of sanctions to use against non-compliant businesses. However, increasing the number of sanctions available to regulators, particularly administrative penalties, is unlikely to have an effect on the compliance record of rogue traders and is more likely to lead to normally compliant firms being penalised more frequently.
3. The consultation document talks about providing regulators with 'a more flexible toolkit'. The CBI would like further clarification as to whether 'flexibility' in this context means giving regulators 'additional sanctions' or 'alternative sanctions'.
4. The business view is that regulators already have enough tools to use to penalise non-compliant business. There are fines for not so serious breaches of the law by normally compliant businesses that may fail to comply with regulation in individual cases and the option of prosecuting non-compliant businesses before a Magistrates' Court. Or, for example, within the area of Health and Safety, there are such systems as employers' liability compulsory insurance and civil liability in place. There is also already a 'toolkit' in place for dealing with real rogues and more serious incidents in the form of both civil and criminal law.

5. At the moment, the business view is not that current problems in the penalty system are a result of regulators not having enough ways of penalising business. The problem is rather, as discussed above, one of inconsistency in regulators' use of these measures and how they interact with business and a lack of proper targeting. Also, imposing fines or prosecuting business should always be a last resort and penalties for transgression must be proportionate to the infringement.
6. If the proposed 'more flexible toolkit' means giving regulator alternative sanctions, the CBI believes that these must be carefully reviewed against the current span of sanctions. We would also like further detail from the Review team on how the alternative sanctions are more effective or efficient in terms of outcome than existing ones.
7. Any new or alternative sanctions will only be feasible in practice and applied proportionately and consistently if the enforcers are knowledgeable about relative risk scenarios, business needs and activities and can communicate legal objectives effectively with employers, employees and others.
8. Especially in the area of environmental legislation, there is great concern about the introduction of further civil penalties. Matters related to environmental legislation are complex and require careful adjudication and cannot be properly addressed by way of civil penalties. There is also a concern among CBI members that increased use of civil penalties would give enforcement officers too many discretionary powers. Instead, the effectiveness of the current environmental regime would be increased if more training were given to Magistrates and other who are expected to judge in related cases.

**3. Do you agree or disagree with the 'Penalties Principles' proposed in chapter one? If you disagree with one or all of the Principles listed below, please elaborate?**

- a. Principle # 1 – Sanctions should **change the behaviour** of the offender to prevent regulatory non-compliance.
- b. Principle # 2 – Sanctions should **eliminate any financial benefit** or benefit which was the result of regulatory non-compliance.
- c. Principle # 3 – Sanctions should be **responsive and take into account what is appropriate for the particular offender and the particular regulatory issue**.
- d. Principle # 4 – Sanctions should be **proportionate** to the nature of the offence and the harm caused
- e. Principle # 5 – Sanctions should include an element of ensuring that the **harm caused by regulatory non-compliance is put right**.
- f. Principle # 6 – Sanctions should aim to **deter future non-compliance**.

1. In general, the CBI would agree with these principles. However, If the Macrory Penalties Principles and framework for applying penalties are to be included in the final recommendations of the Review, effort must be put into ensuring that they will be consistent, and not overlap, with the proposed new Compliance Code framework for enforcement activity.
2. The CBI has supported the 1998 Enforcement Concordat and thinks that it, or a similar statement of enforcement principles, has a significant role to play to ensure that regulatory enforcement is as consistent as possible within and among national bodies and local authorities. We have advocated for the Concordat principles to be placed on a statutory footing to ensure its effectiveness.

3. The CBI has welcomed the proposal of a statutory Compliance Code. However, because the Code is directed to regulators, we have argued that the Enforcement Concordat principles, written for enforcement officers, should be incorporated into the Code in order to secure more consistent enforcement decisions 'on the ground'. The CBI will stay fully engaged in the work now being carried out to draft a new Compliance Code.
4. The CBI would like this ongoing work to result in one concise statement of enforcement principles, based on the Enforcement Concordat principles and the principles of good regulation, setting out in clear terms the factors that should inform all regulators' and enforcement officers' approaches to enforcement, including applying penalties, and dealing with business. Such a statement could greatly improve the way the current enforcement regime operates. It would also mean that both business and regulators could be penalised if they fail to follow the rules.
5. In terms of targeting and punishing offenders there needs to be clear reference to scale or proportionality or a clear statement of the steps that should be taken prior to a prosecution being mounted. The aim should be a consistent enforcement policy applied nationally, taking into account the risk assessment principles.
6. In summary, if the principles of good regulation and good enforcement were put into a statutory Enforcement Concordat or Compliance Code and coupled with an emphasis on flexibility, dialogue and provision of information, advice and guidance by regulators to business, the CBI believes that this would result in higher compliance levels and thus fewer sanctions and prosecutions against business. Improving the current penalty regime and making it work more effectively would probably reduce the need for putting already scarce resources into changing it and devising a new regime.
7. There are calls within the business community for regulators to publish their policies and guidelines relating to prosecution. Nonetheless, it seems that adding yet another set or layer of rather similar principles, as outlined in the Macrory Penalties Principles' and enforcement 'characteristics', would lead to confusion and not greater consistency in the approach taken by regulators in their dealings with business and in making enforcement decisions.

**5. Do you agree that a regulator must ensure the following characteristics to be present in order for a sanctioning regime to be most effective?**

- a. The regulator should have a published enforcement policy
- b. The regulator should attempt to measure regulatory outcomes (such as compliance rates) and as well as outputs (such as the number of enforcement actions taken).
- c. The regulator should be able to justify the enforcement actions they take
- d. The regulator should follow up enforcement actions
- e. The regulator should be transparent in the enforcement actions it takes
- f. The regulator should be transparent in the methodology it uses for setting and calculating monetary administrative penalties.

1. Yes, and, as stated in the draft new Compliance Code, regulators should recognise that a key element of their activity is to encourage economic progress, by ensuring fair competition and the efficient operation of open markets.

**16. In general, do you agree that regulators should have Monetary Administrative Penalties available to them as an additional sanction option in their enforcement toolkits? If no, then please elaborate on your views.**

1. The discussion on administrative penalties is one area where the CBI would like to caution the Review team about potential bias. The consultation document states that there is support for greater use of administrative sanctions among regulators and special interest groups. However, the introduction of more administrative fines is not something that the business community would support.
2. 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.
3. CBI members are concerned that there is not enough detail in the consultation document about how the proposed system/s for administrative penalties will work in practice, especially regarding the level of proof, appeals procedures and who will decide in what instances administrative penalties will be used – CBI members are of the view that regulators should not be allowed to make such decisions on a case-by-case basis, but that firm rules should be drawn up for the use of penalties in order to guarantee consistency of enforcement decisions.
4. Using administrative penalties to replace some offences that are currently prosecuted in a Magistrates' Court would give enforcers the option of imposing instant fines on business without due legal process would be to disregard the principles of sound justice and accountability.
5. Business must, in all cases, have the right to appeal against decisions on penalties. However, a situation where the magnitude of management time and costs required to launch an appeal in comparison to the size of the penalty dissuade business from mounting an otherwise justifiable challenge to regulators' decisions must be avoided. Moreover, as discussed above, reputation is extremely important to all responsible businesses and there must be a guarantee that that businesses launching an appeal do not risk unsubstantiated damage to their reputation until, and unless, proven guilty.

**25. Should regulators follow-up statutory notices such as Enforcement or Improvement Notices on a risk adjusted basis?**

1. Reform and enhancement of the enforcement notice regime should be a priority. An enforcement notice should be the preferred form of action over penalties. The Enforcement Notices system works well for business because there is an emphasis on prevention of injury or harm rather than on prosecution. Also, formal cautions work well in cases where an offence is accepted by the business and this can be formally recorded in such a way that it can be taken into account on sentencing if the organisation is ever prosecuted for an offence of a similar nature.

**35. Do you agree that Restorative Justice is something that can be applied to the area of regulatory non-compliance? Please elaborate on your views.**

1. On the issue of restorative justice, overlaps with the forthcoming environmental liability regime need to be considered carefully and any restorative penalties must be determined by a full legal process due to the complex nature of environmental issues and the likelihood of multi-party involvement.
2. Also, CBI members would still like clarification regarding how the Government would prevent a situation where publicity-seeking interest groups use restorative justice mechanisms for self-serving or malicious purposes? Those businesses with no reputation to protect will be less concerned about adverse publicity than generally responsible business.