European Competition Law Review 2017

Ethical Business Regulation and Competition Enforcement: Challenging Orthodoxy

Christopher Hodges[1]

There has been a revolution within the world of regulatory theory and practice in relation to 'enforcement'. This piece summarises how the understanding of how 'enforcement' can—and can fail to—affect future behaviour has shifted. Instead of asking how to increase deterrence, the real question is how to affect future behaviour. Evidence is reviewed of the limited empirical evidence that deterrence affects behaviour, of the findings of behavioural science on why people obey or break rules, of a shift by UK regulators from enforcement based on deterrence to responsive regulation, of the emergence of 'Ethical Business Regulation' as the fundamental policy to support regulatory compliance and business growth, and of examples of where public authorities have adopted such approaches with success. These subject is treated at greater length elsewhere, and readers are referred to that extensive discussion.[2] The piece concludes with a recommended approach to enforcement of competition law.

The Classical Approach to Enforcement

Enforcement in competition law is based on deterrence. There are at least two meanings of deterrence, from legal and economic thought, but both include the idea that *future* behaviour can, and will only but fully, be affected by the imposition of a penalty for *past* infringement of rules. The idea behind much of the history of legal systems is that compliance with rules can be induced by *fear*.[3] The fear is that unless you, a vassal, do what the head of the group says, you will suffer. It does not take much thought, or reference to human rights law and constitutions, to conclude that the idea of ruling by fear is not compatible with modern democracies.

The classical economic theory of the 20th century postulates a different idea of deterrence. This theory assumes that all decisions are taken on economic grounds only, namely by objectively rational actors who calculate the costs and benefits of every action before taking it, and therefore make the decision only that appears to achieve the optimal balance of maximising benefits compared with minimising costs. In the context of a corporate entity operating in a capitalist system, the idea is that the intrinsic purpose of the entity is to make profits and not to be altruistic, so 'the firm' can always be assumed to make every decision on a profit-maximisation basis, and the purpose of enforcement of law is to internalise the external costs that its actions created, so that it is rationally deterred from creating similar external costs in future.[4] The idea is that the 'right level' of punishment will efficiently deter actors from committing crimes by changing the cost of the crime.[5] It will be cheaper to comply than to infringe.[6] The approach relies on using *ex post* controls, assuming that these act *ex ante* in relation to

[1] Professor of Justice Systems and Supernumerary Fellow of Wolfson College, Oxford. Research funding is received from the Swiss Reinsurance Company, the European Justice Forum and the international law firm CMS.

[2] C Hodges, *Law and Corporate Behaviour: Combining Theories of Regulation, Enforcement, Compliance, Culture and Ethics* (Hart Publishing, 2015).

[3] J Bentham, *An Introduction to the Principles of Morals and Legislation* (JH Burns and HLA Hart, eds) (London, Methuen, 1789/1982); G Williams, 'The Aims of Tort Law' (1951) 4 *CLP* 137.

[4] AC Pigou, *The Economics of Welfare* (London: MacMillan, 1920), 168-71; M Allingham, *Rational Choice* (New York, NY, St. Martin's Press Inc., 1999); MS Archer and JQ Tritter. *Rational Choice Theory: Resisting Colonization.* (New York, NY, Routledge, 2001).

[5] WK Estes, *An Experimental Study of Punishment.* (Evanston, IL: The American Psychological Association, Inc., 1944); A Bandura, *Principles of Behaviour Modification* (New York, N.Y: Hole, Rinehart and Winston, 1969); B Schwartz, *Psychology of Learning and Behaviour* (New York, NY: Norton, 1989).

[6] G Becker, 'Crime and Punishment: An Economic Approach' (1968) 76 *Journal of Political Economy* 169-217; GJ Stigler, 'The Theory of Economic Regulation' (1971) 2 *Bell Journal of Economics and Management*

future behaviour.[7] This type of deterrence is stated to be the sole rationale of competition regimes round the world.[8]

However, competition enforcement policy based on increasing deterrence has not been notably successful: numbers of cases coming to light at EU level, for example, have been 30 in 2000-2004, 33 in 2005-2009 and 30 in 2010-2014.[9] Although the rate of detection may have increased since 1996,[10] we do not know what the true incidence is.[11] Cartels typically last for several years before they come to light (on average 9 years in the USA, where the individuals who instigated the cartel will typically have moved firms *twice* before the cartel is discovered, and have no risk of adverse consequences from the infringing firm,[12] and five or six years in Europe[13]). Further, since almost no public competition authority has been able to discover any cartel, some authorities shifted to incentivising firms to do this through offering to waive fines for being the first to 'own up' and reduce them for the second.[14] A member of the Romanian Competition Council concluded in 2015 that the leniency system is not working well.[15]

Shifts in Economic Enforcement Practice

The classical theoretical paradigms set out above have shifted in a number of ways. Let us note four major shifts. First, there has been a shift from treating 'a firm' as a single entity, anthropormorphised to assume that it acts like a human and makes decisions as a unitary entity with a single mind, and that those decisions are all made rationally (like an automaton) on cost-benefit grounds alone. The shift has been to recognising that many individuals and sub-cultures make up a firm, that actions emanating from multiple complex groups have multiple origins, and that the behaviour of individual employees cannot be controlled by either external sanctions imposed by the state, or by internal sanctions imposed by the employing organisation.

The second shift is from entities to individuals. Anyone who works in large organisations, whether private or public, is likely to realise that the idea that an entity can control the behaviour of all of its staff is 'pie in the sky'. A major response has been for firms to develop compliance systems and for authorities to shift towards encouraging or requiring firms to have compliance systems, and to give

Science 3-21; M Faure, A Ogus and N Philipsen, 'Curbing consumer financial losses: the economics of regulatory enforcement' (2009) 31 *Law & Policy* 161-191.

[7] Communication from the Commission to the European Parliament and the Council, Ten Years of Antitrust Enforcement under Regulation 1/2003: Achievements and Future Perspectives, COM(2014) 453, 6.5.2014, para 6.

[8] See e.g. K Yeung, *Securing Compliance. A Principled Approach,* (Hart Publishing, 2004), 86; WPJ Wils, *Efficiency and Justice in European Antitrust Enforcement* (Hart Publishing, 2008), 57; C Harding, 'Cartel deterrence: The search for evidence and argument' (2011) 56(2) *The Antitrust Bulletin* 345-376 (noting a rhetoric of deterrence).

[9] *Cartel Statistics* (European Commission).

[10] E Combe and C Monnier, 'Fines Against Hard Core Cartels in Europe: The Myth of Over Enforcement' *Cahiers de Recherche PRISM-Sorbonne*, June 2009.

[11] C Harding, 'Cartel deterrence: The search for evidence and argument' (2011) 56(2) The Antitrust Bulletin 345-376.

[12] DA Crane, *The Institutional Structure of Antitrust Enforcement* (Oxford University Press, 2011).

[13] Combe and Monnier, above; JM Connor, 'Cartel Fine Severity and the European Commission: 2007-2011' (2013) 34 *European Competition Law Review* 58-77; C Veljanovski, *European cartel fines in 2012* (Case Associates, 2013) and subsequent years; in 2015 the durations were between 3.5 and 10 years.

[14] The origin being US Department of Justice, *Corporate Leniency Policy* (10 August 1993). The current EU policy is *Revised Leniency Policy* (European Competition Network, November 2012). See recently ES Lachnit, 'Compliance Programmes in Competition Law: Improving the Approach of Competition Authorities' (2014) 10(5) *Utrecht Law Review* 31; WPJ Wils, 'The Use of Leniency in EU Cartel Enforcement: An Assessment after Twenty Years' (2016) 39(3) *World Competition: Law and Economics Review* 327.

[15] A Serban, 'Are EU Leniency Programmes Enough for Detecting Cartels?' (2015) 1-2 *Romanian Competition Journa*l, at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2714341.

some sort of credit when imposing a sanction on a firm for 'its' non-compliance if it has an acceptable compliance system. The policy of the US Department of Justice Antitrust Division to reduce fines for the existence of 'an effective compliance and ethics program' is well known.[16] That approach has generally been resisted by the EU authorities. Wils noted in 2013 that the European Commission had never granted a reduction of a fine because of the existence of a compliance programme at the time of the infringement.[17] In contrast, the UK has regularly granted fine reductions of up to 10% where 'adequate steps [have] been taken with a view to ensuring compliance',[18] and the Australian Competition and Consumer Commission's Enforcement and Compliance Project takes into account 'commitment to the values of the rules and motivation to comply with them'.[19]

However, the theory remains that firms are able to control all their staff, and that firms should be incentivised to control all their staff by having internal compliance systems. The art of compliance systems has developed, but effectively includes statements of the rules, internal training and continuous education, and auditing functions.[20]

This line of thought offers some recognition that it is individuals rather than the entity whose behaviour is 'at fault', and the cause of the infringement. We have seen a difference between countries and between sectors in the extent to which 'some sort of credit' might be permitted for having and operating a compliance system. A notable development occurred when the UK Bribery Act 2010 introduced the ability to impose deterrent criminal sanctions on both individuals and commercial organizations, but provided a defence for a corporation where it can show that it had in place 'adequate procedures' designed to prevent bribery on its behalf.[21] This has resulted widespread adoption by firms of sophisticated internal compliance regimes in relation to bribery,[22] although the same trend towards large compliance systems and departments was occurring in relation to competition and human rights compliance.

The current approach to leniency is unfair. First, if a firm is in fact 'guilty' why should it be excused any sanction? Or any involvement in implementing internal changes so as to reduce the future risk of repeating the behaviour? Second, why should the firm retain illicit profits and not pay redress? Third, there has been an outcry by firms that if they take strenuous steps to have such compliance systems, they should be wholly excused from any sanction.[23] Huge penalties have been imposed on firms when they thought they were doing their best to prevent illegal behaviour by all staff, and they are as annoyed as anyone else when some individual staff break the—public and internal—rules. Firms' reactions to large fines in such circumstances are to see them as wholly unjust and unfair. That reaction is dangerous, as it undermines respect in the competition authorities generally, and drives a wedge between any possible collaboration on compliance in the relationship between the authority and firms, leading to mistrust and gaming over the rules.

[16] U.S. Sentencing *Guidelines Manual* (November 1, 2011).
[17] WPJ Wils, 'Antitrust Compliance Programmes & Optimal Antitrust Enforcement' (2013) 1.1 *Journal of Antitrust Enforcement* 52.
[18] *Applications for leniency and no-action in cartel cases OFT's detailed guidance on the principles and process* (Competition and Markets Authoirty, 2013), OFT1495.
[19] Cartel Project, at http://cartel.law.unimelb.edu.au.
[20] D Boehme and JE Murphy, 'Fear no evil: a compliance and ethics professional's response to Dr Stephan' (2012), at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=1965733
[21] Bribery Act 2010, s 7(2).
[22] *Corporate confessions to serious fraud office almost double in last year* (Pinsent Masons, 2013), available at http://www.pinsentmasons.com/en/media/press-releases/2013/corporate-confessions-to-serious-fraud-office-almost-double-in-last-year/.
[23] DH Ginsburg and JD Wright, 'Antitrust Sanctions' (2010) 6(2) *Competition Policy International* 18; F Brunet, 'The role of antitrust compliance programs in competition law enforcement', New Frontiers of Antitrust Conference (Paris, 10 February 2012), *Concurrences* N° 2-2012, www.concurrences.com, 16, 22, K Hofstetter and M Ludescher, 'Fines against Parent Companies in EU Antitrust Law: Setting Incentives for "Best Practice Compliance"' (2010) 33 *World Competition* 55.

Competition leniency policies do not in fact incentivise firms to take steps to discover infringements in which their staff are involved, they only incentivise firms to be the first (or second) to inform the authorities. The primary objective is not in fact to prevent non-compliance, but to provide a lot of evidence to prosecutors that the firm has done so much and ought to have a reduced penalty under leniency rules. In other words, the enforcement system is being gamed, but the real goals of maximising compliance are being forgotten. Corporate experts know the nagging truth that some people still do bad things (e.g. get involved in a cartel or bribery) even where they are fully aware of states' rules on competition law and of their own firm's rules on compliance, and they are not 'deterred' by the existence of internal compliance systems or the threat of internal or external punishment.

A similar trend has been to impose external supervisors on firms, with the idea that they can make key decisions and over-rule the decisions of management. That approach involves some recognition that decisions are taken by individuals, but ignores that fact that preaching at staff does not guarantee that no staff member will not break the rules. It also interferes with management of the firm by those who are capable of understanding best how 'its' decisions are made.

Much debate has occurred around extending private enforcement, on the theory that the imposition of any money penalty has deterrent effect, and thus fines and damages are equivalent. It is right that a firm may benefit from an infringement caused by one or more of its staff, but this does not mean that the firm is necessarily the root cause of the infringement. The remedy should be disgorgement of profits unlawfully obtained, rather than a fine for criminal conduct 'of' the firm. Most people would seem to agree that a firm who has benefited should pay compensation for the losses caused to others by the infringement, although this raises long-debated issues over whether the extent of such a private law liability should extend to losses that have not been suffered by a third party because they have been passed on.

A third shift in enforcement policy has been to include individuals as well as firms in the sights of prosecutors. For most national authorities, not gone as far as from sanctioning firms to sanctioning individuals. The U.S. Department of Justice made this shift in 2015, when the 'Yates Memo' announced that the state would enhance its deterrent effect on corporate wrongdoing by prosecuting the individuals who are responsible in the context of resolving cases of corporate criminal liability.[24]

It is instructive to look at what we know about how and why cartels are formed. Research into the sociology of cartels is scare, but shows the following. Offenders act with great care and in secrecy to avoid detection and punishment.[25] Cartel meetings are normally disguised,[26] transmitted information is encrypted sometimes[27] and evidence of illegal agreements may be destroyed.[28] Ashton and Pressey's examination of all 74 cartel investigations made by the European Commission between 1990 and 2009 noted that the relationship between the individuals is based on trust and camaraderie, and these features tend to prolong cartel duration.[29] The sales and marketing personnel involved identify with mutual

[24] U.S. Department of Justice Memorandum, 'Individual Accountability for Corporate Wrongdoing', September 9, 2015.
[25] H Hovenkamp, *The Antitrust Enterprise: Principle and Execution* (Harvard University Press, 2005), 66.
[26] For instance, 'budget meetings' in the Vitamin cartel, European Commission, Case COMP/E-1/37.512 *Vitamins* [2001] OJ L6/1.
[27] European Commission, Case COMP/F/38.899 *Gas Insulated Switchgear* [2007] OJ C75/19.
[28] European Commission, Case COMP/38354 *Industrial Bags* [2005] OJ L282/41.
[29] JK Ashton and AD Pressey, 'Who Manages Cartels? The Role of Sales and Marketing Managers within International Cartels: Evidence from the European Union 1990-2009' CCP Working Paper 12-11 (2012). One British businessman imprisoned for a cartel in U.S.A. commented: 'it doesn't seem right that by dumping everybody else in the mud you can get away with it. Especially when, clearly in some of these incidents, the people that have gone to the authorities in the first place were by far the most culpable participants in this illegal activity': M O'Kane, 'Does prison work for cartelists? The view from behind bars. An Interview with Bryan Allison' (2011) 56(2) *The Antitrust Bulletin* 483-500, 490-91.

interests and often desire to achieve ‘fair’ outcomes amongst themselves,[30] they can consider team-crime such as price-fixing as an acceptable option in lean times,[31] especially if they lack awareness of the illegality of cartels,[32] or succumb to narcissism and flattery when being asked to undertake actions that facilitate organizational survival.[33] Lower ranked managers can be the victim of coercive senior managers when certain management philosophies, such as a ‘profit-making at all costs’ approach.[34]

This is not to say that incentives cannot affect behaviour—but the real incentive that operates on a manager might be to make budget at any cost, so how can that be tempered? Hylton’s economic theoretical analysis of the incentives of firms and agents concluded that ‘almost any plausible effort to use penalties against agents to deter price fixing can be undone by the firm’s own system of rewards for agents. For deterrence, penalties against the firm sufficient to eliminate the firm’s incentive to fix prices are necessary.’[35]

However, Harding concluded his review of the evidence in 2011 by asking if there was any evidence that deterrence works in relation to competition law. [36] It is completely unknown what affect large fines have in fact had on firms, or whether the level of such fines has been calibrated at the ‘right’ level to produce ‘optimal deterrence’ of either the firm sanctioned or others. Evidence that deterrence ‘works’ appears to be largely anecdotal interpretation, and ingrained or wishful-thinking.

Equally, some firms are not immune from believing that the existence of a code of ethics and of an expensive compliance system is all that is needed. A shift to incentivising a firm to have and operate an internal compliance system—with a lot of rules, education, training, and auditing and whistleblowing procedures—will not work, because culture and other behavioural influences are not being addressed.

So thinking has been shifting. One should not be surprised if orthodox thinking were to be fundamentally challenged. In fact, a series of separate pieces of evidence challenge the classic theory. These are behavioural science, the practice of a large number of non-competition enforcers, empirical evidence on the failure of deterrence to work as a regulatory strategy, and the findings of behavioural science. To these we turn.

The Findings of Behavioural Psychology

If one wants to know how people behave, it might make sense to start by looking at what we know about human behaviour. The key to a fresh approach is not to ask ‘How do we increase deterrence?’ but ‘Why do people obey or break rules?’. A great deal of research is available on this latter issue.

Research in evolutionary biology suggests that the reason why *homo sapiens* was able to dominate the globe as a species was because our ancestors’ genes mutated perhaps 80,000 years ago to introduce an inherent feeling of morality into human brains, which gave us the ability to trust others and hence enable

[30] RR Faulkner, ER Cheney, GA Fisher and WE Baker, ‘Crime by Committee: Conspirators and Company Men in the Illegal Electrical Industry Cartel’ (2003) 41 *Criminology* 511-554.
[31] G Mars, *Cheats at Work: An Anthropology of Workplace Crime* (London: Unwin Paperbacks, 1982).
[32] D Bush and BD Gelb. ‘When Marketing Practices Raise Antitrust Concerns’ (2005) 46 *MIT Sloan Management Review* 73-81; DT Le Clair, ‘Marketing planning and the policy environment in the European Union’ (2000) 17 *International Marketing Review* 193-215.
[33] HS Schwartz, ‘Anti-social Actions of Committed Organizational Participants: An Existential Psychoanalytic Perspective’ (1987) 8 *Organization Studies* 327-340.
[34] SS Simpson and CS Koper, ‘The Changing of the Guard: Top Management Characteristics, Organizational Strain and Antitrust Offending’ (1997) 13 *Journal of Quantitative Criminology* 373-404.
[35] KN Hylton, ‘Deterrence and Antitrust Punishment: Firms versus Agents’ (2015) 100 *Iowa Law Review* 2069.
[36] C Harding, ‘Cartel deterrence: The search for evidence and argument’ (2011) 56(2) *The Antitrust Bulletin* 345-376.

us to collaborate, and thereby able to build cooperative societies.[37] The moral gene is relatively recent, and the collaborative response can conflict with far more deeply genes based on self-preservation, and hence selfishness. Together, the genes can drive a feeling of wanting one's tribe to win, rather than a general sense of collaborative fairness. But as we become more civilised, we can learn to trust more, and the resulting consensus drives a values-driven culture and inspirational purpose, which outperforms other less trusting groups.[38]

Reality is that human decisions are predominantly based on 'fast brain'/gut reactions, emotions and irrationality, and a widely diverse set of influences. Research in behavioural psychology has identified many reasons why people might do bad things. Some of the main points are that people may follow the behaviour of their group, take risks too easily without assessing them, underestimate the risk of the activity, underestimate the risk of being identified, or think that what they are doing is fair even if it is strictly against the rules.[39] These findings resonate with the sociological conclusions about why managers agree cartels, referred to earlier, such as the social influence of a convivial group, the crowding out of the ethical imperative by other considerations such as to meet targets, support one's team in succeeding against other teams, and keep one's job.

Further findings redefine the traditional ideas on economic deterrence. A person will obey a rule out of fear of being punished has been shown to be effective only where an individual *perceives* there to be a *high risk that he will be identified*, from which he will suffer embarrassment and loss of reputational esteem.[40] Second, increasing the severity or certainty of punishment alone in fact results in only modest, if any, increases in deterrence.[41]

---

[37] A summary of extensive scientific literature is J Haidt, *The Righteous Mind. Why Good People are Divided by Politics and Religion* (Penguin Books, 2012). Haidt argues that champions of rational utilitarianist cost-benefit theories of Bentham and Kant came from, and will be attractive to, individuals who 'are high on systematizing and low on empathizing'.

[38] F Laloux, *Reinventing Organizations: A Guide to Creating Organizations Inspired by the next Stage of Human Consciousness* (Brussels, Nelson Parker, 2014). Laloux drew on AH Maslow, *Motivation and Personality* (New York, Harper Collins, 1987); *Toward a Psychology of Being* (New York, Wiley, 1968); *The Farther Reaches of Human Nature* (New York, Penguin/Arkana, 1993).

[39] A summary of extensive scientific literature is D Kahneman, *Thinking, Fast and Slow* (Allen Lane, 2011). D Ariely, *The (Honest) Truth about Dishonesty* (HarperCollins, 2012).

[40] A recent overview is A Bottoms and A von Hirsch, 'The Crime-Preventive Impact of Penal Sanctions' in P Cane and HM Kritzer, *The Oxford Handbook of Empirical Legal Research* (Oxford University Press, 2010), 104. FH Easterbrook, 'Criminal Procedure as a Market System' (1983) 12 *Journal of Legal Studies* 289, 295 and n7; R MacCoun, 'Drugs and the law: a psychological analysis of drug prohibition' (1993) 113 *Psychological Bulletin* 497; DP Farrington, PA Langan and P-O Wikström, 'Changes in Crime and Punishment in America, England and Sweden between the 1980s and 1990s' (1994) 3 *Studies in Crime and Crime Prevention* 104; PH Robinson and J Darley, *Justice, Liability and Blame* (Westview, 1995); PH Robinson and J Darley, 'The utility of desert' (1997) 91 *Northwestern University Law Review* 453; D Nagin, 'Criminal Deterrence Research at the Outset of the Twenty-first Century' in M Tonry (ed), *Crime and Justice: A Review of Research* (University of Chicago Press, 1998); PA Langan and DP Farrington, *Crime and Justice in the United States and England and Wales, 1981-96* (Bureau of Justice Statistics, 1998); HL Ross, *Deterring the Drinking Driver* (Lexington Books, 1982); PH Robinson and JM Darley, 'The Role of Deterrence in the Formulation of Criminal Law Rules: At Its Worst when Doing Its Best' (2003) 91 *Georgetown Law Journal* 949, 953-56; A Blumstein, 'Prisons' in JQ Wilson & J Petersilia (eds), *Crime* (Institute for Contemporary Studies Press, 1995) 387, 408-09. See also M Miller, *Director Leadership of Health and Safety* (Health & Safety Laboratory, 2005), iv.

[41] LS Beres & TD Griffith, 'Habitual Offender Statutes and Criminal Deterrence' (2001) 34 *Connecticut Law Review* 55, 59; see I Ehrlich, 'Crime, Punishment, and the Market for Offenses' (1996) 10 *Journal of Economic Perspectives* 43, 55-63 (surveying the research on the question); PW Greenwood et al., *Three Strikes and You're Out: Estimated Benefit and Cost of California's Mandatory New Sentencing Laws* (RAND Corporation, 1994) 16. But see D Kessler & SD Levitt, 'Using Sentence Enhancements to Distinguish Between Deterrence and Incapacitation' (1999) 42 *Journal of Law & Economics* 343. **Association studies:** DP Farrington, PA Langan and P-O Wikström, 'Changes in Crime and Punishment in America, England and Sweden between the 1980s and 1990s' (1994) 3 *Studies in Crime and Crime Prevention* 104; D Nagin, 'Criminal Deterrence Research at the Outset of the Twenty-first Century' in M Tonry (ed), *Crime and Justice: A Review of Research* (University

The science also finds that people are likely to obey rules where three factors are present, all based on the idea of fairness (and hence, on the ethical gene). The factors are that: [42]

a. The rule corresponds to their internal moral value system;
b. The rule has been made fairly; and
c. The rule is applied fairly.[43]

This body of behavioural science has been incorporated—arguably mislabelled—as 'behavioural economics', and its relevance is accepted in the fields of how a state may influence its citizens,[44] or a regulator may influence consumers.[45] But its relevance has hardly been realised in relation to general behaviour within legal systems, employment contexts, or regulatory and enforcement contexts.[46] The science also finds little empirical evidence that increasing a penalty increases the effect on future behaviour.[47]

The Disappearance of Deterrence from Mainstream Regulatory Policy

What are the implications of this evidence? What changes should be made if deterrence forms no part of affecting future behaviour? But the seriousness of a sanction is only relevant to *past* behaviour and not to *future* behaviour?

A great deal of research into regulation and enforcement has identified the widespread approach of 'responsive regulation' by enforcers, who focus on exerting influence to improve performance and compliance, rather than blaming and prosecuting people. The 'responsive regulators' have found that blaming and prosecuting people when they think they are doing their best, destroys relationships and impedes ongoing learning and improvement. In contrast, the way to support ongoing compliance and improved performance is usually by supporting social relationships of trust. Similarly, research by different UK agencies found that small and medium sized businesses (SMEs) believe that they are complying until a person they respect points out that they could improve, in response to which advice

---

of Chicago Press, 1998). **Meta-analysis**: TC Pratt, FT Cullen, KR Blevins, LE Daigle and TD Madensen, 'The Empirical Status of Deterrence Theory: a Meta-analysis', in FT Cullen, JP Wright and KR Blevins (eds), *Taking Stock: The Status of Criminological Theory* (Transaction Publishers, 2006).

[42] L Friedman, *The Legal System: A Social Science Perspective* (Russell Sage Foundation, 1975), 105-13; RA Kagan, N Gunningham and D Thornton, 'Fear, duty, and regulatory compliance: lessons from three research projects' in C Parker and VL Nielsen (eds), *Explaining Compliance: Business Responses to Regulation* (Edward Elgar, 2012).

[43] J Darley, TR Tyler and K Bilz, 'Enacting justice: the interplay of individual and institutional perspectives,' in M Hogg and J Cooper (eds), *The SAGE Handbook of Social Psychology* (Sage, 2003); JT Jost and B Major (eds), *The Psychology of Legitimacy* (Cambridge University Press, 2001); TR Tyler, *Why People Obey the Law* (Yale University Press, 2006); TR Tyler and SL Blader, *Cooperation in Groups: Procedural Justice, Social Identity, and Behavioral Engagement* (Psychology Press, 2000); TR Tyler and SL Blader, 'Can businesses effectively regulate employee conduct? The antecedents of rule following in work settings' (2005) 48 *Academy of Management Journal* 1143; J Jackson, B Bradford, M Hough, A Myhill, P Quinton and TR Tyler, 'Why Do People Comply with the Law? Legitimacy and the Influence of Legal Institutions' (manuscript, 2013).

[44] RH Thaler and CR Sunstein, *Nudge* (Yale University Press, 2008); CR Sunstein, 'Empirically Informed Regulation' (2011) 78 *The University of Chicago Law Review* 1349; D Halpern, *Inside the Nudge Unit: How Small Changes Can Make a Big Difference* (WH Allen, 2015)..

[45] *Applying behavioural economics at the Financial Conduct Authority* (FCA, April 2013); E Costa, K King, R Dutta and F Algate, *Applying behavioural insights to regulated markets* (The Behavioural Insights Team and Citizens Advice, 2016).

[46] Executive Order, Using Behavioral Science Insights to Better Serve the American People, September 15, 2015, https://www.whitehouse.gov/the-press-office/2015/09/15/executive-order-using-behavioral-science-insights-better-serve-american.

[47]

they usually follow the advice.[48] That person need not be a public official and could be from a Chamber of Commerce, trade association or other expert or adviser.

The supporting research covers care homes for the elderly,[49] water pollution,[50] occupational health and safety and environmental control and also railway safety,[51] environmental protection,[52] the mining industry,[53] manufacturing in Thailand,[54] and food businesses,[55] a range of Australian agencies,[56] Danish farming,[57] and UK fish protection.[58]

UK Government policy on regulation has evolved over the past 15 years under the title of 'Better Regulation', involving reducing burdens on enforcers and firms, to clear support of businesses in improving performance and growth by being responsive to those who need help, even if they can have committed infringements. Key milestones have been the 2005 Hampton Report (advocating that regulators should adopt a risk-based approach towards securing compliance, and use advice and persuasion as the first step),[59] the Macrory Penalty Principles for regulatory enforcement (the first of which is to aim to change the behaviour of the offender),[60] the duty imposed on many regulatory bodies[61] to observe statutory principles of good regulation is that 'regulatory activities should be carried

---

[48] R Fairman and C Yapp, *Making an impact on SME compliance behaviour: An evaluation of the effect of interventions upon compliance with health and safety legislation in small and medium sized enterprises* (Health and Safety Executive, 2005), Research Report 366; *The Anderson Review of Government Guidance on Regulation. Business Perspectives of Government Guidance. Research Study Conducted for Department for Business, Enterprise and Regulatory Reform. Final Report* (Ipsos MORI, 2008); *The Anderson Review. Summary of views from meetings with small and medium sized enterprises (SMEs)* (Department for Business, Enterprise and Regulatory Reform, 2009); *How Your Business Can Achieve Compliance: Guidance* (Office of Fair Trading, 2010) OFT1278.

[49] Summarised in the seminal work: I Ayres and J Braithwaite, *Responsive Regulation: Transcending the Deregulation Debate* (Oxford University Press, 1992).

[50] K Hawkins, *Environment and Enforcement: Regulation and the Social Definition of Pollution* (Clarendon Press, 1984); K Hawkins, *Law as Last Resort* (Oxford University Press, 20902).

[51] H Genn, 'Business responses to the regulation of health and safety in England' (1993) 15 *Law and Policy* 219; BM Hutter, *Compliance: Regulation and Environment* (Clarendon Press, 1997); BM Hutter, *Regulation and Risk: Occupational Health and Safety on the Railways* (Oxford University Press, 2001).

[52] P Grabosky, 'Beyond the Regulatory State' (1994) 27(2) *Australian and New Zealand J of Criminology* 192; P Grabosky, 'Green Markets: Environmental Regulation by the Private Sector' (1994) 16(4) *Law and Policy* 419-48; N Gunningham and P Grabosky, *Smart Regulation. Designing Environmental Policy* (Oxford University Press, 1998).

[53] F Haines, *Corporate Regulation: Beyond 'Punish or Persuade'* (Clarendon Press, 1997).

[54] F Haines, 'Regulatory Reform in Light of Regulatory Character: Assessing Industrial Safety Change in the Aftermath of the Kader Toy Factory Fire in Bangkok, Thailand' (2003) 12 *Social and Legal Studies* 461; reprinted in F Haines (ed), *Crime and Regulation* (Ashgate, 2007).

[55] BM Hutter and C Jones, 'From government to governance: external influences on business risk management' (2007) 1 *Regulation & Governance* 27.

[56] J Braithwaite and P Grabosky, *Of Manners Gentle: Enforcement Strategies of Australian Business Regulatory Agencies* (Oxford University Press, 1987).

[57] PJ May and S Winter, 'Regulatory Enforcement and Compliance: Examining Danish Agro-Environmental Policy' (1999) 18(4) *Journal of Policy Analysis and Management* 625.

[58] J Black and R Baldwin, 'Really Responsive Regulation' (2008) 71(1) *Modern Law Review* 59.

[59] P Hampton, *Reducing administrative burdens: effective inspection and enforcement* (HM Treasury, 2005).

[60] R Macrory, *Regulatory Justice: making sanctions effective* (HM Treasury, 2006); reprinted in R Macrory, *Regulation, Enforcement and Governance in Environmental Law* (Hart Publishing, 2010). Implementation was in the Regulatory Enforcement and Sanctions Act 2008. Subsequent codification occurred in the Consumer Rights Act 2015.

[61] See the Legislative and Regulatory Reform (Regulatory Functions) Order 2007, SI 2007/3544 specified various bodies including 27 national regulatory agencies including the Civil Aviation Authority, the Environment Agency, the Financial Services Authority, the Food Standards Agency, the Health and Safety Commission, the Health and Safety Executive, the Office of Fair Trading (other than any regulatory function under competition or merger law), the Pensions Regulator. See subsequent amendments in The Legislative and Regulatory Reform (Regulatory Functions) (Amendment) Order 2009, SI 2009/2981, The Legislative and

out in a way which is transparent, accountable, proportionate, consistent, and that regulatory activities should be targeted only cases in which action is needed',[62] the duty on specified bodies not to impose or maintain unnecessary burdens in the exercise of regulatory functions,[63] and the Regulators' Code,[64] which now stresses the need for regulators to adopt a positive and proactive approach towards ensuring compliance, requiring that: [65]

- Regulators should carry out their activities in a way that supports those they regulate to comply and grow; and
- Regulators should ensure clear information, guidance and advice is available to help those they regulate meet their responsibilities to comply.

It is no accident that the UK competition authority has avoided exposure to these developments by arguing that it is not a 'regulator'. However, the result is that it has been left behind as almost all other public enforcers have moved to a different approach. Rather than accept the mantra that deterrence works, scientific measurement of effects is required. The empirical evidence is that deterrence is not particularly effective as a regulatory tool.[66] Studies need to be viewed against the background that most researchers assumed there was a deterrent effect, but when the underlying data is viewed objectively, sanctions can be seen to have some reminder effect in relation to future behaviour, but there is surprisingly little evidence that deterrence affects future behaviour.[67]

Deterrence has largely been abandoned in UK criminal enforcement. UK's 2015 evidence-based policy,[68] built on the finding that a small minority of people commit the majority of crimes,[69] focuses strongly on how to affect the `character' of individuals, especially people who at a young age

Regulatory Reform (Regulatory Functions) (Amendment) Order 2010, SI 2010/3028, The Legislative and Regulatory Reform (Regulatory Functions) (Amendment) Order 2014, SI 2014/860 (adding the Groceries Code Adjudicator, Monitor and the Regulator of Community Interest Companies, and omitting three others). An order may not specify *regulatory* functions in relation to the Gas and Markets Authority, the Office of Communications, the Office of Rail Regulation, the Postal Services Commission, and the Water Services Regulatory Authority (since these are specified in primary legislation): Legislative and Regulatory Reform Act 2006, s24(5).

[62] Legislative and Regulatory Reform Act 2006, s21. The government later claimed that the principles of Good Regulation were 'a widely accepted definition of best practice': S Vadera, *Government Response to the House of Lords Select Committee on Regulators-Report on UK Economic Regulators* (Department for Business Enterprise & Regulatory Reform, 2008), para 1.2.

[63] Regulatory Enforcement and Sanctions Act, ss 72, 73(3)-(6).

[64] *The Regulators' Code* 2014. Introduced as the *Regulators' Compliance Code: Statutory Code of Practice for Regulators*, (Department for Business Enterprise and Regulatory Reform, 2007), made under the Legislative and Regulatory Reform Act 2006, s 22(1).

[65] *Regulators' Code*, provisions 1 and 5.

[66] DN Dewees, D Duff and M Trebilcock, *Exploring the Domain of Accident Law: Taking the Facts Seriously* (1996); ML Smith, 'Deterrence and Origin of Legal System: Evidence from 1950-1999' (2005) 7 *American Law & Economics Review* 350; WK Viscusi, 'The Social Costs of Punitive Damages Against Corporations in Environmental and Safety Torts' (1998) 87 *Georgetown Law Journal* 285; FA Sloan, EM Stout, K Whetten-Goldstein, & L Liang, *Drinkers, Drivers, and Bartenders: Balancing Private Choices and Public Accountability* (University of Chicago Press, 2000). There are many personal injury and medical liability studies with complex results, e.g. F Sloan and L Chepke, *Medical Malpractice* (Cambridge, Mass, The MIT Press, 2008) (no statistical connection found); PH Rubin & JM Shepherd, 'Tort Reform and Accidental Deaths' (2007) 50 *Journal of Law & Economics* 221 (finding that tort reforms led to a decrease in accidental deaths); J Shepherd, 'Tort Reforms' Winners and Losers: The Competing Effects of Care and Activity Levels' (2008) 55 *UCLA Law Review*. 905 (different medical malpractice reforms were associated with increases or decreases in death rates).

[67] See a review at C Hodges, *Law and Corporate Behaviour*: *Integrating Theories of Regulation and Enforcement* (Hart Publishing, 2015).

[68] *Modern Crime Prevention Strategy March 2016* (Home Office, 2016).

[69] ME Wolfgang, 'Delinquency in two birth cohorts', in KT van Dusen and SA Mednick, (eds), *Prospective studies of crime and delinquency* (Springer, 1983) 7; TE Moffitt, 'Adolescence-Limited and Life-Course Persistent Antisocial Behavior: A Developmental Taxonomy' (993) 100 *Psychological Review* 674.

demonstrate characteristics of a 'willingness to break social norms,[70] and their levels of empathy[71] and self-control[72]' and improving 'positive character traits' such as learning to improve decision-making and concentrating on the early years of development. Similarly, deterrence has largely disappeared from tort law: in 2010 Lord Bingham said that securing compensation is the primary function of tort, and deterrence has no party to play.[73]

Since UK enforcers have been required to publish their enforcement polices under the 2007 Regulators' Compliance Code, it can be seen[74] how many do not adopt deterrence as their sole enforcement policy, or regard it as particularly relevant to much of their work[75]—with only a small number of exceptions, who have remained outside the others' discourse.[76] Crane has noted that 'Antitrust has become almost exclusively the concern of small groups of legal and economic specialists, who carry on their work without widespread public interest or support.'[77]

Underlying these shifts by non-competition bolides lies an evolution in the role of what an economic regulatory should be. A focus on market structures and prices has widened to include customers, the levels of service that they expect, and ensuring that fair and good quality service is in fact delivered and that problems are rectified and performance is improved. The addition to the 2013 Regulators' Code of a duty to promote growth links with this transformed view of the function of a market controller, who represents the public interest. These changes underpin a shift away from economics towards overseeing

---

[70] POH Wikström, D Oberwittler, K Treiber and B Hardie, *Breaking rules: The social and situational dynamics of young people's urban crime* (Oxford University Press, 2012).
[71] D Jolliffe and DP Farrington, 'Empathy and offending: A systematic review and meta-analysis' (2004) 9(5) *Aggression and violent behaviour* 441.
[72] TE Moffitt, R Poulton and A Caspi, 'Lifelong Impact of Early Self-Control' (2003) 101(5) *American Scientist* 352; L Levy, D Santhakumaran and R Whitecross, *What Works to Reduce Crime? A Summary of the Evidence* (Justice Analytical Services, Scottish Government, 2014).
[73] Lord Bingham of Cornhill, 'The Uses of Tort' (2010) 1 *Journal of European Tort Law* 3. See also P Cane, *Atiyah's Accidents, Compensation and the Law* (Cambridge University Press, 8ed 2013), 477.
[74] See CJS Hodges, *Law and Corporate Behaviour: Integrating Theories of Regulation, Enforcement, Compliance, Culture and Ethics* (Hart Publishing, 2015), ch 13.
[75] *Enforcement and Sanctions – Guidance. Operational Instruction 1356_10, version 2* (Environment Agency, 2014); *The Bank of England's Approach to the Supervision of Financial Market Infrastructures* (Bank of England, April 2013); *The Prudential Regulation Authority's Approach to Banking Supervision* (Prudential Regulatory Authority, 2013); *The Prudential Regulation Authority's Approach to Enforcement: Statutory Statements of Policy and Procedure* (Prudential Regulatory Authority, April 2013); *Enforcement Guidelines: Ofcom's guidelines for the handling of competition complaints and complaints concerning regulatory rules* (OFCOM, 2012); *Enforcement Guidelines* (OFGEM, 2014); *Procedural Guidelines on the Authority's use of its Investigatory and Enforcement Powers under REMIT* (OFGEM, 2013); *Ofwat's approach to enforcement* (OFWAT, 2009); *Delivering proportionate and targeted regulation: Ofwat's risk-based approach* (OFWAT, 2012); *Office of Rail Regulation: Empowering stakeholders through enforcement* (Office of Rail Regulation, 2010); *ORR's HSWA enforcement policy statement* (Office of Rail Regulation, 2013); *Civil Aviation Authority Regulatory Enforcement Policy* (Civil Aviation Authority, 2012); *Compliance and Enforcement: Statement of Policy* (Legal Services Board, 2010); *National Local Authority Enforcement Code. Health and Safety at Work. England, Scotland & Wales* (Health and Safety Executive, 2013); *Fraud, Bribery and Money Laundering Offences Guideline. Definitive Guidance* (Sentencing Council, 2014); *Enforcement policy* (Care Quality Commission, 2015); *Statement of consumer protection enforcement principles* (Office of Fair Trading, 2012); *Consumer Protection: Guidance on the use of its consumer powers* (Competition and Markets Authority, 2014).
[76] *Decision Procedure and Penalties (DEPP) Manual* (Financial Conduct Authority); *OFT's Guidance as to the appropriate amount of a penalty* (Office of Fair Trading, 2012); *Administrative Penalties: Statement of Policy on the CMA's Approach* (Competition & Markets Authority, 2014).
[77] DA Crane, *The Institutional Structure of Antitrust Enforcement* (Oxford University Press, 2011). Crane cites R Hofstadter, 'What Happened to the Antitrust Movement?' in *The Paranoid Style in American Politics and Other Essays* 188 (1966).

service delivery through understanding behaviour. This has strong resonance with Polanyi's conception that economics and market competition needs to be embedded back in social relationships.[78]

In short, huge transformation has occurred in regulation, compliance and 'enforcement' in many areas of law. But very little of the above seems to have percolated into the world of antitrust, which remains stuck in the dark ages.

Ethical Business Regulation

The author developed the concept of Ethical Business Regulation (EBR) from the above evidence and many discussions with regulatory authorities, enforcers, and company personnel across a wide range of sectors and regulatory systems.[79] It is based on addressing human behaviour through what we know about *science* rather than economic or legal *theory*. The idea was to build on that science so as to maximise human behaviour to 'do the right thing' (comply with fair rules in a fair system) and respond to mistakes, problems and deliberate wrongdoing in an effective, fair and proportionate way. The basic principles of EBR are that people should aim to 'do the right thing' in relation to all activities, and check and obtain feedback on what the right thing is. This basic approach can be used to construct ways of inter-relating with others, within organisations and with outsiders. Many successful businesses have values in which they compete with themselves (rather than others).constantly striving to improve, based on doing the right thing.[80]

Hodges suggested[81] that a regulatory system would be most effective as where it adopts the following the design and operation principles, and this has been supported by the UK Committee on Standards in Public Life (Nolan Committee):[82]

1. **A policy of supporting ethical behaviour.** The regulatory system will be most effective in affecting the behaviour of individuals where it *supports ethical and fair behaviour*.

2. **Ethical regulators.** Regulators should—self-evidently—adopt unimpeachable, consistent and transparent ethical practice.

3. **Ethical businesses.** Businesses should be capable of demonstrating constant and satisfactory evidence of their *commitment to fair and ethical behaviour* that will support the *trust* of regulators and enforcers, as well as of employees, customers, suppliers and other stakeholders.

4. **A learning culture.** A blame culture will inhibit learning and an ethical culture, so businesses and regulators should encourage and support an essentially *open* collaborative '*no blame*' culture, save where wrongdoing is intentionally or clearly unethical.

[78] K Polanyi, *The Great Transformation: The Political and Economic Origins of Our Time* (first published 1944, 2nd edn, Boston, Beacon Press, 2001); B Lange, F Haines and D Thomas (eds), *Regulatory Transformations: Rethinking Economy-Society Interactions* (Hart Publishing, 2015).
[79] C Hodges, *Ethical Business Practice: Understanding the Evidence* (Better Regulation Delivery Office, 2016). The author is grateful for assistance in particular from Graham Russell, Helen Kirkman, Ruth Steinholtz and Richard Thomas CBE.
[80] J Collins and JI Porras, *Built to Last: Successful Habits of Visionary Companies* (HarperCollins, 1994, 12ed 2005).
[81] C Hodges, 'Ethics in Business Practice and Regulation' at https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/550542/Prof_Christopher_Hodges_-_Ethics_for_regulators.pdf.
[82] *Striking the Balance. Upholding the Seven Principles of Public Life in Regulation* (Committee on Standards in Public Life, 2016), at https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/550998/Striking_the_Balance__web_.pdfhttps://www.gov.uk/government/uploads/system/uploads/attachment_data/file/550998/Striking_the_Balance__web_.pdf, pp 62, 69-70.

5. **A collaborative culture.** Regulatory systems need to be based on collaboration if they are to support an ethical regime, and to *maximise performance*, compliance, and innovation.

6. **Proportionate responses.** Where people break rules or behave immorally, people expect to see a *proportionate response*.

Trust will only be placed where there is evidence that on which the trustor can rely.[83] Multiple sources of evidence can be made available by a firm that wishes to be trusted that it behaves ethically. Firms that value their reputation know this well, and focus on maintaining the flow of evidence that supports their reputation, which is why enforcement measures that diminish brand value can be highly effective on their own.[84] The requirement for trust has been emphasised recently by the Financial Reporting Council in its reform of the Corporate Governance Code[85] and by the UK Government's proposals on Corporate Governance.[86] The Government's proposals include measures to increase fairness in pay and incentives.[87] As an example, two extreme practices should sound alarm bells that an ethical culture is not being demonstrated internally: paying sales staff on 100% commission and CEO remuneration that is many multiples of ordinary staff.

It will be noted that the Nolan Committee also emphasised that a public regulator or enforcer needs to behave fairly and proportionately, otherwise it will not deserve the trust of the public or those over whom it exercises the state's authority. Where people are essentially trying to do the right thing, they may not be aware how to do it, or how to improve.[88] In such circumstances, individuals will be reluctant to share information that might expose them to criticism.[89] Accordingly, where it is important that individuals should have a culture of checking if they or others are doing the right thing, a 'no blame' culture (what is called an 'open culture' in civil aviation) is essential.[90] A system that relies on whistleblowing will not support an open culture, or be particularly effective.

---

[83] O O'Neill, 'Trust, Trustworthiness, and Accountability' in N Morris and D Vines (eds), *Capital Failure; Rebuilding Trust in Financial Services* (Oxford University Press, 2014), 178; TM Jones, 'Ethical Decision Making by Individuals in Organizations: An Issue-Contingent Model' (1991) 16(2) *Academy of Management Review* 366.

[84] The 2016 Business Perceptions Survey reported 'The most important factor in encouraging businesses to comply with regulation is maintaining their reputation with customers (95%), with three-fifths (61%) deeming this essential and a further third (34%) considering it very important. This was closely followed by it simply being important to do the right thing (91%) with 55% considering this essential and 36% very important': *Business Perceptions Survey 2016 Report* (Department for Business, Energy & Industrial Strategy, 2016), BEIS Research Paper 293.

[85] Recently *Corporate Culture and the Role of Boards. Report of Observations* (Financial Reporting Council, 2016). See the associated report P Montagnon, *Stakeholder engagement – values, business culture and society* (The Institute of Business Ethics, 2016).

[86] *Corporate Governance Reform: Green Paper* (Department for Business, Energy and Industrial Strategy, 2016). This included proposals on 'increasing the connection between boards of directors and other groups with an interest in corporate performance such as employees and small suppliers' and 'strengthening the employee, customer and wider stakeholder voice within large UK companies' as well as increasing shareholder influence on executive pay and the differential between highest and lowest paid workers.

[87] See also *The Investment Association Principles of Remuneration* (Investment Association, 2016).

[88] There are many assertions of this proposition by official bodies, such as *Statement of consumer protection enforcement principles* (Office of Fair Trading, 2010), OFT1221, which stated 'We believe that most businesses aim to treat their customers fairly and comply with consumer protection law and that OFT aims to enable and encourage them to do so, and to take enforcement action only where there is no better route to securing compliance.' See also *Lightening the Load: The Regulatory Impact on UK's Smallest Businesses* (Department for Business Innovation & Skills, 2010); *Consumer Rights and Business Practices* (IFF Research, March 2013).

[89] S Dekker, *Just Culture. Balancing Safety and Accountability* (Ashgate Publishing, 2007). See recently *Building a culture of candour: A review of the threshold for the duty of candour and of the incentives for care organisations to be candid* (Royal College of Surgeons of London, 2014); *A review into the quality of NHS complaints investigations where serious or avoidable harm has been alleged* (Parliamentary and Health Service Ombudsman, December 2015).

[90] *The transformation to performance-based regulation* (Civil Aviation Authority, 2014).

On the other hand, where an individual consistently behaves unethically, such as where a concerted course of conduct intends to break the law, a proportionate response is required both as a matter or retrospective 'just deserts', to protect society, and to demonstrate to society that a fair system is being maintained. However, the fallacy is that the imposition of a sanction will necessarily affect the future behaviour of the infringer or of others.

Examples of EBR

A whole range of examples can be given of where UK public authorities have adopted supportive and responsive, rather than punitive, approaches to non-compliance, that have focused on the *behaviour* involved and have resulted in increased compliance. There is only space to mention a few examples here, omitting others from the water, gambling, human rights, food, environment and medicines sectors. One example referred to above occurred after the UK Bribery Act 2010, when the number of businesses self-reporting white collar crime to the Serious Fraud Office almost doubled from 7 reports in 2010-2011 to 12 in 2011-2012, attributable to introduction of the Act.[91]

First, the relationship between firms and local authorities' Trading Standards departments has been transformed under the Primary Authority Scheme.[92] The arrangements include written agreements on who is going to have what responsibilities, and the opportunity for questions to be answered by 'assured advice'. The Primary Authority structure has been a considerable success and is to be extended to include trade associations and some national regulatory authorities within the relationships.[93]

Faced with widespread unsafe practice in the construction sector, in the 1960s, the Health & Safety Executive (HSE) adopted a new approach, which was

> to leverage influence within the industry supply chain in high risk areas, engaging and forming partnerships with parties able to effect widespread change (such as company directors or strategic bodies focused on particular interest groups or sectors).[94] HSE's role was as a catalyst, utilising its unique overview from official data of the harm being caused industry-wide and expertise in understanding reasonably practical controls (but explicitly relying on those who created the risk ultimately to control it).
> …. The new approach centred on influencing or triggering changes, reliant on the action of others. For the theory to work in practice it was crucial that the risks to be addressed could be recognised by industry as being significant (what), and that the parties engaged with (who) were relevant and influential.[95]

The HSE's Influence Network created significant improvements especially in organisational and strategy factors relating to the management of companies and sites. The result was a fall in fatal and major injury accidents in 2012/13 to 38% of the rate in 2000/01. This was achieved by working *with* businesses rather than *against* them.

The energy regulator Ofgem has transformed its approach in a number of ways. Instead of passing individual infringements over to a department for isolated 'enforcement' action to be taken, many cases now involve agreement with the firm on what action the firm will take to address the root cause of the relevant *behaviour* so as to reduce the risk of recurrence of the problem, to make reparation or redress,

---

[91] *Corporate confessions to serious fraud office almost double in last year* (Pinsent Masons, 2013), available at http://www.pinsentmasons.com/en/media/press-releases/2013/corporate-confessions-to-serious-fraud-office-almost-double-in-last-year/.

[92] See *Regulation and growth* (BRDO, 2016), https://view.pagetiger.com/Regulation-and-Growth/Spring-2016; *Primary Authority Handbook* (Regulatory Delivery, 2016).

[93] Enterprise Act 2016, s 20 and Sch 3.

[94] This was based on earlier successful pioneering projects in the 1990s, such as the engagement with parties in charge of steelwork erection which led to recognition of the safety benefits of using nets and the elimination of deaths and serious injuries from related falls.

[95] M Webster and H Bolt (Frontline Consultants), *The effectiveness of HSE's regulatory approach: The construction example* (HSE, 2016), RR1082.

and to agree to a fine of £1, thereby triggering formal oversight that can drive wider publicity and supervision of the agreed actions. It is noteworthy that ensuring redress is paid comes *before* agreeing the formal resolution of a case, and a decision on any sanctions.

Conclusions for Competition Enforcement

Given the evidence above, the following policy is suggested to support maximised observance of competition law.

Society should adopt an approach that encourages and incentivises an ethical approach in relation to its rules, based on supporting continuous performance. Compliance with the rules needs to be seen as a partnership between society (represented by the public authorities) and the private sector. It is up to individual firms and their staff to choose whether to obey the rules or not, but it should be possible to distinguish between those whose basic intent is to make profits by adding value to society or to extract profit from society without regard to others (i.e. selfish, anti-social, criminal behaviour).

The system therefore should enable society (including staff, customers, suppliers, investors, regulators, and external observers) to see a body of evidence of the extent to which an organisation is or is not ethical (i.e. playing by society's rules)—whether the organisation is public or private. There is insufficient space to develop where what such evidence might be, but both regulators and firms may need to adopt important changes in approach. Having a code of ethics, and a 'supposed 'tone from the top' is required, but all those observing actions at whatever level should be able to feel that the culture is ethical throughout the organisation. An organisation should operate consistent with its code of ethics and an effective compliance system, but the more fundamental requirement is for a consistent ethical culture. Leniency policies need to be realigned to incentivise and recognise that result. The fundamental requirement is not for a compliance system but for an ethical culture. Ensuring such a pervasive and holistic culture is the way to address unethical behaviour, rather than old fashioned ideas on deterrence, and the prime responsibility for achieving such a culture lies with firms, but can be incentivised or deterred by public enforcement actions as much as by internal actions. Evidence of the existence of an ethical culture should exclude sanctions.

The response to infringements of rules depends critically on whether the intention behind the act was essentially ethical or not. Based on this binary decision, the consequence should be either to support improvement or to punish. In the latter situation, if individuals have committed anti-social activities, these are offences against the internal social culture of ethical colleagues, and the ethics of the firm, as much as crimes against society. Accordingly, an effective and proportionate response should be coordinated by all those groups—led by the social response of work and professional colleagues. It is not fair to impose sanctions on someone who could not have prevented an infringement by others, even if they are in some position of authority over them – if the converse were true, one might as well sanction a competition authority for an infringement by a firm.

On the other hand, if the motivation is to do the right thing, even if one fails, the response should be to aim to change behaviour so as to avoid recurrence of the risk. In order to achieve this, it is necessary to identify (as is standard practice in many regulatory systems) what the root cause is of the problem, so that it can be addressed, and that lesson learned by others. There may be many root causes, human and systemic. The analysis might conclude that it was just a mistake, or that particular incentives should be changed, or the balance between competing perceived incentives should be altered, or certain individuals should not be permitted to perform certain tasks.

It is the responsibility of public authorities to oversee the maintenance of a level playing field.[96] Even if firms and individuals have not acted unethically, the consequences of infringements should still be addressed. But this is a matter of rectifying market balance by removing illicit profits and paying redress to those harmed, rather than punishment. These aspects (redress and skimming off) should be achieved swiftly by authorities, and should be overseen *before* sanctions are considered.[97] There is ample precedent for this approach by consumer and sectoral regulators in UK, Denmark, Greece and Ireland.[98]

The prevailing enforcement policy in antitrust is fundamentally misconceived. It will not support compliance. It is unfair and will alienate firms from competition authorities. It will remove large sums unfairly and pointlessly from the economy. A new approach is needed, based on an understanding of well-established scientific knowledge of human behaviour. Within this new approach, both firms and regulators need to adopt new ways of working, based on demonstrating that they are both being ethical—doing the right thing—in everything that they do. The results should drive strong economic performance and social cohesion.

---

[96] See C. Hodges, 'European Competition Enforcement Policy: Integrating Restitution and Behaviour Control. An Integrated Enforcement Policy, Involving Public and Private Enforcement with ADR' (2011) 34(3) *World Competition* 383.

[97] C Hodges, 'Fast, Effective and Low Cost Redress: How do Public and Private Enforcement and ADR Compare?' in B Rodger (ed), *Competition Law Comparative Private at Enforcement and Collective Redress across the EU* (Wolters Kluwer, 2014).

[98] See C Hodges, *The Reform of Class and Representative Actions in European Legal Systems: A New Framework for Collective Redress in Europe* (Hart Publishing, 2008); R Money-Kyrle, 'Collective Enforcement of Consumer Rights in the United Kingdom', in Martin Schmidt-Kessel, Christoph Strünck, and Malte Kramme (ed.), *Im Namen der Verbraucher? Kollektive Rechtsdurchsetzung in Europa*, (Jena, Schriften zu Verbraucherrecht und Verbraucherwissenschaften, Band 5 Jenaer Wissenschaftliche Verlagsgesellschaft, 2015); C Hodges, 'Mass Collective Redress: Consumer ADR and Regulatory Techniques' (2015) 2 *European Review of Private Law* 829; C Hodges, *Law and Corporate Behaviour: Integrating Theories of Regulation, Enforcement, Culture and Ethics (Hart Publishing, 2015)*, ch 10; C Hodges and N Creutzfeldt, 'Transformations in Public and Private Enforcement' in H-W Micklitz and A Wechsler (eds), *The Transformation of Enforcement* (Hart, 2016).