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ENFORCEMENT BY REGULATORS THROUGH SELF REGULATION AND COMPLIANCE PROGRAMS

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Abstract of paper

A tendency can be observed where regulators (agencies) are looking for new instruments to enforce regulation. Within the traditional legal framework, regulators are equipped with vertical legal instruments to ensure compliance with the applicable rules, such as (punitive) sanctions and orders. Examples of this practice can be found with Dutch regulators such as OPTA (*Onafhankelijke Post en Telecommunicatieautoriteit*, the Dutch independent post and telecommunications authority), AFM (*Autoriteit Financiële Markten*, the Netherlands Authority for the Financial Markets) and to some extent the NMa (*Nederlandse Mededingingsautoriteit*, the Netherlands Competition Authority) and the *Consumentenautoriteit (*the Dutch Consumer Authority). A more horizontal approach is followed where - in coordination with the (association of) undertakings concerned - arrangements are made to set up rules and compliance schemes. This is done through different forms of self regulation, co-regulation or agreements (*covenants*). These regulators use these instruments as an incentive to improve compliance with regulation.

The question arises whether this practice is indeed effective and whether this is in line with the tasks of regulators to ensure enforcement of the (sector) specific rules. It should be investigated under which circumstances these horizontal instruments can be used.

According to European and Dutch law authorities have the obligation to enforce rules and to take effective measures. Do these horizontal instruments fit into the legal framework of administrative law and are they in accordance with this enforcement obligation? It can be questioned whether the sector specific regulation provides sufficient legal basis to make use of these instruments. Moreover: what can a regulator do in case the undertakings concerned do infringe the horizontal arrangements made?

In this paper these questions will be elaborated.[1]

[1] This paper is based on the Inaugural lecture of the author *De markt meester? De zoektocht naar nieuwe vormen van toezicht?* delivered upon the public acceptance of the chair of public economic law at the University of Utrecht on 18 September 2008, published The Hague: Boom Juridische uitgevers, 2009.

1. Supervising the market

Market supervision is a relatively new phenomenon. Forty years ago, it was generally accepted that only the state could oversee public services such as telephone and the utilities. In the late 1980s and early 1990s, partly as a result of new technological advances, the insight however started to emerge that these interests could perhaps be safeguarded better and more efficiently by introducing competition on these markets. Competition was seen as the instrument of choice for eliminating inefficiency, for promoting technological advances and for achieving greater prosperity. The state therefore divested itself of various tasks and left these to market forces.

At the same time, the state established independent regulatory agencies to monitor this liberalisation process and to foster and oversee fair competition. The state itself was unable to assume this role in view of the fact that it had an interest in some of the market players which needed to be supervised. In the Netherlands, these independent regulators include the *NMa*[2], the *OPTA*[3] and the NMa's Office of Energy Regulation. In addition to these *market* regulators, there are authorities, such as the *VWA*[4], the *ConsumentenAutoriteit*[5] and the *AFM*[6], which monitor companies' *conduct* to protect the interests of consumers and other users. For the sake of convenience, both kinds of authorities will be refereed to as *regulators* or *market authorities*[7]. These public authorities supervise markets and market players on the basis of legal mandates and instruments.

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2 *Horizontal supervision*

2.1 Two styles: vertical or horizontal supervision

[2] *Nederlandse Mededingingsautoriteit*, the Netherlands Competition Authority, hereinafter: *NMa*.
[3] *Onafhankelijke Post en Telecommunicatieautoriteit*, the Dutch independent post and telecommunications authority, hereinafter: *OPTA*.
[4] *Voedsel en Waren Autoriteit*, the Dutch Food and Consumer Product Safety Authority, hereinafter: *VWA*.
[5] The Dutch Consumer Authority.
[6] *Autoriteit Financiële Markten*, the Netherlands Authority for the Financial Markets, hereinafter: *AFM*.
[7] Regulator: this term shall be used in this lecture as the organ which has 'in short the task to conduct the liberalization of markets'.

Theory broadly distinguishes two styles of supervision: *vertical* and *horizontal* supervision or between *repressive* and *cooperative* supervision.[8]

Vertical supervision employs conventional supervisory instruments such as cease-and-desist orders and administrative fines to uphold the law and is a classic *command-and-control model*.[9] There is vertical steering, as conduct is dictated top-down. This is contrasted by a horizontal approach where the focus is on collaborating with the supervisee. This alternative is based on trust, and this trust is the point of departure for the relationship between the regulator and the supervisee. Examples of this more horizontal form of supervision are self-regulation, co-regulation, covenants and voluntary compliance programmes. A notable example is the new tack adopted by the Dutch tax authorities that favour an active horizontal enforcement policy.[10]

2.2 Trend towards horizontal supervision

In the last few years there has been a visible – but still cautious – trend in the Netherlands towards more horizontal supervision of the marketplace. In addition to the conventional administrative law instruments, market regulators would seem to be on the lookout for new forms of supervision designed to place more responsibility on the supervisee. Just a few examples.

[8] See for a description of these models from aen legal economic point of view: M.G. Faure, 'Onbegrensd toezicht?', in: Toezicht op markt en mededinging, *Justitiële verkenningen*, October, 6/08, p. 84-104.
[9] See R. Baldwin & M. Cave, *Understanding regulation. Theory, Strategy and Practice*, Oxford: Oxford University press, 1999, p. 35: "The force of law is used to prohibit certain forms of conduct or to demand some positive action or to lay down conditions for entry into the sector."
[10] See for a good study of the horizontal supervision of the tax collectors office and the underlying investigations (also outside the sphere of tax law): L. A. de Goffau, *Vertrouwen in horizontaal toezicht*, Tax Assurance in Beeld, Deel 3, Universiteit van Neijenrode.

VWA, the Dutch Food and Consumer Product Safety Authority

In a report on supervision and new supervisory instruments to ensure and improve its effectiveness[11], the *VWA* explores how and which instruments can be utilised most effectively. The *VWA* wishes to focus more on promoting a company's willingness to comply with the rules on consumer goods, for example via self-regulation. But if companies are unwilling to comply, it will intervene forcefully.[12]

AFM, the Netherlands Authority for the Financial Markets

The *AFM* has set itself the explicit goal of making the transition from 'rule-based' to 'principle-based' supervision. This means that the supervisee is increasingly responsible for organising its activities in such a way that these comply with the objectives laid down in law as well as with general legal standards.[13] The *AFM* has for example done this by encouraging the development of compliance programmes. In late 2007, it launched a pilot scheme for tailor-made supervision[14] in which it set up compliance programmes in collaboration with nine major financial institutions. These are the first steps towards a more open dialogue for reaching agreement and for more 'arm's length' supervision.[15]

OPTA, the Dutch independent post and telecommunications authority

In its publication on new perspectives in supervision and enforcement of March 2008[16], the *OPTA* stated that it wished its enforcement policy to devote more attention to preventing breaches of the law and other rules of conduct. It intends to achieve this by encouraging market players to develop their own compliance programmes and to implement and execute these within their own organisations, for which the *OPTA* offers its support in the form of 'compliance assistance'. If a company succeeds in upholding its own compliance programme, the *OPTA* can then exercise more remote supervision.

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[11] *Zicht op Toezicht. Effectief toezicht houden, hoe doe je dat?*, Report entitled "Naar prestaties met effect", January 2005, www.vwa.nl. (Not available in English.)
[12] Annual report 2005, p. 20.
[13] See Jaaragenda 2007 AFM, www. AFM.nl
[14] The pilot scheme is called '*Toezicht op Maat*'.
[15] See the interview with T. Brosens, *Connecties* 2008, nr. 1, p. 6-7. See also de memorandum of the AFM 'State of the art toezicht-effectief beïnvloeden', November 2007.
16 *Visie op toezicht & handhaving*, 12 March 2008, www.opta.nl. (Not available in English.)

***NMa*, the Netherlands Competition Authority**
Competition law is also placing an increasing emphasis on collaboration and negotiation, for which various new instruments such as the leniency scheme, commitment resolutions and direct settlements have been introduced. The *NMa* also encourages companies to draft their own compliance programmes and advises trade organisations as well as individual companies on these programmes.[17] At the instigation of the *NMa*, the Dutch insurance industry has for example drawn up and introduced an industry-wide compliance scheme, and the *NMa* now only monitors the effect of this scheme.

In this paper this tendency towards the increasing horizontalisation of supervision will be explained (**chapter 2.3**). Thereafter, horizontal supervision will be analysed in teh context of the regulator's tasks (**chapter 2.4**). In **Chapter 3.1** self-regulation and covenants will be discussed within the context of market supervision. In **Chapter 3.2** compliance programs used as a regulatory instrument are dealt with. Finally, it will be questioned whether this tendency will be continued under the new circumstances of the current financial crisis (**chapter 4).** Will supervisors become more cautious to apply a horizontal style of supervision?

2.3 Explaining the increased horizontalisation

There are various explanations which can be given. Firstly, regulators are being charged with an increasing number of tasks. Although there has been a clear desire during the last few years to restrict the number of regulators (referred to in Dutch Parliament with the metaphor of 'self-raising flour'[18]), in practice, they are being 'lumbered' with more and more tasks and there are regular calls for more, and more stringent supervision. The costs of the major regulators are however being viewed more critically: they need to do more with fewer resources. Politicians are demanding that resources be deployed effectively, and this has its repercussions on how regulators perform their enforcement tasks.

[17] Annual report NMa 2005. See also the speech of P. Kalbfleisch of 21 September 2005, *Integere naleving, integere handhaving*, www.nmanet.nl.
[18] […]

This tendency is also a result of a more fundamental perspective on supervision. In its report on the future of the rule of law[19], the *WRR*[20] indicated that effective enforcement of the law is an essential pre-requisite for upholding the rule of law. At the same time, it noted that the classic pattern of vertical state steering was past its prime and in need of modernisation. The *WRR* believes that there should be a more horizontal steering based on target requirements, whereby companies must have a certain leeway in deciding for themselves how to achieve the desired results, and whereby the WRR advises placing more emphasis on a company's own responsibility.[21] Such a system creates greater flexibility and allows a more alert response when adapting in line with changing social dynamics. The European Commission also points out the importance of giving companies their own responsibility, something which it refers to as *social responsibility*.[22] And the Dutch Cabinet also recently referred to the need for a more *high trust* policy, whereby companies should be trusted to chart their own courses, which will make arm's length supervision possible.

According to the *instrumental* school of thought, law is instrumental to policy objectives; it is seen as a tool for implementing government policy, and many forms of legislation for organising the market can be described as instrumental. The *guardian* role focuses on the administrative law regulation of government action and is designed to safeguard the legal position of ordinary citizens vis-à-vis the state. In this role, the administrative body is bound by rules, both in terms of substantive law and procedure. This is where the work of *VerLoren van Themaat* catches the eye: he singled out the principles of liberty, equality and solidarity (*liberté, égalité, fraternité*) as the three fundamental principles of economic law (referred to here as *VerLoren's trinity of principles*[23]). He believed that economic law decisions should be made on the basis of these three principles and that these legitimise the rule of economic law.[24] Under his influence[25], public economic law was studied not only from an

[19] WRR, *De toekomst van de nationale rechtsstaat*, Report to the Dutch government no. 63, The Hague: Sdu Publishers 2002. (Not available in English.)
[20] *Wetenschappelijke Raad voor Regeringsbeleid*, the Scientific Council for Government Policy, hereinafter: *WRR*.
[21] Report 2002, p. 259.
[22] *Green paper Promoting a European framework for corporate social responsability*, Directorate-general for Employment and Social Affairs, July 2001.
[23] '*Kenmerkende drieslag*' in Dutch: P. VerLoren van Themaat, *Het coördinatiebeginsel als coördinerend beginsel van sociaal economisch recht*, inaugural lecture upon accepting the chair of social economic law at the University of Utrecht, on 28 October 1968, Deventer: Kluwer 1968.
[24] K. Hellingman & K.J.M. Mortelmans, *Economisch publiekrecht. Rechtswaarborgen en rechtsinstrumenten*, Deventer: Kluwer, 1989, p. 86
[25] See as well the work of Van Gerven, for example: W. van Gerven, 'Schets van een Belgisch Economisch Grondslagenrecht', *SEW* 1971, p. 404 a.f.

instrumental perspective in the Netherlands, but attention was also demanded for the principles of substantive law.

VerLoren van Themaat proceeded on the basis of the principle of *liberty* – giving citizens the freedom to participate in the economy as they see fit. This principle is supported by the principle of *equality*, whereby the state must guarantee that all the players are able to participate on the market on an equal competitive footing. However, the supply and demand mechanism does not necessarily protect general interests, and this is where VerLoren's principle of *solidarity*[26] comes in. It is the state's task to protect those interests which threaten to fall between two stools as a result of a free-market system, an aspect which has been neglected in recent years. The absolute trust in the supply and demand mechanism has entailed that the principle of solidarity has disappeared further and further into the background. Attention is now - rightly so - once again being demanded for solidarity. If the spotlight focuses too strongly on commercialism, based on a more individualistic perspective on society, there is a clear emphasis on the principles of liberty and equality, but less on solidarity. Commercialism means that that the state maintains a greater distance, and leaves various issues up to market forces. If more attention is however devoted to the principle of solidarity, state measures will be more designed to stimulate companies' own responsibility. Different perspectives on man and society lead to different outcomes when these three principles are applied, and this is especially true of the solidarity principle. The application of this principle could lead to different choices, also for market supervision.

Solidarity is in fact the forerunner of what we now refer to as social responsibility, and I would like to refer to the principle of solidarity as the modern-day *principle of responsibility*. The principle of responsibility affects various aspects of public economic law. The state can *itself* take responsibility for social issues by taking steps to protect certain interests, but it can also create rules to *encourage* corporate social responsibility. By appealing to a company's own social responsibility, it is perhaps possible to ensure that certain objectives or interests are achieved better than via unilateral state measures. This is based on the assumption that good results are possible via consultation and collaboration. This is not altered by the fact that the companies concerned also have their own interests, such as their desire to avoid risks or to protect their reputation.

[26] See for an elaborated description of the notion of solidarity B. Hessel, *Rechtsstaat en economische politiek*, Zwolle: W.E.J. Tjeenk Willink, 1987.

But what does this mean for market supervision? The conviction that companies are willing to consider the interests of others in my opinion explains some of the choices which are made when setting up market supervision. The principle of responsibility plays a conscious or unconscious role when supervisory instruments are selected. After all, a regulator should focus on how companies can be persuaded to comply with the rules most effectively. If it assumes that it can achieve better results by making a greater appeal to a company's own responsibility, it could employ more *consultative* instruments than if it believed otherwise. Supervision which is on the contrary based on distrust of the supervisees will lead to more stringent and repressive action.

This in fact reflects the convergence of two different developments, resulting in an increasingly horizontal supervision. In the first place, horizontalisation is a response to an increasingly complex society which makes it virtually impossible to continue to adhere to top-down steering. The co-operation of the social stakeholders is necessary to achieve the objectives, while leaving the scope to respond effectively to new developments. Secondly, there is a clear belief that a more horizontal approach will yield better results.

As long ago as in the 1990s, a host of publications pleaded for a less vertically-oriented approach when monitoring companies' compliance with the rules. These studies pointed out the benefits of a different approach to enforcement, for example in terms of public administration, organisational studies and business ethics. They demanded attention for horizontal instruments for complying with the rules, proceeding on the basis of the view that it would be more effective to give companies more responsibility for complying with and enforcing certain rules. These non-legal disciplines also pointed out the drawbacks of a one-sided vertical approach and advocated a more integrated approach which combined the two (vertical and horizontal) styles of supervision. The best-known work is that by *Ayres and Braithwaite*[27] who developed the *responsive regulation model*

[27] I. Ayres & J. Braithwaite, *Responsive regulation: transcending the deregulation debate*, New York: Oxford University Press 1992. The pyramid is discussed on pp. 38-39. In his recent book Braithwaite has worked out his pyramid further: J. Braithwaite, *Regulatory capitalism. How it works, ideas for making it better*, Cheltenham, Uk Northampton, USA: Edward Elgar, 2008. See for a discussion of this topic for example: J. van der Pligt e.a., *Bestraffen, belonen en beïnvloeden. Een gedragswetenschappelijk perspectief op handhaving*, Den Haag: Boom Juridische uitgevers, 2007, p. 60-61. The work of Ayres & Braithwaite has influenced the Dutch tax collectors office and the VWA by the implementation of the horizontal supervision. For a critical perception about the effectivity of this pyramidmodel: see H. van de Bunt, 'Rekeningen vereffenen in de bouw', *Tijdschrift voor Criminologie* 2008 (50) 2, p. 130-147 and specifically for the enforcement practice of the VWA: P. Mascini & E. van Wijk, 'Vis ruikt nou eenmaal zo. Responsive regulation door de Voedsel en Warenautoriteit', *Tijdschrift voor Criminologie* 2008 (50) 2, p. 114-129. For other references of the various disciplines see the interesting literature study by W. Huisman & A. Beukelman,

which used an *enforcement pyramid* to examine which enforcement instruments should be deployed: a hierarchy of sanctions, graded from light to hefty, and from horizontal to vertical.

The base of the pyramid is made up of the most co-operative instruments for ensuring compliance, and the most hefty instruments, such as fines and the withdrawal of permits and licences, are found at the top. The message of the model is clear: a regulator must first confirm whether co-operation and consultation is possible, and opt for heavier sanctions only as a last resort. The instrument the regulator selects should depend not only on the characteristics of the companies concerned and the nature of the standards to be complied with, but in my opinion also on the specific circumstances of the relevant markets and the (public) interest to be protected. In that respect the pyramid illustrates the regulator's search for the right sanctions.

This *customised enforcement* system not only entails a check in the light of the principle of proportionality (which is an important guideline for lawyers when deploying enforcement instruments), but it also means that a regulator must consider horizontal sanctions first, *before* it can deploy the legal instruments at its disposal, such as a cease-and-desist order or a fine. At the same time, the model acknowledges that there should be scope for imposing heavier sanctions as a means of pressuring supervisees to ensure a better voluntary compliance.[28]

2.4 Horizontal supervision and the regulator's tasks

What does a more horizontal approach to supervision mean from a legal point of view and to which questions does it give rise?

If seen from the perspective of the regulator's tasks, the transfer of responsibility to the companies it supervises leads to a certain tension. Does this transfer mean that the regulator will still be performing the tasks with which it is charged? Or will it in fact undermine the regulator's very *raison d'etre*, viz. *supervising* companies?

Critics will wonder to which extent horizontal supervision can be combined with incentives to promote a free market system, one of the regulators' key tasks. Is there any scope for consultation with and between the market players in those fields where a viable form of competition is

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Invloeden op regelnaleving door bedrijven. Inzichten uit wetenschappelijk onderzoek, Den Haag: Boom Juridische uitgevers, 2007.

[28] See Ayres & Braithwaite 1992, p. 39.

being aimed for? In his essay on government intervention in a 'relationist' state, *Hessel* points out – and, in my view, rightly so – that there is in reality more scope for combining elements of solidarity with a free market system than the free-market model might suggest[29]. In a later essay arguing for collaboration between law and business ethics, he pleads for a consultative framework for market supervision, with mandatory state intervention as disincentive, to safeguard effective competition[30]. This need not necessarily result in the re-instatement of the old Dutch cartel paradise, as long as the regulators keep a constant finger on the pulse and ensure proper compliance with competition rules.

Competition regulators are increasingly casting around for horizontal instruments to perform their task – preventing cartels – more effectively. Supervision itself is geared more to collaboration and negotiation to track down and end breaches, especially to improve the effectiveness of the supervision and, therefore, to achieve greater competition.[31] This also applies to sector-specific regulators instructed by the EU authorities to supervise specific markets. The European Commission has already acknowledged the usefulness of implementing EU directives via *soft regulations*.[32] The national regulators should also be able to take this approach when executing regulatory directives via horizontal supervision, not only for the way in which they regulate the market, but also for the way in which they enforce the rules.[33]

In my view horizontal supervision does not conflict with the EU or Dutch in-principle obligation to enforce rules.[34] Horizontal supervision is after all not a question of turning a blind eye; it is designed to ensure that there are

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29 B. Hessel, *Overheidsoptreden in de relationistische rechtstaat. Enige kritische kanttekeningen bij de afbraak van de verzorgingsstaat*, Zwolle: W.E.J. Tjeenk Willink 1988, p. 22.
30 See B. Hessel, 'Economisch recht en bedrijfsethiek: meerdere perspectieven voor samenwerking', in: B. Hessel et al (ed.), *Over recht en bedrijfsethiek. Pleidooien voor samenwerking*, Nijmegen: Ars Aequi Libri 1998, p. 104.
31 See for a few critical observations about this horizontal approach : D. Waelbroeck, 'Le développement en droit Européen de la concurrence des solutions négociées (engagements, clémence, non-contestation des faits et transactions): que va-t-il rester aux juges?', *The Global Competition Law Centre Working Papers Series*, GCLC Working paper 01/08, www.gclc.coleurop.be.
32 See for example: L. Senden, 'Soft law, self-regulation and co-regulation in European law: where do they meet?', *Electronic Journal of Comparative Law*, January 2005, www.ejcl.org.
33 Obviously does this initial concept raise some questions. So it seems that article 4 of the Framework directive (Directive 2002/21/EG) proceed from 'the decision of a national legislational authority'. Should this practice automatically lead to a decision towards which legal remedies can be used?
34 See about the Dutch and European duty to enforce: A.T. Ottow, Telecommunicatietoezicht. De invloed van het Europese en Nederlandse bestuursprocesrecht, Den Haag: Sdu Uitgevers, 2006, p. 294-296. Besides there should be a clear distinction be made between the Dutch fulfillment of this obligation and the European principle. About the influence of the law of the European Union on this duty: for example Michiels 2006, p. 13-15.

no breaches.[35] Opting for non-public-law instruments does not mean non-compliance; compliance with the rules is the point of departure, as the company involved must abide by the law. Under horizontal supervision, the regulator must *actively* monitor compliance, but can do so precisely by encouraging companies to comply of their own accord. The regulator is under no obligation to use only repressive measures or merely seek out breaches which need to be punished.[36] The regulator should, on the contrary, see the *prevention* of breaches as an important task. There are however few administrative law instruments for such preventative supervision, and the regulator will have to come up with appropriate but creative solutions which are not available via the customary administrative law channels.

Horizontal supervision demands a different tack, not only of supervision and enforcement *practice*, but also of supervision and enforcement *law*.[37] Supervision and enforcement practice is designed to charge the company itself with more responsibility using alternative instruments such as *covenants* or *compliance agreements*, while the regulator looks on from a distance. The search for new forms of supervision is creating friction between the law and practice, as these new forms of regulation are not easy to fit into the system of administrative law: the conventional administrative law instruments are after all more vertical and repressive. In practice, new, non-conventional supervision instruments are being developed. Those developments should be treated flexibly within the context of (Dutch) administrative law.

This, for example, applies to the Dutch principle of legality (*legaliteitsbeginsel*). In most cases, there is no (special) legislation granting the regulator an explicit power to conclude covenants or compliance agreements, and such initiatives are usually made voluntarily between the supervisee and the regulator. Under dynamic conditions which characterise a market, it would be appropriate to put the principle of legality into

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[35] Vgl. J.R. van Angeren, 'Handhaven met handvesten. Hoe verhoudt het nieuwe handhaven van OPTA zich met de bestaande handhavingsmiddelen en met het algemene bestuursrecht?', *Mediaforum* 2008-9, p. 338-352, he is of the opinion that the enforcement charter of OPTA cannot be qualified as an agreement for non-compliance. The Afdeling bestuursrechtspraak has rejected the notion of agreements to tolerate: ABRvS 16 november 1995, *AB* 1996, 288. On the contrary is Blomberg of opinion that agreements to tolerate as such should be allowed: A.B. Blomberg, *Integrale handhaving van milieurecht*, Den Haag: Boom Juridische uitgevers, 2000, p. 115.

[36] Vgl. W.J. Witteveen, 'A self-regulation paradox: Notes towards the social logic of regulation', *Electronic Journal of Comparative Law*, vol. 9.1 (January 2005), www.ejcl.org. On the basis of the sociological work of Philip Selznick 'The Moral Commonwealth' Witteveen indicates that "responsive legal institutions", such as regulators, should line up in favour of the social developments and should stimulate consultation and compliance. Repressive sanctions only serve as a "last resort": p. 8-9.

[37] On the hybrid character of selfregulationforms and their indetermined juridical status is recently (again) pointed out in the VAR opinion of R.A.J. van Gestel, 'In de schaduw van het bestuursrecht', in: S.E. Zijlstra e.a., *Privaat bestuur?*, VAR Preadviezen, Den Haag: Boom Juridische uitgevers, 2008, p. 95-161.

perspective and that it should not stand in the way of a more horizontal approach to supervision.[38] It would however be better if the legislature regulated these powers in special rules. This has evident advantages: not only will it prevent disputes on these powers, but it will also offer a foothold for embedding this form of supervision into administrative law, and this could then be linked to procedural safeguards. These safeguards are still lacking at present, so that it is for example unclear in which cases a decision was made by the regulator or whether a regulator or supervisee can terminate a covenant unilaterally (and what the consequences could be).

2.5 Conclusion on horizontal supervision

In this paper it is argued that there should be more room for new forms of supervision.[39] Modern supervision demands that regulators not only steer vertically, but also keep a weather eye on the horizontal aspects. In my opinion regulators must master the art of delegating responsibility to their supervisees and not just opt for vertical supervision instruments (sanctions). Greater horizontalisation will not only improve the extent to which such rules are accepted, but also the impact of the supervision. Legislation is therefore not superfluous; legal standards will have a greater impact if the regulator makes a greater appeal to the supervisee's sense of solidarity or loyalty. Vertical and horizontal supervision instruments can be complementary and need not always be seen as two extremes. It is a question of creating the *right mix of instruments*, depending on the rules to be enforced, the nature of the supervised company and the phase of the market's development.

Regulators should however remain alert when applying a more horizontal style of supervision. Horizontal supervision entails certain risks: intensive, horizontal consultations with supervisees could lead to the *capture* of the regulator, to a lack of transparency, and the risk that other stakeholders will be sidelined. And this could threaten the principle of equality. A more horizontal supervision is therefore not a straightforward instrument for an independent regulator, and its use demands a *complex balancing act*.[40] The

[38] Ottow 2006, p. 86-96. Also the WRR points in the mentioned report out that working with goal regulations and open norms shall lead to a less strict application of the principle of legality: report nr. 63 (2002), p. 259.
[39] This is also pointed out with emphasis in the memorandum 'Bruikbare rechtsorde. Over de aard en de oorzaken van de regelgroei, de ongewenste effecten en de aanpak daarvan', *Kamerstukken II*, vergaderjaar 2003-2004, 29 279, nr. 9, p. 12 en 14.
[40] See also: W.H. van Boom, 'Financiële toezichtwetgeving en nietige overeenkomsten', *Vermogensrechtelijke annotaties*, nr. 1, 2006, p. 5-36, where he states hat due to this balancing act there is a risk that the regulator becomes an advisor instead of a supervisor.

supervision system must incorporate sufficient legal safeguards to legitimise this style of supervision and to guarantee the regulator's impartiality under all circumstances. A regulator must continually check whether there is reason to opt for vertical supervision and administrative sanctions, and it must always have these repressive instruments up its sleeve. If it becomes clear that a company is abusing the consultations or that the horizontal instruments are ineffective, a regulator will have no option but to fall back on the classic enforcement instruments.

This exploration into the right balance between horizontal and vertical supervision, between effectiveness and legality, is the great challenge in applying market supervision.

3. Self-regulation and compliance

Two horizontal instruments will be further discussed in this paper: self-regulation and compliance. Subsequently these horizontal instruments will be compared with a vertical instrument at the other end of the supervision scale: criminal law sanctions, and especially those designed for competition law. The introduction of criminal law sanctions in EU and Dutch competition law is presently the subject of debate, and gives rise to various questions.

3.1 Self-regulation and covenants within the context of market supervision

Self-regulation is not new, and centralised and decentralised governments have used this instrument in many forms for many years.[41] This is in contrast to market supervision, where there is only limited self-regulation within the framework of the supervision tasks.[42] Market supervision is in the first place designed to regulate, and takes the shape of formal resolutions. And yet there are various instances of a market being organised via agreements with the industry itself. We can distinguish between various alternatives:

[41] See for example the article by Geelhoed dealing with the various forms of self-regulation: L.A. Geelhoed, 'Deregulering, herregulering en zelfregulering', in: P. Eijlander e.a. (red.), *Overheid en zelfregulering. Alibi voor vrijblijvendheid of prikkel tot aktie*, Zwolle: W.E.J. Tjeenk Willink, 1993, p. 33-52.
[42] Self-regulation can in itself diminish detailed regulation, see: I. Bartle & P. Vass, 'Self-regulation within the regulatory state: towards a new regulatory paradigm', *Public Administration* Vol. 85, No. 4, 2007, p. 885-905.

(i) Agreements where the regulator has no power to act and whereby a company is willing to make agreements with the regulator on the pain of possible regulation in the future;
(ii) The regulator has powers, but prefers self-regulation;
(iii) Regulation takes place by the regulator on request and in cooperation with the market players (referred to as co-regulation)
(iv) Enforcement agreements (referred to as 'enforcement covenants').

The following example can be used from the practice of OPTA and the *ConsumentenAutoriteit*. A few years ago, the text messaging industry in the Netherlands introduced their own code of conduct for text messaging. The *OPTA* and the largest consumer organisation, the *Consumentenbond,* had received numerous complaints from consumers who thought they had applied for free text message services (such as ringtones and mobile phone games) but then turned out to be tied to a subscription. At the request of the Dutch State Secretary of Economic Affairs, the *OPTA* subsequently brought the market players together to tighten up their code of conduct and supervised this process from a distance. It expects the number of complaints concerning text messaging services to drop as a result of the new agreements.[43] Although the *OPTA* has no powers in this specific field, these voluntary agreements entail an improvement for the users. The regulator acts as a kind of *director* and uses its role as expert and independent regulator to persuade the industry to arrive at an acceptable arrangement in the interests of competition or consumer protection. When doing so, the regulator must naturally always continue to ensure that self-regulation does not lull the parties into a false sense of security, but actually leads to effective measures introduced by the industry itself.[44]

Another example, is the case of credit lending of the AFM.[45] After an investigation on excessive credit lending, the AFM started an intensive dialogue with the branch organizations. A new business code was developed which states clearly the criteria for complying with the principle of responsible credit lending. The AFM considers the code as a minimum standard and uses the code in its enforcement practice. This practice, where a combination of self-regulation with public enforcement can be seen as a

[43] See Annual report and Market Monitor OPTA 2007, p. 30.
[44] See in this context Huisman 2001 (p. 495), who points out that the actual work of self-regulation needs to be more examined in an empirical way. For a critical analysis of compliance codes from a legal economic point of view: R. van den Bergh, 'De maatschappelijke wenselijkheid van gedragscodes vanuit rechtseconomisch perspectief', *WPNR* 25 oktober 2008/6772, p. 792-798.
[45] This case is taken from: T. Brosens cs. 'Choices in conduct of business supervision: the case of money lending', In: Toezicht op markt en mededinging, *Justitiële verkenningen*,oktober 2008, 6/08, p. 52-65.

form of co-regulation, also known as *enforced self-regulation*[46], which offers clear advantages. It means that the industry endorses the measures and that they can be implemented quickly. The implementation of the industry's agreements into the regulator's rules will furthermore increase the regulator's enforcement powers and means that measures can be introduced in the same way for the entire industry. This does justice to the principles of equality and legal certainty.

This touches a difficult aspect of self-regulation, i.e. the enforceability of the agreements. This places the regulator in a dilemma: on the one hand it uses horizontal agreements to give companies more responsibility, but on the other, it wishes to keep a finger on the pulse to check whether these agreements are being complied with and to ensure that they remain adequate. The self-regulation process will lose a great deal of its speed and flexibility if the agreements are recorded formally in a regulatory decision. A covenant offers a small foothold, but there is great doubt about the legal value of such agreements, and the supervision context is no exception. Courts are also hard put to place such agreements within an administrative law framework[47], and when reviewing and assessing the consequences of such agreements, the court must take care to leave the regulator sufficient room to manoeuvre. The regulator must also be able to give an expert opinion and properly weigh up the interests which the agreements serve and to assess the economic repercussions. After all, that is precisely what it is equipped to do.

In this context attention can be drawn to a new legal instrument which can be of use to stimulate compliance. Since recently, the Dutch competition act has provided for a *commitment instrument*. The *NMa* can pronounce undertakings given by a company binding in a commitment resolution.[48] If, in the course of an investigation into a possible breach of the Dutch competition act, the supervisee gives an undertaking to improve its conduct, the *NMa* can record this in a resolution and waive a sanction, avoiding a lengthy sanction procedure but still putting a swift stop to the undesirable conduct. The *ConsumentenAutoriteit* has a similar

[46] Ayres & Braithwaite 1992, p. 101-132. This mode of operation boils down to the fact that the involved undertakings set their own rules and those regulatory officials check if these rules are being followed. These authors make apart from that a difference between co-regulation and enforced self regulation. In their definitions co-regulation does not uphold any public observing, though contains only a weak form of government participation: Ayres & Braithwaite 1992, p. 101-102.

[47] This is pointed out by J.A.F. Peters, 'Zelfregulering en rechter', *JBplus*, 2007, p. 186-2001. See for the application by the civil judge: I. Giessen, 'De omgang met en de handhaving van 'meervoudigheid van maatschappelijke normstelsels': een analyse van recente rechtspraak', *WPNR* 25 oktober 2008/6772, p. 785-792.

[48] Artikel 49a, lid 1 Mededingingswet, vgl. artikel 9 Vo 1/2003. The NMa has until now only used this instrument once: decision of 30 June 2008, Kinderopvang Amsterdam, nr. 5709_1/242.B931. For the European version: M.J. Frese, 'Het toezeggingsbesluit; kenmerken van een nieuw handhavingsinstrument', *M & M* 2007, nr. 2, p. 39-48 and the (literature)references therein.

instrument.[49] If a company fails to comply with its commitments, the regulator can impose sanctions, opening up the way to re-launching the original investigation. The commitments are then recorded in a resolution, this is published, and they can then be subjected to a judicial decision.

The introduction of such commitment resolutions should be encouraged. Also other market regulators should also be able to benefit from this instrument. This would enable regulators to handle cases quickly, transparently and as part of a sanction trajectory, preventing further damage. This instrument gives both the regulator and the company involved an *incentive* to round off the case more quickly, companies are not confronted with lengthy proceedings and within a short period of time it is clear where both parties stand. A sanction is moreover waived in return for the commitment. The company itself accepts responsibility and comes up with a solution to the problem. This is an effective way for a regulator to achieve rapid results, and at the same time promote the interests which it represents.[50] Such a system of commitment resolutions could prove its worth, not only in the case of enforcement, but also when drafting and observing covenants or agreements on compliance with certain rules, such as compliance agreements.[51]

3.2 Compliance programmes

This brings me to the subject of *compliance*. Criminologists and organisational experts see in-company compliance programmes as an important means of encouraging compliance with rules, and of not only preventing breaches, but also pinpointing these quickly if they do occur.[52]

[49] Article 2.23 Wet handhaving consumentenbescherming. The ConsumentenAutoriteit has until now only taken one commitment decision: decision in case 39/Garant-O-matic e.a. d.d. 30 mei 2008, www.Consumentenautoriteit.nl. **[check]**

[50] The Court of First Instance pronounced an interesting judgment about the application framework of the Commission for the usage of this instrument: GvEA 11 juli 2007, T-170/06, Alrosa Company Limited vs. Commissie, discussed by J.M.M. van de Hel, 'Het arrest Alrosa: een gepolijst raamwerk voor de toezeggingsbeschikking', *NTER*, nr. 9, September 2008, p. 242-248. According to this judgment, is the Commission while using this instrument bound by the principle of proportionality. The voluntarily character of the commitments does not discharge the Commission from taking this principle in observance.

[51] The commitment decision does have to be distinguished from the so-called direct settlement decisions, by which in bargain with the undertaking at hand with acknowledgement of the facts the procedure will be settled with a 'agreed' sanction. See for this kind of conclusion: D. Waelbroeck 2008, p. 31-49 and for the practice of the NMa: P. Kalbfleisch, *The Dutch experience with plea-bargaining/direct settlements*, written contribution for the 13th Annual EU Competition Law and Policy Workshop, EUI, Florence, 6/7 June 2008.

[52] See for an overview of studies discussed by J. van der Pligt cs., 'Handhaving. Over bestraffen, de vergeten rol van belonen en sociale normen', in: F.L. Leeuw cs., *Turven, tellen, toetsen. Over toezicht, inspectie, handhaving en evaluatie en hun maatschappelijke betekenis in Nederland*, Den Haag: Boom Juridische uitgevers, 2007, p. 67-77.

Regulators could encourage the introduction of compliance programmes in varying degrees of flexibility, from non-binding agreements to detailed enforcement covenants. This could provide scope for different monitoring and enforcement methods. The regulators would be able to dictate more rules in terms of targets and pre-requisites, but would need to monitor these in outline only.[53] It is clear from empirical studies in the environmental industry that the presence of a compliance programme is no guarantee that the rules will be (properly) complied with, but that it is an important instrument for being able to comply with environmental regulations.[54] There is no reason why this experience could not be applied to market supervision, and I believe that this could certainly be the case where the market is in a more advanced stage of liberalisation and most of the regulations have already been fleshed out.

As stated, implementing compliance systems and the agreements which these entail can be difficult in terms of administrative law supervision. To which extent can the regulator monitor the systems and the outcomes, and what consequences must the outcomes have? In other words, where does the administrative supervision end and the company's responsibility start?

The presence of a compliance programme is often 'rewarded' by the promise of lower fines.[55] If a company nevertheless commits a breach, despite a compliance programme, any fine will take account of the company's compliance efforts, and could also be reduced by any damages paid out to any injured parties. This practice is designed to encourage companies to accept their own responsibility. If the programme is however no more than window dressing, the non-compliance with the rules or the compliance programme could then be seen as an aggravating circumstance and a good reason to increase a fine.[56]

It would be advisable to actively promote the drafting and use of compliance programmes in practice, not only by taking the existence and effectiveness of these programmes into account when fines are imposed, but also by encouraging companies to implement such programmes

[53] Van de Bunt & Huisman 1998, p. 172.
[54] Huisman 2005, p. 37.
[55] See for example the Boetebeleidsregels OPTA, *Stcrt*. 11 March 2008, nr. 50, p. 27. See in this connection the speech of the president of the board of the NMa 'Integere naleving, integere handhaving' of 21 September 2005, www.nmanet.nl.
[56] In the case British Sugar the European Commission took along the non-compliance of the set compliance program to raise the penalty: decision of the Commission of 14 October 1998, case nr. IV/F-3/33.78, Pb EG, L 76/1-66 (consideration 208: "British Sugar acted in conflict with the explicit wording of its own compliance program"). See as well ECJ 29 April 2004, British Sugar vs. Commission, case C-359/01P.

themselves.[57] Supervision and enforcement policy should be geared to this.[58]

4 A new phase: the end of horizontalisation?

As a storm, regulators have been confronted with the financial crisis at the end of last year, which raises the question whether the trend towards horizontalisation can be continued or whether a more strict, vertical approach is needed under the new circumstances.

From the first reactions of market parties and the financial regulators it can be derived that they are opting for more powers and a stricter supervision by the (Dutch) (financial) regulators.[59] This suggests the use of more vertical instruments and less cooperation. It has to be investigated, however, whether the supervision of these financial markets was characterized with too many cooperative or horizontal elements and that this reaction forms a correction towards some *over*horizontalisation by these regulators.

As stated, vertical and horizontal supervision instruments should be seen as complementary. The search for the *right mix of instruments* should be depending on factors such as the rules to be enforced, the nature of the risks involved, the behaviour of the supervised companies and the phase of the market's development. Crisis leads normally to drastic changes and amendments of regulatory systems.[60] However, one should be cautious to throw away the baby with the bath water. The steps taken to introduce more horizontal elements into supervisory systems should not be stopped immediately. Supervision cannot work without confidence in and of the

[57] An example of this is the Commission Directive 2006/73/EC implementing Directive 2004/39/EC of he European Parliament and of the Council as regards organisational requirements and operating conditions for investment firms and defined terms of the purpose of that directive, obliging the introduction of the compliance officer. For the implementation in the Netherlands: F.M.A. 't Hart, 'De compliancefunctie', in: M. Jurgens & R. Stijnen (eds.), *Compliance in het financieel toezicht, Deventer: Kluwer, 2008*, p. 61-84.

[58] F.O.W. Vogelaar, 'Criminalisering van het mededingingsrecht: trendy of noodzaak?', *AA* 54 (2005) 12, p. 1019. Vogelaar pleads for an imposed internal compliance system in the field of competition law, in which the board of an undertaking can be obliged to state in their annual report that the undertaking has been 'cartel free' for the last year. He states that statements which have been made in contrary with the truth can produce a punishable fact.

[59] See for example: Position Paper Dutch insurance companies: *Verzekeraars trekken lessen uit kredietcrisis*, 5 February 2009 and BCG Report, *Bouwen aan een meer crisisbestendige verzekeringssector in Nederland. Lessen uit de kredietcrisis*, Boston Consulting Group, January 2009; Speech of J. Kellerman, member of the board of the Dutch Central bank, *Veranderend toezicht naar aanleiding van de kreditecrisis?*, Amsterdam 16 January 2009 and speech of R. Maatman, member of the board of the AFM, *Veranderend toezicht vanuit de optiek van de AFM*, Amsterdam 16 January 2009.

[60] See F. van Waarden, […]

supervised companies.[61] Compliance with the rules should be the starting point of the regulatory system. Without this building stone, market supervision will become unproductive.

It must be admitted, however, that more empirical study of the results achieved with the various enforcement styles and instruments is needed. From the recent study of *Huisman & Beukelman* (2007)[62] it follows that little is known about the achieved effects of sanctions on the compliance by undertakings. A sounder empirical basis for these effects is necessary to make responsible decisions and to correct any imbalances if necessary.[63]

These authors indicate that for the choice of the vertical or horizontal style of supervision it is necessary to know what the causes for non-compliance are. A better understanding of the possible causes will improve the efficiency[64] of the instruments used by the regulator. Studies for example indicate that a horizontal style of supervision will not work in case of an intentional infringement of the applicable rules and regulations.[65] In any case, the choice for the correct enforcement policy is not an easy task for the regulator.

[61] See also H. van der Bunt, 'De tragiek van toezichthouders', *Ars Aequi*, February 2009, p. 88-90.
[62] W. Huisman & A. Beukelman, *Invloeden op regelnaleving door bedrijven. Inzichten uit wetenschappelijk onderzoek*, Den Haag: Boom Juridische uitgevers, 2007.
[63] Reference however can be made to the interesting work of F. Fukuyama, *Het bouwen van een staat*, Contact, 2005, in which he develops criteria for the intensity of control by the state on activities in different markets. Discussed by: H. Albeda, 'Het burgerperspectief in toezicht', in: Van Leeuwen cs. 2007, p. 320-322.
[64] W. Huisman, 'Naleving van regels door bedrijven', in: Barkhuysen e.a. (red.), *Recht realiseren. Bijdragen rond het thema adequate naleving van rechtsregels*, Deventer: Kluwer, 2005, p. 49. Zie ook: W. Huisman, *Tussen winst en moraal. Achtergronden van regelnaleving en regelovertreding door ondernemingen*, Boom Juridische uitgevers, Den Haag, 2001.
[65] Huisman 2005, p. 44.

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