



Liability of Regulators (Aansprakelijkheid van Toezichthouders)

An analysis of the liability risks for regulators for inadequate supervision and enforcement, as well as some recommendations for future policy

(Een analyse van de aansprakelijkheidsrisico's voor toezichthouders wegens inadequaat handhavingstoezicht en enige aanbevelingen voor toekomstig beleid)

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Summary
(Samenvatting)

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This report concerns the liability risks for public bodies with a supervisory function in the areas of economic regulation and health and safety. The particular focus is on liability risks for inadequate supervision or enforcement. The project investigated what these risks are, and how they can be limited or eliminated. The conclusions are based on English, French, Italian, German, Belgian and Dutch law and are set in the framework of European community law and the case law of the European Court of Human Rights.

Chapter 2 (Policy framework)

The liability of supervisors is directly linked with a number of aspects of general government policy. These are as follows:

- to promote the balanced development of liability law, to discourage a claim culture and to monitor developments in this field;
- to combine a strong market with a strong government; in its role as supervisor, the government defines the rules of the game and supervises compliance therewith, which does not rule out alternative supervisory arrangements; and
- to promote a sound enforcement policy and a more professional approach to the implementation thereof, inter alia by stimulating systematic enforcement, setting priorities and learning to deal with enforcement dilemmas.

While enforcement was once the ugly duckling of a permissive society, nowadays it has turned into the white swan of government which has made responsibility, the importance of norms and values and the implementation of rules the spearhead of its policy. This shift in the policy perspective was already under way before the firework disaster in Enschede and the café fire in Volendam. More recently there has been greater reflection on finding alternatives for supervision and enforcement.

The shift in perspective has had consequences for supervisors in the sense that the concomitant legislation and case law have resulted in a reduction of their policy freedom. Enforcement is no longer simply a matter for the free policy discretion of supervisors. That is not to say that supervisors today are obligated to enforce in all circumstances, but rather that they should now have good reasons for *not* enforcing. Furthermore, a sound supervisory and enforcement policy is directly related to the supervisor's risk of being held liable; a well implemented supervisory and enforcement policy will considerably limit the possibility of a successful liability claim on the part of third parties.

Chapter 3 (Supervisors)

The supervisors to which this study relates form a very diverse and broad-ranging group, including local supervisors of safety/security (i.e. local authorities), national supervisors of safety/security (for example the *Voedsel en Warenautoriteit* (Food and Consumer Product Safety Authority)) and the new market supervisors (such as the *Nederlandse Mededingingsautoriteit* (Netherlands Competition Authority; NMa) and the *Onafhankelijke Post en Telecommunicatie Autoriteit* (the independent post and telecommunications authority which supervises compliance with legislation and regulations in the areas of post and electronic communications; OPTA). The aim of supervision is to contribute to reducing – although not eliminating – risk in the public domain, thereby promoting public confidence in the market or in the institutions (companies and persons) supervised.

The common denominators for the supervisors in this study are, in particular, that they supervise crucial fields of public interest, such as security/safety, health and the operation of the market. This supervision takes place through the use of administrative law instruments such as the *bestuursdwang* (administrative enforcement), the *last onder dwangsom* (order with conditional penalty payments), and the *bestuurlijke boete* (administrative penalty). Moreover, supervisors can commonly grant, refuse or revoke licences, approval and/or legitimation. Supervisors are subject to a *beginselflicht tot handhaving* (the 'in principle' duty of enforcement), but not to a duty to guarantee the prevention of damage to third parties.

Most supervisors can find themselves facing what is known as the "supervisor's dilemma": if a supervisor is not vigorous enough in taking action, this can result in damage to third parties, with the result that it will run the risk of being held liable (e.g. for a fire in a café which has failed to comply with safety regulations). However, if a supervisor acts too vigorously and adopts measures (such as revoking a licence or issuing a warning) which, given the circumstances of the case, are too premature, this can be damaging to the interests of supervisees, with the result that the supervisor runs the risk of being held liable for damage incurred by such parties. More generally, this amounts to the fact that supervisors have to weigh up the conflicting interests of different groups against one another.

In cases of damage to third parties, the potential liability of supervisors will run in parallel with that of the primary tortfeasor (such as the operator of the café which failed to comply with fire safety standards). Both will be jointly and severally liable vis-à-vis injured parties; in other words, the injured parties can sue both these parties for the entirety of the damage incurred. Supervisors have a right of recourse vis-à-vis the primary tortfeasor. However, in particular in the case of very extensive damage, this right of recourse can be illusory.

Alongside the parallels, there are also a number of significant differences between supervisors.

Besides the divergence in supervisors' competences, an important difference lies in the fact that market supervisors have to deal with interests which differ from those dealt with by supervisors of health and security/safety. In the case of the latter category, the interests concerned are generally acknowledged to be of great importance. Market supervisors focus their attention largely on the operation of the market and thus on financial and economic interests. However, these interests too can be of a crucial nature, as in the case of the financial supervision of banks and insurers.

Chapter 4 (Study of the situation in practice)

From a study among national and local supervisors as to the situation obtaining in practice, it emerges that the number of claims for damages brought against supervisors on grounds of inadequate enforcement supervision is relatively small. Though it was thought that the cases published on liability for inadequate enforcement supervision formed the tip of the iceberg, it would, in fact, appear that they form virtually the whole of the iceberg. The extent of the registered claims against supervisors ranges from a few hundred up to – very occasionally – tens of millions of euro.

Both national and local supervisors declare that their policy is not guided by a fear of liability claims; rather, they see such claims as a test of their professionalism. Judicial decisions against supervisors lead, where necessary, to modifications of policy.

From an examination of the situation in practice it can be concluded that, at the current time, supervisors do not regard liability claims as a particular problem. The relatively low number of registered claims would serve to bear this out. Although occasional "mega-claims" (such as in the Volendam and Enschede cases, as well as in the Vie d'Or case) warrant keeping one's figure on the pulse, such claims make little impression on the picture which supervisors have of the influence of liability law on their daily operations.

Chapter 5 (International framework)

In all of the countries under investigation in this survey (Belgium, Germany, England and Wales, France and Italy) local supervisors have been around (almost) since time immemorial, and the number of national market supervisors has risen considerably in recent years. This rise can be attributed to a number of international developments. In the first place, market supervisors have come to the fore within the framework of European policy, in which the privatisation of state monopolies and the liberalisation of, in particular, the telecommunications, energy and transport markets has been followed by the appointment of supervisors of the operation of the market in these sectors. Furthermore, Dutch competition law has been running along European lines since 1998, and the NMa has been implementing parts of European competition law enforcement since 2004. Ultimately, supervision of the financial sector has become much more intense and has

been brought within the realm of Community law in the context of the creation of an internal market for financial services. Second, supervisors in the field of security/safety – particularly (but not exclusively) local authorities – have come to the fore as a result of developments in the rulings of the European Court of Human Rights, which specify the minimum standards with which supervisors' (public authorities') security/safety policy, in particular in terms of supervision and enforcement, must comply.

The national legal systems show strong similarities with regard to the rules applicable to supervisors' liability. In principle, liability is based on fault – as is the case with public authority liability in general. Where the conduct concerned simultaneously invokes the issue of a supervisor's policy freedom, this is taken account of by adopting a more reticent approach to establishing liability based on the supervisor's conduct.

In a number of countries this has found expression in the fact that liability can only be established in cases of intention or gross negligence. By comparison with Belgium, France and Germany, England and Italy are more reticent in assuming liability on the part of supervisors, although the reticence shown by these countries can be seen to have decreased somewhat, inter alia as a result of rulings of the European Court of Human Rights.

Financial supervisors form a special category. In Belgium, Germany and England, there is a (quasi) immunity for such supervisors. In Belgium and England such immunity does not hold in the case of fraud, gross negligence or bad faith on the part of the supervisor. In Germany such immunity is absolute: even in cases of intention or bad faith, a German banking supervisor cannot be held liable for damage causally linked with inadequate supervision. The Basel Committee on Banking (consisting of central bank representatives) recommends excluding liability on the part of banking supervisors where these act in good faith, as supervisors would otherwise feel constrained in carrying out their activities on account of the risk of liability which they run. However, empirical data to bear out this effect are not provided.

From the perspective of the injured party, the liability of the supervisor is directly related to the possibility of obtaining alternative means of compensation in the event that a bank or insurer goes bankrupt. As regards banks, such a possibility exists in the form of the European Deposit Guarantee Scheme Directives. The Netherlands, Germany and Belgium have adopted the European minimum guarantee level of €20,000, while the guarantee level in other countries are higher; in Italy such level even exceeds €100,000. These guarantee levels do not, however, apply to insured parties which, for example, see their insurance company go bankrupt.

Although national authorities do not tend to take out insurance against their liability, the introduction of the new national supervisors has given fresh impetus to thinking about insurance

and, more generally, covering the costs of their liability. Moreover, it is not unusual for local supervisors (communities) to obtain insurance cover for their liability.

Chapter 6 (Legal framework)

According to Dutch law supervisors can only be liable if they have caused damage by an imputable, unlawful act. In establishing an imputable unlawful act, account is taken of the fact that a supervisor is exercising a public law task and thus enjoys a certain amount of policy freedom. In matters falling within the supervisor's policy remit, the court will not step into the supervisor's shoes. The policy freedom of supervisors is limited, in particular, by the fact that they must comply with the general principles of good governance and with the obligations arising from European law and the ECHR.

Thus, a supervisor's liability under civil law cannot be seen in isolation of the provisions of administrative, European and human rights provisions. This makes the whole area less clear-cut, but is the inevitable consequence of the international obligations which the Netherlands has entered into in this regard.

Supervisors run a liability risk in respect of a range of different types of conduct. The applicable liability standards can vary, as can the scope for policy freedom.

- If a supervisor adopts a decision (e.g. refusal of a licence) which is later overturned by the court, it will have committed a clear-cut, imputable, unlawful act and will be liable for the damage thereby caused.
- If a supervisor has made a public announcement (e.g. to the effect that an investigation has been launched against certain companies on account of a reasonable suspicion of price-fixing), its liability will depend on the wording of the press release and the way in which it can be represented in the media.
- If a supervisor has enforced inadequately (e.g. compliance with the rules of a building permit), its liability will depend on the gravity of the risk caused by non-compliance; in the case of a real and immediate safety risk, a supervisor's policy freedom will be reduced to virtually nil.

Supervisors run the risk of being held liable both by supervisees and by third parties which incur damage as a result of inadequate enforcement supervision. With regard to the latter risk, a distinction must be made between a general supervisory inadequacy (*algemeen toezichtsfalen*) – in a nutshell the failure to recognise dangerous situations – and a particular supervisory failing (*bijzonder toezichtsfalen*) – i.e. failure to address situations known to be dangerous. General supervision is largely a matter for the policy freedom of the supervisor; if the latter has a reasonable supervision and enforcement plan which it implements in an appropriate manner, the

court will usually have little room for construing an unlawful act on the part of the supervisor on the grounds of a general supervisory inadequacy (quite apart from the fact that even if the court were to come to such a conclusion, it would generally be hard to establish a causal link with the damage incurred).

The policy freedom of the supervisor has been limited by a number of different developments. A number of stipulations as to the terms of reference for supervisory and enforcement policy have been or are being incorporated into the relevant legislation, especially in the environmental and construction fields. Pursuant to European law, there are certain obligations to supervise institutions posing a particularly large security/safety risk. Pursuant to rulings of the European Court of Human Rights, there is a duty to intervene in situations which pose a direct and immediate risk to a person's life, human dignity or health. The Administrative Law Division of the Council of State has developed the "duty 'in principle' to enforce" (*beginselflicht tot handhaving*) principle, which is tantamount to an administrative body in principle having to enforce in the event of infringement of a legal provision, unless there is a concrete prospect of legalisation or unless enforcement would be disproportionate to the circumstances of the situation. Such developments have curtailed supervisors' policy freedom, especially in situations of particular risk known to supervisors.

Where a supervisor has acted in an imputably unlawful manner this does not automatically mean that it will be liable for the damage. In the first place, the legal norm infringed by the supervisor must be intended to protect against the damage as suffered by the injured party (relativity requirement, "*relativiteitsvereiste*"). In the *Duwbak Linda* judgement the Supreme Court suggested that this requirement can serve as a barrier to extensive liability on the part of the supervisor.

Second it must be established that the damage incurred by the injured party is causally connected with the imputable unlawful act of the supervisor. In practice this is not always easy to establish, and it is unclear whether the so-called *omkeringsregel* ("reversal rule" whereby the burden of proof is shifted) – a rule which works in the injured party's favour in its attempt to establish a causal link – is applicable in such cases.

Third, possible liability on the part of the supervisor may be reduced where there is contributory negligence on the part of the injured party. This can be the case, for example, where a financial supervisor has exercised inadequate supervision in respect of the unlawful sale of a certain financial product and the purchaser of such product has, at the same time, shown imputable inattentiveness.

A supervisor can be liable alongside others for one and the same damage – e.g. where a

company has infringed security/safety regulations and the supervisor has exercised inadequate supervision. In such an instance the injured party can hold both parties liable for the entirety of the damage incurred. Damages will then be shared by the liable parties pro rata in accordance with their share of blame for the damage caused. In theory the lion's share of the damages should be borne by the company which has violated the rules, but in practice this can prove to offer no redress. In such instances the damages will be borne entirely – or at least in large part – by the supervisor.

What emerges from this overview is that liability law is not a miracle remedy for injured parties and for that reason alone need not be viewed as a nemesis for supervisors. The injured party will usually have to overcome a large number of significant hurdles in order to be able to establish an imputable unlawful act on the part of the supervisor with regard to supervision and enforcement. Even in cases where such an imputable unlawful act has been established, a lack of relativity and causality can ultimately result in a claim for damages being refused.

It can be deduced from the above that a supervisor which acts reasonably does not run any real liability risk. The court does not make extremely high demands on the quality of supervision and enforcement and takes account of a supervisor's policy freedom. Moreover, a supervisor is not obligated to prevent damage to third parties in all circumstances. In that sense there is a significant parallel between the judicial standard of the "reasonably acting supervisor" and the supervisor's own professional standards. Only in the case of stricter liability for annulled decisions is the threshold for unlawful conduct lower, although in such cases the causal link between the decision and the damage incurred frequently poses certain problems for injured parties.

Chapter 7 (Functions of liability)

In theory, supervisor liability can be said to have a preventive effect on the conduct of supervisors. This effect is seen as strongest where the activities in question are systematic or calculable. However, there is no empirical study available in this area to bear out this argument. What does emerge from a study of the situation in practice is that supervisors learn from court rulings and take account of these in their quality policy.

Alongside liability law, other mechanisms can encourage a supervisor to act carefully. In this context political responsibility plays a part in the case of local supervisors and national safety/security supervisors, but not – or at least to a much smaller degree – in the case of new market supervisors, which are at a remove from politics. While the role of criminal law in this regard is very limited, administrative law and liability law constitute significant external stimuli for the supervisor. The role of administrative law and liability law should not, however, be overstated, as the court has only a limited assessment framework. It is not unreasonable to suppose that,

alongside the impact of these external factors, particularly the supervisors' own sense of professionalism encourages them to act carefully.

The awarding of damages is not the most important aim of liability law. Liability law in fact serves to establish whether there is a good reason to compensate the damage incurred by the injured party. That reason will only exist if a supervisor has committed an imputable, unlawful act through inadequate enforcement supervision. In the case of other possibilities for obtaining compensation the threshold is generally lower; damages are awarded irrespective of the issue of who is to blame. Social and private insurance schemes and payments from compensation funds are cases in point. Such compensation possibilities are available in particular in cases of personal injury and damage to property. An exception to this is the Deposit Guarantee Scheme, which pays out a maximum amount of €20,000 to account holders in the event of insolvency on the part of a banking institution.

The study – be it the examination of the situation obtaining in practice (Chapter 4), the discussion with representatives of insurers (section 7.8) or the examination of the legal status quo (Chapter 6) – has revealed that there is an insufficient factual basis for two of the arguments adduced against supervisor liability, namely that it leads both to defensive supervision and a barrage of claims. The other significant counter-argument – that supervisors work in the public interest and have to weigh up complex issues – does not apply exclusively to supervisors but also to public authorities in general and to other professional groups such as doctors.

This means that the arguments against liability currently carry less weight than those in favour of liability; the latter category includes, in particular, the preventive function of liability law and the need for supervision and enforcement to promote confidence in social and economic life; this does not mean confidence in the fact that supervisors will be able to prevent all damage, but rather confidence in the fact that supervisors, just like other authorities, companies and citizens, will assume their responsibility and thereby contribute to a society in which risks are kept to an acceptable level.

Chapter 8 (Conclusions and recommendations)

The conclusion of this study is that there is currently no reason for undue concern as regards supervisor liability. From discussions with supervisors, it would appear that this conclusion is broadly shared.

There is some difference of opinion with regard to the issue of whether *potential* problems are apparent in this area – in other words, of whether problems can be expected in the foreseeable future. From discussions with supervisors it can be deduced that they do not appear to be too concerned, but that they are naturally monitoring developments closely. More generally, most

supervisors said they regarded liability law as a useful instrument for their own learning process with regard to the quality of good supervision and enforcement, and also from the point of view that if a supervisor has not come up to the mark, then the injured parties are entitled to compensation.

Nor do the findings of Chapter 6 give any obvious grounds for assuming that problems are to be expected in the foreseeable future. Judicial opinion has been reticent in imputing liability to supervisors, requiring of supervisors no more (but also no less) than that they act reasonably. Where, in a given instance, the consequences of liability would be excessive for a supervisor, the court has the competence to moderate the extent of the damages in question (Article 6:109 Civil Code).

In a nutshell: even though the current situation with regard to supervisor liability gives no grounds for concern, there are certainly grounds for being alert to a number of issues, if only given the number of procedures pending and a possible increase in the number of cases brought. Another reason is that effective liability law is very much in the public interest.

Recommendation one is to continue with the quality policy in the area of supervision and enforcement and, in so doing, to integrate – insofar as this is still necessary – the rules relating to supervisor liability which emerge from case law. Given the link between judicial decisions in the field of supervisor liability on the one hand and the quality of supervision and enforcement on the other, the risk of liability can thereby be reduced.

Recommendation two is to set up a simple system to allow information on liability risks for supervisors to be more effectively disseminated among this group. With regard to local supervisors, the Association of Netherlands Municipalities (*Vereniging van Nedelandse Gemeenten*; VNG) is already playing an important role. As regards national supervisors, such an exchange of knowledge is lacking. Thus there are a range of judicial decisions which could be of significance for supervisory policy in general. In this way, lessons can be learned from other cases and the risk of liability reduced further. Furthermore, as a complementary measure, it is worth recommending that supervisors be obligated to incorporate such information in their annual report.

Recommendation three is to examine – insofar as this has not already occurred – the budgetary consequences of liability in the case of the new supervisors. For supervisors with legal personality, the pros and cons of liability insurance or of an alternative means of covering their liability risk should be looked into. Moreover, a mixed system involving state participation would also be conceivable. Given that supervisors differ in the liability risks which they run, no general recommendation can be given as to what would be the best financial arrangement for each

supervisor. This would have to be looked into for each supervisor on a case-by-case basis.

Recommendation four is to look into the pros and cons of a greater degree of financial liability on the part of operators. This could take the form of compulsory liability insurance with a higher level of cover (such as that applicable in Belgium) than is the norm at the present time. It could also take the form of an obligation to put up a financial security within the context of licensing.

Recommendation five is to monitor developments in the field of supervisor liability for a number of years by means of a monitoring system in order to highlight potential problems at an early stage and adopt appropriate measures in good time. Within the context of such a monitoring system, a simple, reliable and uniform registration system should be used to, inter alia, maintain up-to-date information on the cases in which a claim has been lodged against a supervisor for damage caused by inadequate enforcement supervision, on whether such claims are being honoured by supervisors, on the instances in which cases are being brought before the courts and on how a court has decided in the respective case. Furthermore, in instances where a supervisor has acknowledged liability or else such liability has been established by the court, an analysis should be conducted of, inter alia, what has gone wrong and of whether the circumstances constitute a one-off or rather structural shortcoming in the case of the supervisor.

Ultimately this report contains a number of scenarios which could be considered if the current situation with regard to supervisor liability were to change substantially to the detriment of supervisors. Data from the monitoring process (see recommendation five) could then be used to establish which of these scenarios can offer a solution to the problems which have arisen.