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## ***Refining the approach to small business liability for environmental damage***

***Blanca Mamutse\****

### *Abstract*

Discussions concerning business liability for the environment have traditionally centred on the role of large corporations. This is consistent with the extensive reach and impact of their activities. The vast majority of incorporated entities in the United Kingdom are small private companies, and thus collectively attract a substantial share of prosecution activity for environmental offences. This article contrasts the positive effects of criminal sentencing for environmental offences on the management of large companies, with the difficulty of attaching liability to the controllers of small companies. Recent developments in the field of company law have exposed a fault-line in the scope for imposing personal liability on legitimate small business operators, raising the broader question whether an improved approach to criminal sentencing is as pertinent to such businesses as they are to large businesses and illegal operators. This paper argues that these improvements should be more strongly complemented by support for such businesses to avoid non-deliberate breaches of the criminal law.

### *A. Introduction*

The role and responsibility of companies with respect to the environment is a well-traversed subject in academic literature. Reflections on this matter range from analyses of the conflicts between the fundamental company law principles of limited liability or separate corporate personality, and the goal of protecting the environment,<sup>1</sup> to companies’ ability to improve their compliance with environmental obligations by integrating hard and soft law principles into their decision-making processes.<sup>2</sup> However, while some works focus on the position of large enterprises such as

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<sup>1</sup> G. Dent, ‘Limited Liability in Environmental Law’ (1991) 26 *Wake Forest Law Review* 151 D. Bakst, ‘Piercing the Corporate Veil for Environmental Torts in the United States and the European Union: The Case for the Proposed Civil Liability Directive’ (1996) 19 *Boston College International and Comparative Law Review* 323; C. Schipani, ‘Taking it Personally: Shareholder Liability for Corporate Environmental Hazards’ (2001-2002) 27 *Journal of Corporate Law* 29.

<sup>2</sup> C. Villiers, ‘Directors’ duties and the company’s internal structures under the UK Companies Act 2006: obstacles for sustainable development’ University of Oslo Faculty of Law Legal Studies Research Paper Series No. 2010-03; J. Borck and C. Coglianese, ‘Beyond Compliance: Explaining Business Participation in Voluntary Environmental Programs’ University of Pennsylvania Law School, Public Law Research Paper No.12-06; C. Bradshaw, ‘The Environmental Business Case and Unenlightened Shareholder Value’ (2013) 33 *Legal Studies* 141.

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transnational corporations,<sup>3</sup> or acknowledge the particular problems associated with smaller companies,<sup>4</sup> there is limited comparison of the types of environmental harm perpetrated by smaller businesses and larger businesses, and the effectiveness of legal responses that are adapted to businesses of different sizes. The new approach to sentencing for environmental offences has cast a spotlight on the corporate governance implications of poor environmental compliance, for larger companies, by contrast with the reduced scope for holding controllers of legitimate small businesses personally liable for damage resulting from environmentally harmful operations. This latter effect signals the importance of taking a more rounded view of the factors hindering compliance by legitimate small business operators.

The need to differentiate between the treatment of large companies and small companies is especially relevant in the United Kingdom (‘UK’), where small businesses account for 99.3% of all private sector businesses and 51% of private sector turnover.<sup>5</sup> Companies registration data shows that ‘private limited companies have consistently accounted for over 96% of all corporate body types’ since 2006.<sup>6</sup> An average number of 2 directors and 2 shareholders per company was recorded in 2016,<sup>7</sup> reflecting very high concentration levels of ownership and control for a typical company in the UK. In addition to the demographic differences, contrasting consequences can be identified with respect to the conduct of large companies and small companies in the field of environmental liability. For example, water companies (that earn huge profits<sup>8</sup>) are frequently held to account for pollution offences.<sup>9</sup> On

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<sup>3</sup> M. Anderson, ‘Transnational Corporations and Environmental Damage: is Tort Law the Answer?’ [2001-2002] 41 *Washburn Law Journal* 399.

<sup>4</sup> K. Bergmann, ‘Bankruptcy, Limited Liability and CERCLA: Closing the Loophole and Parting the Veil’ University of Maryland Public Law Research Paper No. 2004-02, p.2 – environmental remediation costs can bankrupt small companies; P. Bentata and M. Faure, ‘The role of environmental civil liability: an economic analysis of the French legal system’ (2012) 20 *Environmental Liability: Law Policy and Practice* 120, 121 – ‘small firms can cause harm to a large number of individuals or to entire ecosystems’.

<sup>5</sup> Department for Business, Energy and Industrial Strategy, *Business Population Estimates for the UK and Regions 2017*, 1.

<sup>6</sup> *Companies Register Activities 2016-17* (Companies House, 2017), [1.1].

<sup>7</sup> *Companies Register Activities Infographic 2016*

[https://www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/547010/Companies\\_Register\\_Activities\\_infographic\\_2016.pdf](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/547010/Companies_Register_Activities_infographic_2016.pdf) (accessed 01/05/2018)

<sup>8</sup> e.g. *R v Southern Water Services Ltd* [2014] EWCA Crim 120, [16], noted that the defendant had a turnover of £0.75 billion in the previous year and profitability after tax of £156.9 million in 2013; Environment Agency, ‘Severn Trent Water fined £426,000 for repeated raw sewage leak into the Shire Brook’ (22/07/2016) – Severn Trent Water had a turnover of £1.8 billion and pre-tax interest and profit of £512.6 million in the previous financial year.

<sup>9</sup> J. Ambrose, ‘Yorkshire Water hit with £600,000 pollution fine’ *Telegraph* (21/01/2016); ‘United Utilities and contractors fined almost £1 million for polluting brook with corrosive bleach’ Environment Agency press release (15/07/2016); D. Carrington, ‘Thames Water hit with record £20m fine for huge sewage leaks’ *The Guardian* (22 March 2017); *R v Anglian Water Services Ltd* [2003] EWCA Crim 2243; *R v Southern Water Services Ltd* [2014] EWCA Crim 120; *R v Thames Water Utilities Ltd* [2010] EWCA Crim 202; *R v Thames Water*

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the other hand, there is a very high representation of small and medium sized enterprises (‘SMEs’) in the area of waste crime. In 2003, it was estimated that SMEs generated roughly 60% of commercial waste and up to 80% of pollution incidents in England and Wales,<sup>10</sup> and more recent research has established that 94% of businesses which fail to comply with their statutory obligations regarding the safe management of waste are SMEs.<sup>11</sup> The causes of non-compliance range from a lack of awareness regarding their obligations<sup>12</sup> to deliberate contraventions of the law, reaching the level of organised crime.<sup>13</sup> The business model attached to waste management activities, whereby customers tender full payment in advance for the agreed services<sup>14</sup> is attractive to dishonest operators due to its low entry costs, high profitability in the short-term, and ‘the low perceived risk of being caught and of subsequent enforcement action’.<sup>15</sup> However, it also carries the risk that (even in relation to unintended non-compliance) the business lacks sufficient capital to carry out any clean-up of the damage resulting from its activities. While various preventative approaches may be taken to address non-compliance with environmental obligations,<sup>16</sup> it is also vital for legal responses to non-compliance to be tuned to the relative needs of smaller and larger businesses – a dichotomy which has been addressed by the new Sentencing Guidelines for Environmental Offences, with ripple effects for the governance of larger companies, as discussed below. While this division may be regarded as axiomatic, it also presents a danger that the headline-grabbing effect of the successful prosecutions of large companies<sup>17</sup> will overshadow some of the emerging difficulties of imposing liability on small business operators. This paper thus aims to demonstrate that criminal sentencing techniques will have a much more limited impact in relation to legitimate small business operators, a constituency that is strongly

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*Utilities Ltd* [2015] EWCA Crim 960. The large fine recently imposed on Tesco was for a health and safety offence and an environmental offence – J. Parsons, ‘Tesco fined £8m for major petrol spill’ ENDS (16/06/2017).

<sup>10</sup> Environment Agency, *SME-nvironment Survey 2003*, 1.

<sup>11</sup> *Duty of Care Awareness Campaign Launched*, Right Waste Right Place (12/04/2016); C. McGlone, ‘Waste Industry launches SME campaign to tackle waste crime’ ENDS (12/04/2016).

<sup>12</sup> According to the Head of Regulation at the Environmental Services Association, ‘Very few organisations want to actively flout the law, but most are simply not informed about what they have to do.’ *Duty of Care Awareness Campaign Launched* (ibid); Environment Agency, *SME-nvironment Survey 2009*, 4, 7.

<sup>13</sup> C. Mills, *A Review of Waste Disposal at the Mobouy Site and the Lessons Learnt for the Future Regulation of the Waste Industry in Northern Ireland* (2013), pp.1, 2, 77, and paragraphs 5.27-5.30, 6.3.

<sup>14</sup> ‘Small firms and waste: an industry underwritten by the public purse’ 1998 ENDS 238, 31

<sup>15</sup> Defra, *A consultation on proposals to tackle crime and poor performance in the waste sector & introduce a new fixed penalty for the waste duty of care* (2018), [6].

<sup>16</sup> e.g. ‘a proactive approach’ including reliance on intelligence resources, and collaboration between concerned agencies – Environment Agency, *Cracking Down on Waste Crime: Waste Crime Report 2012-2013* (Environment Agency, 2013), 13-17; Criminal Justice Inspection Northern Ireland, *A Review of the Northern Ireland Environmental Agency’s Environmental Crime Unit* (Department of Justice, 1.3).

<sup>17</sup> e.g. I. Kaminski, ‘South West Water nets its largest ever fine for polluting Devon stream’ ENDS (01/12/2015); Environment Agency, ‘Repeated raw sewage leaks, lead to one of the largest water company fines’ (25/09/2015).

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affected by the activities of dishonest operators and yet may be constrained in their ability to avoid breaching their own legal obligations.

### *B. Background: reforms to sentencing for environmental offences*

New sentencing guidelines for environmental offences were released in 2014.<sup>18</sup> Prior to this, concerns had been expressed regarding the weakness of the sentencing framework. The levels of fine imposed were seen as being relatively low, inadequate to reflect the severity of offences or achieve a deterrent effect, and yielding inconsistent outcomes in similar cases.<sup>19</sup> The guidelines provide separate principles for the sentencing of individuals and organisations.<sup>20</sup> With respect to organisations, different starting points and ranges are prescribed for fining large, medium, small and micro-organisations.<sup>21</sup> Starting points for fines are gauged according to an organisation’s annual turnover;<sup>22</sup> though it is appreciated that certain defendants’ turnover may ‘very greatly’ exceed the threshold for large organisations,<sup>23</sup> and that some small organisations may be quite similar in nature to individual offenders (necessitating some overlap in starting points for fines).<sup>24</sup>

It is at these two extremes (largest and smallest organisations) that the implementation of a new approach to sentencing may be seen to have far-reaching implications, an observation supported by data collected to assess the impact of the guideline. A key finding from this data is that the majority of prosecutions, following introduction of the new guidelines, related to very large organisations and micro organisations.<sup>25</sup> It is thus worth examining the extent to which the principle that any financial penalty ordered ‘must be sufficiently substantial to have a real economic impact which will bring home to both management and shareholders the need to improve regulatory compliance’<sup>26</sup> manifests itself in relation to these two types of company. The impact of this principle is understandably more

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<sup>18</sup> Sentencing Council, *Environmental Offences: Definitive Guideline* (Crown, 2014).

<sup>19</sup> Sentencing Council, *Environmental Offences Guideline Consultation* (Crown, 2013), 5; P. de Prez, ‘Beyond judicial sanctions: the negative impact of conviction for environmental offences’ (2000) 21 *Environmental Law Review* 11, 12.

<sup>20</sup> *Definitive Guideline* (n.18), 2.

<sup>21</sup> *Definitive Guideline* *ibid*, 6.

<sup>22</sup> *Definitive Guideline* *ibid*, 7.

<sup>23</sup> *Definitive Guideline* (n.18), 7; Sentencing Council, *Environmental Offences: Response to Consultation* (Crown, 2014), 18.

<sup>24</sup> *Response to Consultation* (*ibid*), 19-20.

<sup>25</sup> Sentencing Council, *Assessing the impact of the Sentencing Council’s Environmental offences definitive guideline* (14/11/2016), 1.

<sup>26</sup> *Definitive Guideline* (n.18), 12.

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apparent with respect to very large companies, whereas this goal is more difficult to achieve with respect to owner-managed companies.

### *C. The corporate governance effects of sentencing large companies*

The introduction of the sentencing guidelines for environmental offences in 2014 was marked by the imposition of ‘record’ fines for pollution offences on large water companies, ranging from £2 million to £20 million.<sup>27</sup> These developments made a public impression, as conveyed by a news article attributing the size of the largest fine to the inception of the sentencing guidelines:

Water companies have been the most frequent polluters of beaches and rivers in England and past fines were criticised as too low to deter these highly profitable companies that often offended repeatedly. But a change in sentencing guidelines in 2014 is now leading to far heavier penalties...[O]ne source close to the issue told the Guardian recently: “The courts have basically added a nought. Once it gets to that level, the boards and shareholders of water companies start to take notice.”<sup>28</sup>

For the year following the introduction of the guidelines, the ENDS publication compared 5 prosecutions for major water firms – carrying sanctions of £1.5 million altogether and an average fine of £296,500 per prosecution, with 14 water company sentences during the previous year carrying overall fines of £1.3 million and an average fine of £94,036 per case.<sup>29</sup> The achievement of the desired effect, to reach the management of large companies, is illustrated by the statements made by the chief executive and managing director of United Utilities respectively, concerning fines of £300,000 and £750,000, indicating that the company had since adopted corrective measures;<sup>30</sup> and the court

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<sup>27</sup> D. Carrington, ‘Southern Water fined record £2m for sewage leak on Kent beaches’ *Guardian*, 19/10/2016; ‘Thames Water given record £20.3m fine after 1.4bn litres of raw sewage pollute river, killing thousands of fish’ *Telegraph* (22/03/2017).

<sup>28</sup> D. Carrington, ‘Thames Water hit with record £20m fine for huge sewage leaks’ *Guardian* (22/03/2017).

<sup>29</sup> C. Francavilla, ‘Guidelines bring order to environmental sentencing’ *ENDS* (25/08/2015).

<sup>30</sup> S. Roach, ‘United Utilities fined £750k for “reckless failure” in raw sewage incident’ *ENDS* (05/03/2015); R. Salvidge, ‘United Utilities fined £300,000 for drinking water contamination’ *ENDS* (11/10/2017).

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apology tendered by the managing director of Powerday plc for failures giving rise to £1 million in fines.<sup>31</sup>

The size and impact of the fines is in keeping with the view that enforcement of regulatory obligations through the criminal law should be reserved for ‘the most serious cases of non-compliance’.<sup>32</sup> However, it is vital to acknowledge the emphasis which the courts placed on using fines as a means of strengthening the accountability of the senior management of very large companies, even before the introduction of the guidelines. The judicial approach to sentencing was underpinned by similar considerations regarding the intended deterrent effect of penalties for management and shareholders of companies, and the aggravating/mitigating features of offences.<sup>33</sup> *Re Southern Water Services Ltd*<sup>34</sup> involved an appeal against a £200,000 fine for the discharge of untreated sewage into the sea by a company with ‘a record of persistent offending’.<sup>35</sup> The Court of Appeal found that the board of directors had ‘failed to appreciate the seriousness of the criminality’ associated with this offence, and stipulated that

in offences of the seriousness of the kind represented by this case it is incumbent on the Chief Executive and main board of the company - particularly one with a serious record of minor criminality which this company has - to explain to the court the cause of its offending behaviour, the current offence and its proposals for protecting the public from such further offending.<sup>36</sup>

Accordingly, the court saw no basis for interfering with the fine imposed by the lower court, affirming that in the circumstances of this case it would have refrained from interfering with a fine ‘very substantially greater’ than the one appealed against.<sup>37</sup> Similarly, in *R v Sellafield Ltd; R v Network Rail Infrastructure Ltd*<sup>38</sup> the Court of Appeal concurred with the view that Sellafield Ltd’s failings in processing and disposal of waste evinced management failures that were attributable to a customary laxity or complacency within the company, and senior management should shoulder a share of responsibility for ‘the clearest negligence’ in circumstances where the failure could have been easily

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<sup>31</sup> Environment Agency, ‘Waste firm ordered to pay more than £1.2m for waste offences’ (13/04/2016)

<sup>32</sup> Law Commission, *Criminal Liability in Regulatory Contexts: a Consultation Paper* (Crown, 2010), 1.5.

<sup>33</sup> *R v Thames Water Utilities Ltd* [2010] EWCA Crim 202, [39].

<sup>34</sup> [2014] EWCA Crim 120.

<sup>35</sup> *Ibid*, [18].

<sup>36</sup> *Ibid*, [19].

<sup>37</sup> *Ibid*, [21].

<sup>38</sup> [2014] EWCA Crim 49.

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avoided and quickly detected.<sup>39</sup> The court drew on the statutory obligation to have regard to an offender’s financial position<sup>40</sup> and a mirror principle in the Health and Safety Offences sentencing guideline regarding fines being ‘sufficiently substantial to bring home to management and shareholders’ the importance of legislative compliance,<sup>41</sup> in reaching its conclusion that the £700,000 fine would convey the seriousness of the offence to Sellafield’s directors and shareholders. It would also ‘provide a real incentive to the directors and shareholders to remedy the failures’ found to have existed, particularly any elements of laxity or complacency.<sup>42</sup> With respect to non-dividend companies such as Network Rail, the company’s reduction of directors’ bonus remuneration in consequence of a poor safety record was regarded as an appropriate incentive for executive directors to reform the company’s offending behaviour.<sup>43</sup> In *R v Thames Water Utilities Ltd*,<sup>44</sup> the company appealed successfully against a £125,000 fine for river pollution. It argued, *inter alia*, that the fine was manifestly excessive as it took insufficient account of the voluntary pledge of £500,000 that it had made towards restoration of the river. Reducing the fine to £50,000, the Court of Appeal recognised that this ‘exceptional’ reparation had ‘clearly brought the necessary deterrent message home’ to the company’s management, shareholders and others;<sup>45</sup> and that the imposition of relatively modest sentences in such circumstances may divert attention from the seriousness of the offence.<sup>46</sup> Compared to SMEs, large companies are well-placed to shoulder voluntary expenses in the interests of ‘pre-empting public criticism and negative publicity’.<sup>47</sup>

Overall therefore, the judicial approach prior to the introduction of the guidelines indicates how sentencing techniques were used to capture the attention of key corporate actors and galvanise changes in management practices. Indeed, in the 2015 decision in *R v Thames Water Utilities Ltd*,<sup>48</sup> the first case to be decided following introduction of the sentencing guidelines for environmental offences, the Court of Appeal echoed *R v Sellafield Ltd* in offering guidance on the approach for

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<sup>39</sup> [25]-[27], [31].

<sup>40</sup> Criminal Justice Act 2003, s.164.

<sup>41</sup> Sentencing Council, *Health and Safety Offences, Corporate Manslaughter and Food Safety and Hygiene Offences: Definitive Guideline*, 10. The overlap between these cases and the sentencing principles applicable to health and safety offences is acknowledged in *R v Thames Water* (n.33), [39]

<sup>42</sup> *R v Sellafield* (n.38), [65].

<sup>43</sup> (n.33), [70].

<sup>44</sup> [2010] EWCA Crim 202.

<sup>45</sup> *Ibid*, [55].

<sup>46</sup> *Ibid*, [56].

<sup>47</sup> P. de Prez, ‘Beyond judicial sanctions: the negative impact of conviction for environmental offences’ (2000) 2 *Environmental Law Review* 11, 20.

<sup>48</sup> [2015] EWCA Crim 960.

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sentencing ‘very large commercial organisations run for profit.’<sup>49</sup> It noted that while ‘no amount of management effort can ensure that no unauthorised discharge can ever occur’,

[e]ven in the case of a large organisation with a hitherto impeccable record, the fine must be large enough to bring the appropriate message home to the directors and shareholders and to punish them. In the case of repeat offenders, the fine should be far higher and should rise to the level necessary to ensure that the directors and shareholders of the organisation take effective measures properly to reform themselves and ensure that they fulfil their environmental obligations.<sup>50</sup>

A significant mitigating effect would be provided by ‘[c]lear and accepted evidence from the Chief Executive or Chairman of the main board that the main board was taking effective steps to secure substantial overall improvement in the company’s fulfilment of its environmental duties’.<sup>51</sup> It was noted that in the absence of the explanation provided by the company’s External Affairs and Sustainability Director, the facts of the case and the company’s record of prior offences would ‘have required the Court to take a starting point for a fine significantly into seven figures’.<sup>52</sup>

The potential impact of sentencing techniques aimed at influencing the conduct of the managers and shareholders of large companies is especially important in relation to defendants that are large private companies owned entirely by parent companies<sup>53</sup> or by professional shareholders;<sup>54</sup> compared to public companies that are quoted on the Stock Exchange, and thus subject to wider share ownership and listing requirements.<sup>55</sup> Indeed, a key benefit of the sentencing guidelines is that they permit the resources of any organisation linked to an offender to be taken into account;<sup>56</sup> a factor recognised as salient in *R v Ineos ChlorVinyls Ltd* where the defendant company was operating at a loss but capable of obtaining any necessary finance from its parent company.<sup>57</sup> This enables the courts to circumvent the fundamental principle that ‘each company in a group of companies ...is a separate legal entity possessed of separate legal rights and liabilities’.<sup>58</sup> As the prospect of fines exceeding £100 million

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<sup>49</sup> *Ibid*, [33]–[42].

<sup>50</sup> *Ibid*, [42].

<sup>51</sup> *Ibid*, [41].

<sup>52</sup> *Ibid*, [45].

<sup>53</sup> e.g. *Network Rail, R v Sellafeld Ltd* (n.38), [7].

<sup>54</sup> e.g. *Sellafeld Ltd, R v Sellafeld Ltd* *ibid*, [7]; *R v Southern Water Services Ltd* [2014] EWCA Crim 120, [1], [16]–[17].

<sup>55</sup> P. Davies, *Introduction to Company Law* (2<sup>nd</sup> edn OUP, 2010), 15–16.

<sup>56</sup> *Definitive Guideline* (n.18), 6.

<sup>57</sup> [2016] EWCA Crim 607, [12], [20].

<sup>58</sup> *Albacruz v Albazero* [1977] AC 774, 807.

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becomes increasingly realistic,<sup>59</sup> this device may come to play a more significant role in circumstances where an offender lacks the financial capacity to discharge its fines.

Although the introduction of the guidelines is credited with inducing ‘far greater engagement from senior managers of large companies’,<sup>60</sup> there is a danger that companies may come to regard accruing a series of convictions as an inevitability of trading.<sup>61</sup> Hence, a welcome development is the proposed introduction of ‘a voluntary set of corporate governance principles for large private companies’<sup>62</sup> aimed at enhancing the governance and scrutiny of the UK’s largest privately-held businesses.<sup>63</sup> This reflects a recognition of the high degree to which governance and actions of such companies can affect the interests of a variety of stakeholders,<sup>64</sup> and the operation of the principles will be specially pertinent to sectors where the majority of companies are private,<sup>65</sup> more reliant on debt than equity financing,<sup>66</sup> owned by holding companies<sup>67</sup> (accordingly, not subject to the type of oversight associated with stock exchange listing or dispersed share ownership), and benefit from low levels of competition in their sectors.<sup>68</sup> The corporate governance principles also have the potential to provide an important counterweight to one of the uncertainties identified with respect to the sentencing guidelines, namely that they do not indicate what constitutes ‘very large organisations’ or stipulate appropriate starting points or ranges of fines for such organisations.<sup>69</sup> Consequently, the approach to sentencing organisations with a turnover exceeding £1 billion is being developed through the high-profile cases that fall for prosecution.<sup>70</sup> While much will depend on the ultimate substance and implementation of the principles, a company’s assertions that it is incorporating wider interests into its decision-making, would be difficult to square with a weak record of compliance with its environmental obligations; particularly if these failures show that returns to shareholders<sup>71</sup> or lower

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<sup>59</sup> *R v Thames Water* (n.48), [40]; J. Thornton, ‘Significant UK Environmental Law Cases 2016/17’ (2017) 29 *Journal of Environmental Law* 367, 374.

<sup>60</sup> P. Kellett, *The EA’s approach to enforcement undertakings* 2016 ENDS 493.

<sup>61</sup> de Prez, (n.47) 22.

<sup>62</sup> DBEIS, *Corporate Governance Reform: Government Response* (Crown, 2017) 3.27.

<sup>63</sup> *Ibid*, 36-42.

<sup>64</sup> *Government Response*, *ibid* 3.23; DBEIS, *Corporate Governance Reform: Green Paper* (Crown, 2016) 3.2.

<sup>65</sup> Comptroller and Auditor-General, *The economic regulation of the water sector* (National Audit Office), 37-39.

<sup>66</sup> *Ibid*, 9, 34.

<sup>67</sup> *Ibid*, 40; J. Cox, *Observations on the regulation of the water sector* (Ofwat, 2013), 8.

<sup>68</sup> de Prez (n.47), 18.

<sup>69</sup> *Definitive Guideline* (n.18), 7; U. Azmeh, *Judicial warning – deterrence and large organisations* (2015) 2 *Sentencing News* 12; L. Harris, ‘*R v Thames Water Utilities Ltd* sentencing – environmental offences- very large organisations’ 2015 *Criminal Law Review* 739.

<sup>70</sup> *R v Thames Water* (n.44), [33]-[42]; *R v Sellafield* (n.38), [7].

<sup>71</sup> Cox, (n.67) 4.

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operating costs<sup>72</sup> are prioritised over other stakeholder relationships. Criminal sentencing manages these stakeholder relationships to some extent, as seen in the recent prosecution of Thames Water where Sheridan J directed that the company should fully internalise the £20 million fine rather than passing on the cost to its customers.<sup>73</sup> However, measures of this nature are essentially reactive, and should not detract from businesses’ ability to deploy proactive and creative approaches to their promotion of stakeholder interests.

#### *D. Sentencing challenges with regards to smaller companies*

The impact of the sentencing guidelines on small companies has not attracted the same level of judicial comment or media attention as the penalties imposed on large companies. This is consistent with the Environment Agency’s prediction that the guidelines would have a greater effect on fines for very large, large and medium-sized organisations than on individuals and smaller organisations.<sup>74</sup> The goal of deterring commission of future offences has been pursued through the imposition of confiscation orders.<sup>75</sup> In cases involving smaller enterprises, confiscation orders have consequently been imposed for amounts as high as £1.99 million, even in instances where a nominal fine is awarded.<sup>76</sup> Confiscation is the second step to be considered in the sentencing of organisations or individuals in Crown Court cases,<sup>77</sup> and the significant role that such orders play is recognised by the Mills Report, which calculated that confiscation orders in 25 environmental cases between 2009-2013 yielded almost £700,000 more than fines in 470 environmental cases between 2003-2013.<sup>78</sup> In addition to the deterrence function, confiscation orders also provide a means of ensuring compensation for environmental damage, for example to fund an environmental regulator’s clean up of illegal waste,<sup>79</sup> or in situations where innocent landowners might otherwise be burdened with responsibility for

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<sup>72</sup> N. Parpworth, ‘The Environmental Offences Sentencing Guideline and the Court of Appeal’ 2016 *Journal of Planning and Environmental Law* 3, 9-10.

<sup>73</sup> Environment Agency, ‘Thames Water ordered to pay record £20m for river pollution’ (22/03/2017).

<sup>74</sup> A. Brosnan, ‘The New Environmental Offences Sentencing Guideline – a Summary with Comments’ (2014) 16 *Environmental Law Review* 203, 210.

<sup>75</sup> Under Proceeds of Crime Act 2002, Part 2; Environment Agency, ‘Oldbury man sentenced for running illegal waste operation’ (14/07/2014), statement on behalf of Environment Agency: ‘We are increasingly using the Proceeds of Crime Act 2002 to trace the money made by their illegal trade and to make polluters pay for their actions.’ See also Environment Agency, ‘Company hands over almost £250,000 proceeds of crime’ (28/01/2015).

<sup>76</sup> Environment Agency, ‘Melksham Metals boss to pay £1.99 million or be jailed for 8 years’ (20/10/2017); Environment Agency, ‘Company hands over almost £250,000 proceeds of waste crime’ (28/01/2015).

<sup>77</sup> *Definitive Guideline* (n.18), 4, 16.

<sup>78</sup> (n.13), 3.30.

<sup>79</sup> C. McGlone, ‘Skip hire siblings given three months to pay £300,000’ ENDS (17/04/2018).

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clean-up costs.<sup>80</sup> The Report nonetheless observed that the highly profitable nature of waste crime meant that confiscation orders did not have a sufficient deterrent effect.<sup>81</sup>

Against this backdrop, the outcome of *R v Powell*<sup>82</sup> raises questions regarding the extent to which the effects of a tougher sentencing approach should be felt by the controllers of legitimate small businesses. This Court of Appeal judgment centred on the issue whether confiscation orders made against JP and JW, directors and shareholders of Wormtech Ltd (‘Wormtech’), could be varied upwards. JP and JW had been convicted of consenting or conniving as directors in Wormtech’s failure to comply with the conditions of its environmental permit. The company had a permit for a composting facility on land belonging to the Ministry of Defence (‘MoD’). The conditions of the permit were repeatedly breached, resulting in pollution of the site that had to be cleaned up by the MoD (as landowner) and the State at a cost of roughly £1.125 million. Among other sanctions, confiscation orders had been made against JP and JW, who were found to exercise control over the company (although there were 3 other shareholders). Although Wormtech was initially charged with offences together with JP and JW, the prosecution was not pursued after it went into liquidation. This left the burden of any financial recovery to be borne by JP and JW. Thus the Crown argued that JP and JW should be held liable for the pecuniary advantage that Wormtech had derived from its failure to comply with the permit or to clear up the site once it became polluted. This necessitated some argument regarding the circumstances in which the corporate veil could be pierced in criminal cases.<sup>83</sup> In particular, the question whether the principle in *R v Seager & Blatch*<sup>84</sup> that the veil of incorporation should be torn away where an offender had committed criminal offences in the name of a company that resulted in the offender’s conviction<sup>85</sup> could be reconciled with the decision of the Supreme Court in *Prest v Petrodel Resources Ltd*,<sup>86</sup> that the courts may disregard the corporate veil in cases where the evasion principle applies. This principle is invocable where an independent legal right exists against the controller of a company, and the corporate form is interposed for the purpose of using the company’s separate legal personality to ‘defeat the right or frustrate its enforcement’.<sup>87</sup> In *Powell*, the Court of Appeal took the *Seager & Blatch* principle as one which required the court to take account of

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<sup>80</sup> C. McGlone, ‘Waste criminal jailed twice and loses home for failure to pay up’ ENDS (20/10/2017).

<sup>81</sup> (n.13), 3.30.

<sup>82</sup> [2016] EWCA Crim 1043.

<sup>83</sup> *Ibid*, [10].

<sup>84</sup> [2010] 1 Cr App R (S) 60.

<sup>85</sup> *Ibid*, [76].

<sup>86</sup> [2013] UKSC 34.

<sup>87</sup> *Ibid*, [28], [35].

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‘the nature and extent of the criminality involved’.<sup>88</sup> Where the issue of piercing the corporate veil arose in confiscation proceedings, a relevant distinction could be made between cases where an entire enterprise was lawful, and cases where the lawful provision of goods/services was tainted by illegality.<sup>89</sup> Factors worth noting in this case were that the company had been founded for the legitimate disposal of food waste, and obtained the necessary permits and suitable premises for this purpose.<sup>90</sup> It had expended a significant amount on consultants and the costs of compliance with regulations and the permit.<sup>91</sup> JP had made substantial personal investments into the company, and finance agreements, and suffered a considerable personal loss on its failure; JW had also provided guarantees for Wormtech’s debts.<sup>92</sup> The nature of criminality thus showed that this was a legitimate business that had breached the criminal law through non-compliance with regulations, rather than a device for abusing the corporate shield.<sup>93</sup> Notably, for the application of the evasion principle, there was no identifiable ‘right, liability, obligation or restriction’ on JP or JW that existed separately from Wormtech<sup>94</sup> – their criminal liability as managers/officers arose in ‘a secondary way’,<sup>95</sup> ‘parasitic upon proof that the company had committed an offence’.<sup>96</sup> Thus, in the absence of evidence that Wormtech’s legal personality had been used to defeat or frustrate the enforcement of some right against JP or JW, the conditions for attaching liability for clean-up costs to the two could not be fulfilled.

The outcome of the *Powell* case should be viewed in light of the equivocal response to the evasion principle articulated in *Prest*, despite the momentous nature of the latter decision. Within the Supreme Court, Lady Hale expressed doubts as to whether ‘it is possible to classify all of the cases in which the courts have been or should be prepared to disregard the separate legal personality of a company neatly into cases of either concealment or evasion’.<sup>97</sup> Lord Mance and Lord Clarke likewise cautioned against foreclosing ‘all possible future situations which may arise’.<sup>98</sup> Lord Neuberger agreed with the separation between evasion and concealment cases,<sup>99</sup> but had reservations whether certain

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<sup>88</sup> (n.82), [24].

<sup>89</sup> *Ibid*, [24].

<sup>90</sup> *Ibid*, [25].

<sup>91</sup> *Ibid*, [26].

<sup>92</sup> *Ibid*.

<sup>93</sup> *Ibid*, [27].

<sup>94</sup> *Ibid*, [29].

<sup>95</sup> *Ibid*, [30].

<sup>96</sup> *Ibid*, [27].

<sup>97</sup> *ibid*, [92], a point conceded by Lord Sumption: ‘Many cases will fall into both categories...’ [28].

<sup>98</sup> *Ibid*, [100] and [103].

<sup>99</sup> *Ibid*, [60]-[61].

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cases<sup>100</sup> identified in Lord Sumption’s lead judgment as instances in which the veil had been correctly pierced according to the evasion principle,<sup>101</sup> could have been resolved differently.<sup>102</sup> Academic commentary regarding *Prest* has fastened on the inconclusive nature of the evasion/concealment labels,<sup>103</sup> the potency of the notion that evasion is/should be the only form of abuse justifying veil-piercing,<sup>104</sup> and whether the precedent canvassed by Lord Sumption fully supports the demarcation between evasion and concealment.<sup>105</sup> This untidiness envelops authorities such as *Buckinghamshire CC v Briar*,<sup>106</sup> a well-known case on veil-piercing in the environmental context. Mr and Mrs Briar were held liable for the (£1.27 million) costs of cleaning up unlawful tipping on land that they had owned before it was registered in the name of a company that was found to be a ‘mere façade’.<sup>107</sup> The court held that the case fulfilled the veil-piercing criteria accepted in *Trustor AB v Smallbone (No. 2)*,<sup>108</sup> a case whose designation in *Prest* as an example of the concealment principle is subject to debate.<sup>109</sup>

There is some consensus though that the *Prest* decision has restricted the scope for veil-piercing ‘down to a margin which is close to zero’<sup>110</sup> or ‘to a point of near extinction’.<sup>111</sup> Legitimate small business operators in a similar position to JP and JW in *Powell* may also derive some assurance from the lack of ‘a different approach to the separate legal identity of companies’ in the context of confiscation proceedings<sup>112</sup> and the courts’ emphasis that decisions regarding personal liability in confiscation matters should be tailored to the facts and circumstances of each case.<sup>113</sup> In the setting of environmental offences, these factors appear to deflate the sentencing aims of punishment, deterrence and reparation.<sup>114</sup> However, it is doubtful whether these aims should be accorded the same level of prominence with respect to legitimate small operators as they warrant concerning illegal operators and large companies, when considered against the difficulties experienced by such small

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<sup>100</sup> *Gilford Motor Co Ltd v Horne* [1933] Ch 935; *Jones v Lipman* [1962] 1 WLR 832.

<sup>101</sup> (n.86), [29].

<sup>102</sup> *Ibid*, [69]-[72].

<sup>103</sup> S. Griffin, ‘Disturbing Corporate Personality to Remedy a Fraudulent Incorporation’ (2015) 66 *Northern Ireland Legal Quarterly* 321, 339.

<sup>104</sup> E. Lim, ‘Salomon Reigns’ 2013 *Law Quarterly Review* 480, 483-484; A. Schall, ‘The New Law of Piercing the Corporate Veil in the UK’ (2016) 13 *European Company & Financial Law Review* 549, 565-570.

<sup>105</sup> *Ibid*.

<sup>106</sup> [2002] EWHC 2821.

<sup>107</sup> *Ibid*, [152].

<sup>108</sup> [2002] 1 WLR 1177.

<sup>109</sup> Schall (n.104), 565-570; Lim (n.104), 483-484.

<sup>110</sup> Schall *ibid*, 562.

<sup>111</sup> Griffin (n.103), 341. See also *Prest* (n.86), [35], [62], [100], [103].

<sup>112</sup> K. Laird, ‘Piercing the corporate veil in confiscation proceedings’ 2017 *Law Quarterly Review* 217, 222.

<sup>113</sup> *R v Powell* (n.82), [32]; *R v Boyle Transport (Northern Ireland) Ltd* [2016] 4 WLR 63, [97].

<sup>114</sup> Identified in *R v Thames Water* (n.33), [39]; *R v John Paul Braniff* [2016] NICA 9, [13].

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businesses. For example, in situations where profit margins are squeezed by the actions of illegal operators,<sup>115</sup> legitimate operators may be more inclined to grasp any competitive advantages that flow from non-compliance with their obligations.<sup>116</sup> In *R v Powell*, the Court recognised that Wormtech’s profit margins had been low,<sup>117</sup> and that failure to comply with regulations at the material time stemmed from a desire to increase its profitability.<sup>118</sup> Insofar as the penalties for illegal activity that undermines responsible business are still perceived as being an inadequate deterrent,<sup>119</sup> this seems likely to continue. Weak compliance records and rudimentary strategies on the part of SMEs are also attributed to their limited financial, human and technological resources.<sup>120</sup> Added to this, empirical research has found that ‘SMEs only consider non-compliance to be an issue if raised by a regulator and only “serious” if prosecuted’.<sup>121</sup> This is illustrated by the prosecution in *R v Rory J Holbrook Ltd*,<sup>122</sup> where the determination of the defendant company’s culpability included a finding that there was no employee within the company who was suitably qualified to make appropriate applications for permits and exemptions, nor an internal monitoring system to enable the company to detect when it was acting unlawfully, or to investigate and react to deposits of suspect waste;<sup>123</sup> despite a previous conviction some years earlier for depositing waste without a waste management licence.<sup>124</sup> Reports of other small business prosecutions also indicate that defendants lacked the financial capacity to address problems when they first arose, with the result that the situation grew beyond their control;<sup>125</sup> and that the inadequacy of the company’s risk prevention systems and infrastructure stemmed from the owner-manager’s lack of prior research combined with the unexpectedly rapid growth of the company.<sup>126</sup> The facts of *R v Powell* furthermore show how a regulated business’s compliance may be affected by the competing demands and expectations of its stakeholders.<sup>127</sup> The courts acknowledged that Wormtech ‘had provided a valuable service for some

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<sup>115</sup> Eunomia, *Waste Crime: Tackling Britain’s Dirty Secret* (ESAET, 2014), 7.

<sup>116</sup> C. Wilson, I. Williams, S. Kemp, ‘An Evaluation of the Impact and Effectiveness of Environmental Legislation in Small and Medium-Sized Enterprises: Experiences from the UK’ (2012) 21 *Business Strategy and the Environment* 141, 153.

<sup>117</sup> (n.82), [25].

<sup>118</sup> *Ibid*, [27].

<sup>119</sup> J. Carpenter, ‘EA chair calls for tougher penalties for waste criminals’ ENDS (22/03/2018).

<sup>120</sup> G. Lynch-Wood, D. Williamson, ‘Understanding SME responses to environmental regulation’ (2014) 57 *Journal of Environmental Planning and Management* 1220, 1223.

<sup>121</sup> Wilson et al, (n.116) 152.

<sup>122</sup> [2015] EWCA Crim 1908.

<sup>123</sup> *Ibid*, [6], [7], [13].

<sup>124</sup> *Ibid*, [13].

<sup>125</sup> S. Ghaiwal, ‘Investigation revealed hazardous waste stored illegally’ (2015) 21 *Health & Safety at Work* 6.

<sup>126</sup> Environment Agency, ‘Illegal waste site and exports uncovered’ (03/04/17)

<sup>127</sup> V. Nielsen, C. Parker, ‘To What Extent do Third Parties Influence Business Compliance?’ (2008) 35 *Journal of Law & Society* 309, 312.

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years to the communities it served,<sup>128</sup> but experienced difficulties in effecting structural changes to the site due to the reluctance of the MoD (as owner of the site) to permit such adjustments to be made.<sup>129</sup> Thus, contrary to the perception that third parties can exert a positive influence on business compliance where they control resources that are important to a business,<sup>130</sup> stakeholder demands/expectations may diminish a business’s legal compliance.<sup>131</sup> Given the MoD’s status as one of the UK’s largest landowners,<sup>132</sup> this presents a missed opportunity to act as a surrogate regulator,<sup>133</sup> at a time of growing concern regarding the Environment Agency’s resources and reduced regulatory capacity.<sup>134</sup> Furthermore, it highlights that some of an SME’s most powerful stakeholders may fall outside the scope of the legislative and soft law controls imposed by mechanisms such as directors’ duty to promote the company’s success with regard to the need to foster the company’s business relationships<sup>135</sup> and the impact of its operations<sup>136</sup> on the community and environment,<sup>136</sup> or the Corporate Governance Code.<sup>137</sup>

The role of confiscation orders as ‘a tool designed to take the profit out of crime’<sup>138</sup> therefore applies weakly to legitimate small business operators in these circumstances. The combination of factors beyond their control indicates that an enforcement approach that is (primarily) reliant on criminal law interventions is an inadequate means of ensuring greater compliance with their environmental obligations. Similarly, it is arguable that the punishment, deterrence, reform/rehabilitation and reparation objectives of sentencing<sup>139</sup> miss their target with respect to legitimate small business operators, insofar as the causes of their non-compliance may not be solely/mainly attributable to weaknesses in their governance. On the other hand, continued concern regarding the proliferation of rogue operators signifies that the stricter sentencing approach will not suffice to neutralise their incentives to engage in criminal activity.<sup>140</sup>

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<sup>128</sup> (n.82), [25].

<sup>129</sup> *Ibid*, [26].

<sup>130</sup> Nielsen and Parker, (n.127) 315.

<sup>131</sup> Nielsen and Parker, *ibid* 313.

<sup>132</sup> Ministry of Defence, *UK Land Holdings 2017* (13/07/2017).

<sup>133</sup> N. Gunningham, ‘Regulating Small and Medium Sized Enterprises’ (2002) 14 *Journal of Environmental Law* 3, 8.

<sup>134</sup> I. Kaminski, ‘Environment Agency in crisis over rising wave of waste crime’ ENDS (24/02/2015); C. McGlone, ‘EA struggling with poorly performing legitimate waste businesses’ ENDS (05/12/2017).

<sup>135</sup> Companies Act 2006, s.172(1)(c).

<sup>136</sup> Companies Act 2006, s.172(1)(d).

<sup>137</sup> *The UK Corporate Governance Code* (Financial Reporting Council, 2016).

<sup>138</sup> Thornton (n.59), 374.

<sup>139</sup> *R v Sellafield* (n.38), [3].

<sup>140</sup> Francavilla, (n.29).

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### *E. Conclusion*

It is indisputable that the sentencing guidelines for environmental offences were a welcome development, and that they have made a visible impact since their introduction. The gains seen with respect to very large companies in particular risk obscuring the difficulties associated with a stricter sentencing approach for smaller businesses. Where these small businesses happen to be legitimate operators, a renewed approach to sentencing provides a limited solution to the causes of their non-compliance, and efforts to seek redress in the form of personal liability for company controllers may collide with the ebb of veil-piercing doctrine. Insofar as the causes of such non-compliance stem from the actions of illegal operators, the insufficiently deterrent effect of criminal sentencing will ensure that this constituency continues to contribute to the pressures on legitimate operators. With regards to these two types of small business, it would accordingly be premature to celebrate the success of the sentencing guidelines.