

## DESIGNING EFFECTIVE REGULATION: A POSITIVE THEORY

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### I INTRODUCTION

The design of regulation has undergone much change with the rise of the regulatory state.<sup>1</sup> The use of the rigid and punitive command-and-control approach has been superseded by new and more flexible ways of addressing social problems. However, the new approaches are not a panacea.<sup>2</sup> For example, it is widely accepted that newer approaches used to regulate banks in the United States and some European countries contributed to the Global Financial Crisis – a failure having prolonged and catastrophic effects.<sup>3</sup> A more modest example is the near total collapse of the Australian childcare sector in 2008 following the ‘deregulation’ of the industry without adequate public oversight mechanisms.<sup>4</sup>

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1 Donald Feaver and Benedict Sheehy, ‘The Shifting Balance of Power in the Regulatory State: Structure, Strategy, and the Division of Labour’ (2014) 41 *Journal of Law and Society* 203; Donald Feaver and Benedict Sheehy, ‘The Political Division of Regulatory Labour: A Legal Theory of Agency Selection’ (2015) 35 *Oxford Journal of Legal Studies* 153.

2 Joseph Stiglitz, ‘Regulation and Failure’ in David Moss and John Cisternino (eds), *New Perspectives on Regulation* (Tobin Project, 2009) 11; Martin Lodge, ‘The Wrong Type of Regulation? Regulatory Failure and the Railways in Britain and Germany’ (2002) 22 *Journal of Public Policy* 271; Stephen Breyer, ‘Analyzing Regulatory Failure: Mismatches, Less Restrictive Alternatives, and Reform’ (1979) 92 *Harvard Law Review* 547, 578; Stephen Breyer, *Regulation and Its Reform* (Harvard University Press, 1982).

3 Julia Black, ‘The Rise, Fall and Fate of Principles-Based Regulation’ in Kern Alexander and Niamh Moloney (eds), *Law Reform and Financial Markets* (Edward Elgar, 2011) 3, 3–4.

4 It is important to note that the construction of regulatory systems is a political process where the ability to achieve the first-best solutions is constrained by a range of competing interests: see Benedict Sheehy and Donald Feaver, ‘Designing Effective Regulation: A Normative Theory’ (2015) 38 *University of New South Wales Law Journal* 392. See also David Levi-Faur (ed), *Handbook on the Politics of Regulation* (Edward Elgar, 2013); David Allen and Robert Faff, ‘The Global Financial Crisis: Some Attributes and Responses’ (2012) 52 *Accounting & Finance* 1; Erik F Gerding ‘Code, Crash, and Open Source: The Outsourcing of Financial Regulation to Risk Models and the Global Financial Crisis’ (2009) 84 *Washington Law Review* 127; Emma Rush, ‘Child Care Quality in Australia’ (Discussion Paper No 84, The Australia Institute, April 2006).

At its core, regulation will be ineffective because of poor normative policy choices, poor positive design choices, or some combination of both.<sup>5</sup> The normative dimension of a regulatory system is the sum of the many policy choices made in formulating a response to some issue or problem.<sup>6</sup> These policy choices include acknowledging that a problem exists, making a decision to regulate that problem and choosing the measures that ‘should’ be put in place to resolve it. The outcome of these choices is a plan or strategy that informs the design of the positive legal architecture of a regulatory system. Converting that normative strategy into positive law is not a straightforward process. While the normative strategy sets out the policy choices that guide the design of the positive architecture,<sup>7</sup> the positive dimension is made up of a number of additional choices that are more technical in nature, which are identified and described in this article as ‘components’.

The broad objective of this article is to examine the components that make up the positive dimension of a regulatory system. Rather than focusing on failure, the aim of this article is to examine how a more coherent formulation and linking of components might improve the likelihood of regulatory success. Accordingly, the question this article investigates is whether the salient characteristics of, and relationships between, components can be identified. If so, do these relational characteristics enable the identification of general patterns or principles that might guide a more coherent design of the legal architecture?

The structure of this article is as follows. Part II presents a simple analytical framework describing the fundamental components of a regulatory system – most simply described as the structural, governance and operational levels. How these positive aspects of regulation are energised by the ideological and psychosocial aspects of regulatory design is also discussed in Part II. Of particular importance is whether regulation is designed to mandate, prohibit, modify, guide or discipline behaviour. In Part III to Part V, the structural, governance and operational dimensions of regulation are respectively examined in further detail. The relationships between these components discussed in Part III to Part V are then consolidated in Part VI, illustrating patterns informing a coherent configuration of regulatory systems. In Part VII, the patterns identified in Part VI are used to draw several conclusions as to how to reduce regulatory failure generally, and more specifically, in relation to the use of the newer regulatory techniques.

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5 K N Llewellyn, ‘The Normative, the Legal, and the Law-Jobs: The Problem of Juristic Method’ (1940) 49 *Yale Law Journal* 1355; Hans Kelsen, ‘The Pure Theory of Law and Analytical Jurisprudence’ (1941) 55 *Harvard Law Review* 44.

6 The regulatory state is a vast concept. A discussion and overview of the literature is encapsulated in Sheehy and Feaver, ‘Designing Effective Regulation’, above n 4.

7 Neil Gunningham and Darren Sinclair, ‘Designing Environmental Policy’ in Neil Gunningham, Peter Grabosky and Darren Sinclair, *Smart Regulation: Designing Environmental Policy* (Oxford University Press, 1998) 375, 375.

## II THEORETICAL CONSIDERATIONS AND ANALYTICAL FRAMEWORK

Legal systems are regarded as a type of social system.<sup>8</sup> Similarly, contemporary forms of regulation can be conceptualised as subsystems embedded within those larger legal systems.<sup>9</sup> A systemic conceptualisation of regulation differs from traditional definitions that define ‘a regulation’ as a particular type of rule made by an executive body instead of an elected legislature.<sup>10</sup> In this article, the term regulation is used more expansively to mean a specific body of law administered by a specialised administrative body, whether public or private, which constitutes a self-contained law system.<sup>11</sup> This conceptualisation corresponds to regulation being the governance mechanism that has facilitated the rise of the regulatory state.<sup>12</sup> Because regulatory systems now perform the bulk of the administrative work associated with contemporary government, it is imperative that their design and operation be better understood.

It is one thing to describe the institutional and organisational arrangements underpinning regulation as being ethereal-like law systems; it is quite another to identify and articulate the systemic attributes of regulation and explain its operation in a more mechanistic way.<sup>13</sup> Traditional approaches that describe law as a system tend to focus on ‘rules’ and how they are linked, grouped or transformed into different configurations of ideas such as legal facts, judicial decisions, legislation, and organisational constructs such as the police and the courts.<sup>14</sup>

A systemic approach, by contrast, focuses on actors, their behaviours, the nature of the relationships between actors, and the broader social effects of those

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8 Niklas Luhmann, *Law as a Social System* (Klaus A Siegart trans, Oxford University Press, 2004) [trans of: *Das Recht der Gesellschaft* (first published 1993)].

9 J B Ruhl, ‘Complexity Theory as a Paradigm for the Dynamical Law-and-Society System: A Wake-Up Call for Legal Reductionism and the Modern Administrative State’ (1996) 45 *Duke Law Journal* 849, 862. See also Jeffrey Rudd, ‘J B Ruhl’s “Law-and-Society System”: Burying Norms and Democracy under Complexity Theory’s Foundation’ (2005) 29 *William & Mary Environmental Law and Policy Review* 551.

10 *Re Grey* (1918) 57 SCR 150.

11 A regulatory system can be generalised as consisting of: (1) a body of substantive rules of a specialised nature (2) that specifies its own internal remedial mechanisms, which are (3) administered by a dedicated organisational construct that (4) is conferred some combination of governance functions and powers, which it exercises in carrying out its responsibilities.

12 Sheehy and Feaver, ‘Designing Effective Regulation’, above n 4.

13 Candace Jones, William S Hesterly and Stephen P Borgatti, ‘A General Theory of Network Governance: Exchange Conditions and Social Mechanisms’ (1997) 22 *Academy of Management Review* 911; Keith G Provan and Patrick Kenis, ‘Modes of Network Governance: Structure, Management, and Effectiveness’ (2008) 18 *Journal of Public Administration Research and Theory* 229.

14 Joseph Raz, *The Concept of a Legal System: An Introduction to the Theory of Legal System* (Clarendon Press, 1970); H L A Hart, *The Concept of Law* (Clarendon Press, 1961); Julius Stone, *Legal System and Lawyers’ Reasonings* (Stanford University Press, 1964).

behaviours and relationships.<sup>15</sup> Viewed through this lens, a legal system is a system of behaviours and relationships given meaning by rules intended to mediate behaviour within an institutional context. The purpose of a legal system is to respond to actor behaviours if and when those behaviours, referred to in this article as social practices, have (or may have) social implications.<sup>16</sup> Rather than focusing on the relationships between facts of legal significance, rules, legislation and judicial decisions as core units of analysis, as traditional approaches to analysing legal systems do, these legal concepts take on a different character when they are instead viewed as devices that influence actor behaviour, and hence, social practices.

How regulation should be formulated to respond to social practices is, in the first instance, a normative question. The normative dimension of regulation and regulatory systems can be conceptualised as four components, each of which involves a set of decision-making processes that are directed towards a problem and its effects. These are:

1. the perception of the organising problem;
2. the characterisation of the organising problem;
3. framing the problem in a policy context; and
4. a determination of the best approach to resolving that problem.<sup>17</sup>

The objective of this process is to clarify the problem and select an appropriate approach designed to achieve a particular ‘social effect’. The choice of approach also represents an intersection of the normative and positive dimensions; it is the translation point, which marks a shift from the more abstract sociopolitical processes to a technical drafting of legislation.<sup>18</sup> It is the point at which the policy prescription, which should inform the architecture of the regulatory system, is formalised as legislation or other soft law instruments such as codes of practice.

While the focus of the normative dimension is directed towards analysis of the organising problem and identification of a more preferred social effect, the positive dimension focuses on the social practices that give rise to the organising problem. More specifically, the positive dimension deals with the question of

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15 A ‘practice’ (*Praktik*) is a routinized type of behaviour which consists of several elements, interconnected to one other: forms of bodily activities, forms of mental activities, ‘things’ and their use, a background knowledge in the form of understanding, know-how, states of emotion and motivational knowledge. ... The single individual – as a bodily and mental agent – then acts as the ‘carrier’ (*Träger*) of a practice – and, in fact, of many different practices which need not be coordinated with one another.

Andreas Reckwitz, ‘Toward a Theory of Social Practices: A Development in Culturalist Theorizing’ (2002) 5 *European Journal of Social Theory* 243, 249–50.

16 Rather than using the economist’s smallest unit of analysis – the individual or the household – sociologists, drawing upon the work of Wittgenstein, Bordieu, Giddens and Shatzki, identify human ‘practices’ as being the smallest unit of analysis: Theodore R Schatzki, *Social Practices: A Wittgensteinian Approach to Human Activity and the Social* (Cambridge University Press, 1996).

17 Sheehy and Feaver, ‘Designing Effective Regulation’, above n 4, 401.

18 See Adrian Vermeule, ‘Connecting Positive and Normative Legal Theory’ (2008) 10 *University of Pennsylvania Journal of Constitutional Law* 387, 394–5.

how best to alter a particular social practice in order to achieve a more desirable social effect. Regulation seeks to change an undesirable social effect (whether it be a broad social issue, a risk or social opportunity) by:

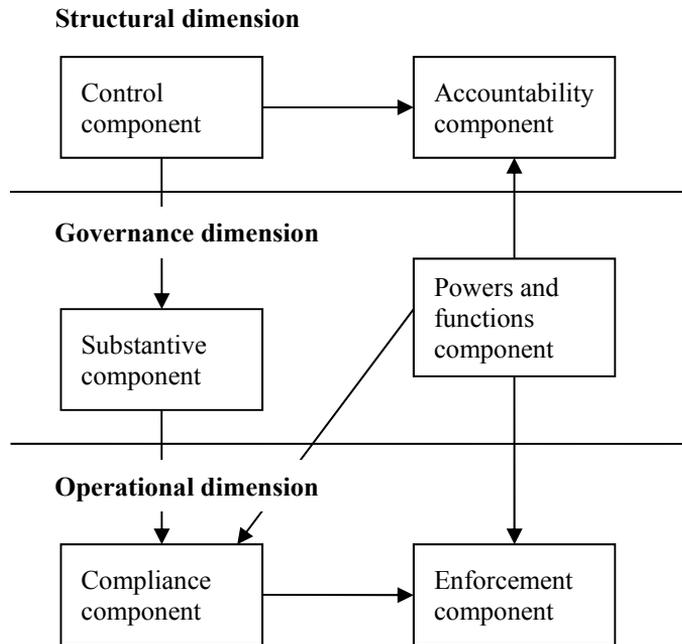
1. mandating;
2. prohibiting;
3. modifying;
4. guiding; or
5. disciplining social practices.

These different ways of altering social practices are embedded within the legal architecture of a regulatory system, each having important implications for the major components of the positive architecture. In this article, the positive architecture of a regulatory system is conceptualised as having three levels of order, each comprised of two components.<sup>19</sup> These levels are illustrated in Figure 1 below and are referred to as the structural, governance and operational levels. The structural level sets out the power relationships among the actors that fall within the scope of the regulatory system. The governance level formalises those power relationships by specifying the legal content of the relationships that connect those actors. Finally, the operational level contains the compliance and enforcement components – the components that influence actor behaviour and hence social practice.

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19 These layers of order broadly correspond to Giddens' theory of structuration and the notion that social structure can be conceptualised as layers of structure, modality and interaction. However, as Giddens' focus is on social structure, his basic framework has been loosely adapted to the more specific institutional context of regulation and regulatory systems. Structure is taken to mean 'relations between actors', modality corresponds to substantive rule systems, and interaction conforms to the operational dimensions of a regulatory system which describes the content of interaction: Anthony Giddens, *The Constitution of Society: Outline of the Theory of Structuration* (University of California Press, 1984) 29.

Figure 1: Legal Architecture



### III THE STRUCTURAL DIMENSION

Society and social systems are both abstract concepts.<sup>20</sup> Theorists have debated what constitutes the ‘structure’ of a society for millennia.<sup>21</sup> More recently, an emerging consensus is that a social ‘structure’ can be discerned from the way social actors are connected and interact. In this article, we use the idea that social actors are connected (both directly and indirectly) by behavioural interactions referred to as ‘social practices’. Social practices, in turn, are shaped by the formal and informal institutional arrangements and other psychosocial phenomena that influence how actors think and interact.<sup>22</sup> In brief, regulatory systems are an example of formal institutional arrangements that connect,

20 Implicit in this project is an acceptance that reality, and the public–private distinction, is socially constructed: see Peter L Berger and Thomas Luckmann, *The Social Construction of Reality: A Treatise in the Sociology of Knowledge* (Penguin Books, first published 1966, 1991 ed) 13.

21 The concept of ‘social structure’ has been debated since Aristotle. See also George Ritzer, *Sociological Theory* (McGraw-Hill, 7<sup>th</sup> ed, 2008); Robert K Merton, *Social Theory and Social Structure* (Free Press, 1968); Giddens, above n 19.

22 Dave Elder-Vass, ‘Integrating Institutional, Relational and Embodied Structure: An Emergentist Perspective’ (2008) 59 *British Journal of Sociology* 281.

hierarchically order and direct the behaviour of social actors within a structure that is reproducible over time and space.<sup>23</sup>

Structure is the foundation of the positive architecture of a regulatory system and can be defined in relation to three characteristics. First, it is defined by the classes of actors that fall within the boundaries of the system. Secondly, it sets out how actors are ordered in terms of power relationships between them. Thirdly, it sets out the general content of the legal relationships that link those actors. The first two aspects are the most basic structural characteristics, which are the focus of this Part. The third aspect warrants a deeper analysis and is discussed in Part IV.<sup>24</sup>

A number of structural models have evolved over time. Each model reflects a different configuration of power relationships within a regulatory system. For example, the ordering of actors within public regulatory systems is predicated upon a delegation of public power. The delegation creates relationships among a minimum of three classes of actors:

1. the state, which is the ultimate source of power;
2. the regulator, which is granted authority to exercise power on behalf of the state; and
3. the regulatee, being the actor subject to the exercise of that power.<sup>25</sup>

Newer models of regulation contemplate a fourth class of actor such as third-party inspectors and auditors who are organisationally independent of the regulator.<sup>26</sup>

The regulator, as a result of the delegation, is the actor that is the focal point of all models. It exercises control powers over the regulatee, and where required, coordinates relationships with the state and other third parties such as co-regulatory bodies or external auditors. However, the regulator's control powers are not unqualified. Regulators are under a liability to account for the exercise of their power. Hence, an accountability obligation arises.<sup>27</sup> As such, the control

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23 José López and John Scott, *Social Structure* (Open University Press, 2000).

24 Structures, Sewell argues, are constituted by mutually sustaining rule schemas and sets of resources that empower and constrain social action and tend to be reproduced by that action: William H Sewell Jr, 'A Theory of Structure: Duality, Agency and Transformation' (1992) 98 *American Journal of Sociology* 1, 19. 'The various schemas that make up structures are, to quote Giddens, "generalizable procedures applied in the enactment/reproduction of social life". They are "generalizable" in the sense that they can be applied in or extended to a variety of contexts of interaction': at 8, quoting Giddens, above n 19, 21. Implicit in these rule schemas is the ordering of relations among the actors included within the structure.

25 Ie, the actor whose behaviour is being changed by the regulatory initiative.

26 Christopher Hood et al, 'Regulation inside Government: Where New Public Management Meets the Audit Explosion' (1998) 18 *Public Money & Management* 6; Michael Power, *The Audit Society: Rituals of Verification* (Oxford University Press, 1997); Mark Thatcher, 'Delegation to Independent Regulatory Agencies: Pressures, Functions and Contextual Mediation' (2002) 25 *West European Politics* 125.

27 For a useful overview of the concept of accountability applied in the context of this article, see Mark Bovens, 'Analysing and Assessing Accountability: A Conceptual Framework' (2007) 13 *European Law Journal* 447. Bovens uses the accountability concept in two ways: in a normative/substantive sense as well as in a procedural sense. While both are relevant, we see accountability as a normative obligation where a substantive power is conferred and exercised (discussed in greater detail in Part IV).

relationships within a regulatory system can be conceptualised as two interrelated components:

1. a control component governing the regulatee; and
2. an accountability component governing the regulator.

The control component usually establishes hierarchical relationships between the state, the regulator and other actors – most specifically, the regulatee. At the same time, it may also include egalitarian, horizontal relationships. For example, a horizontal relationship between two or more regulators collaborating to regulate different aspects of a social problem is not uncommon.<sup>28</sup> The accountability component also links actors within a relational structure based on power and establishes relationships between actors that exercise regulatory powers and government, the judiciary and other social institutions such as markets, the media and interest groups. In theory, the two components should be tightly coupled where the control powers are balanced by corresponding accountability obligations.<sup>29</sup> However, there are a variety of reasons, discussed below, why they are resulting in a major source of incoherence.<sup>30</sup>

### A The Control Component

The structure of a regulatory system is, in the first instance, influenced by the distribution of control powers, which in turn informs the ordering of the power/role relationship between system actors. In the case of public regulation, there are three general structural models examined in this article: centralised, decentred and distributed.<sup>31</sup>

The first model, illustrated in Figure 2, is the centralised model. ‘Centrality’ is measured by the amount of control power that is exercised by the state relative to that delegated to the regulator. For example, within a highly centralised control structure, the state may choose to retain *all* power to make substantive rules and

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28 Jody Freeman and Jim Rossi, ‘Agency Coordination in Shared Regulatory Space’ (2012) 125 *Harvard Law Review* 1131.

29 In a theoretical sense, the control and accountability mechanisms should be tightly coupled. Following Hohfeld, the existence of a power implies the existence of its jural correlative, a liability: see Hohfeld, below n 51. Therefore, control power should have a corresponding accountability liability. The exercise of public power occurs in the context of a public liability to account for the use of those powers: see Part IV.

30 Benedict Sheehy and Donald Feaver, ‘Separation of Accountability and Control: The Agency and the Regulatory State’ (2015) (unpublished, copy on file with authors); Amos H Eblen, ‘Fraud on Special Powers of Appointment’ (1936) 25 *Kentucky Law Journal* 3.

31 The rule-creating mechanisms and administrative and enforcement arrangements of private regulatory systems differ from public regulation. In addition, the power dynamics among and between actors/stakeholders is somewhat less clear and certainly more complex: see Benjamin Cashore et al, ‘Revising Theories of Nonstate Market-Driven (NSMD) Governance: Lessons from the Finnish Forest Certification Experience’ (2007) 7(1) *Global Environmental Politics* 1; Aseem Prakash and Matthew Potoski, ‘Racing to the Bottom? Trade, Environmental Governance, and ISO 14001’ (2006) 50 *American Journal of Political Science* 350; Jeroen van der Heijden, ‘Friends, Enemies, or Strangers? On Relationships between Public and Private Sector Service Providers in Hybrid Forms of Governance’ (2011) 33 *Law and Policy* 367.

delegate only administrative and very limited adjudicative powers to the regulator.

The amount of power that is delegated to a regulator is, in part, determined by how a problem requiring a regulatory response is characterised. Social issues that affect the whole of society equally, for example, are more expediently dealt with using ‘blunt instruments’ such as the imposition of strict duties reinforced by punitive sanctions. All that is required is a simple centralised structure that aligns with the traditional *command-and-control* approach. A simple structure that imposes a hierarchically rigid ordering of actors reinforced by inflexible and punitive sanctions eliminates the need for the state to delegate broad rule-making powers while at the same time minimising the need to delegate complex adjudicative and enforcement powers.<sup>32</sup>

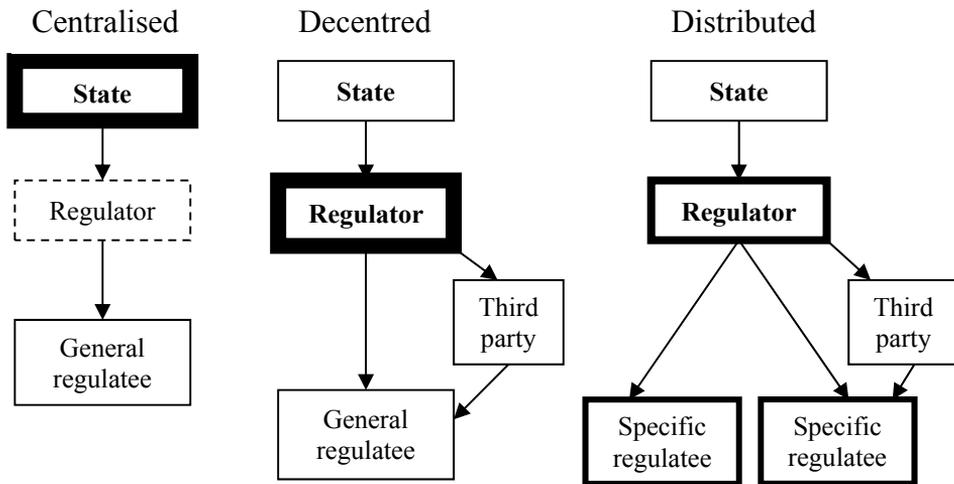
A second model, also illustrated in Figure 2, is the decentred model, which has two distinguishing features. First, greater control powers are delegated by the state to the regulator – in particular, more substantial rule-making and adjudicative powers.<sup>33</sup> Secondly, decentred structures increasingly include external, non-public, third-party actors that may perform administrative or enforcement functions. A more decentralised model is frequently used when the organising problem is characterised as a risk. Accordingly, the decentred model aligns with risk-based approaches that may delegate technical standards making power to the regulator as well as inspection or audit functions to private parties resulting in a shift in the distribution of power from the public to the private sphere.

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32 Jodi L Short, *From Command-and-Control to Corporate Self-regulation: How Legal Discourse and Practice Shape Regulatory Reform* (PhD Dissertation, University of California, 2008) 65–103.

33 Julia Black, ‘Decentring Regulation: Understanding the Role of Regulation and Self-regulation in a “Post-regulatory” World’ (2002) 54 *Current Legal Problems* 103, 113; Julia Black, ‘Constructing and Contesting Legitimacy and Accountability in Polycentric Regulatory Regimes’ (2008) 2 *Regulation & Governance* 137.

Figure 2: Structural Configurations – Public Regulation



Finally, the distributed model is associated with newer regulatory approaches such as *co-regulation*, industry *self-regulation* (also often referred to as *meta-regulation*)<sup>34</sup> and management-based regulation.<sup>35</sup> As the term suggests, the distribution of power includes a delegation of some measure of control powers to regulatees permitting them to develop their own standards, procedures and evaluative mechanisms.<sup>36</sup> The shifting of these powers arises where policymakers characterise the organising problem as one that aligns with the granting of a publicly sanctioned licence (described elsewhere as an opportunity).<sup>37</sup> For example, the inclusion of a range of stakeholders that may exercise some degree of control powers is illustrated by a European Union definition of co-regulation as being a:

mechanism whereby a Community legislative act entrusts the attainment of the objectives defined by the legislative authority to parties which are recognised in

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- 34 Sharon Gilad, 'It Runs in the Family: Meta-regulation and Its Siblings' (2010) 4 *Regulation & Governance* 485. The structural characteristics of co-regulation and meta-regulation are frequently, and incorrectly, associated with the choice of regulatory approach. It will be explained in further detail in Part VI how there is an indirect relationship between regulatory system structure and regulatory approach; however, the two are distinct and are not necessarily directly correlated: see also Neil Gunningham and Joseph Rees, 'Industry Self-regulation: An Institutional Perspective' (1997) 19 *Law & Policy* 363; Monroe E Price and Stefaan G Verhulst, *Self-regulation and the Internet* (Kluwer Law International, 2005); Saule T Omarova, 'Wall Street as Community of Fate: Toward Financial Industry Self-regulation' (2011) 159 *University of Pennsylvania Law Review* 411.
- 35 Cary Coglianese and David Lazer, 'Management-Based Regulation: Prescribing Private Management to Achieve Public Goals' (2003) 37 *Law & Society Review* 691.
- 36 Ian Bartle and Peter Vass, 'Self-regulation within the Regulatory State: Towards a New Regulatory Paradigm?' (2007) 85 *Public Administration* 885.
- 37 Tony Prosser, 'Self-regulation, Co-regulation and the Audio-Visual Media Services Directive' (2008) 31 *Journal of Consumer Policy* 99.

the field (such as economic operators, the social partners, non-governmental organisations, or associations).<sup>38</sup>

## B The Accountability Component

The composition of the accountability component should reflect the distribution of control powers in setting out what can be described as a sort of ‘reverse’ power relationship.<sup>39</sup> The rationale for this ‘reverse power’ is that, on one hand, an unchecked control power granted to the regulator runs the risk of tyranny.<sup>40</sup> However, an overly burdensome accountability obligation can subvert the reasonable or efficient exercise of discretion.<sup>41</sup> Fritz Morstein Marx recognised the former at an early stage of the development of the administrative state noting that:

a ‘well ordered society’ cannot afford to be indifferent to any legal uncertainty attending the exercise of administrative power. It is futile to eulogize the ‘rule of law’ if it fails to offer practical safeguards of legality in the expanding realm of relationships between administrative authority and the individual.<sup>42</sup>

The distribution of control power, that is, the degree of centralisation, is a major determinant of how the accountability relationships should be coherently configured. The structural model determines which actors possess and exercise power, and hence, should be held to account. The more decentralised the structural model, the greater the number of actors that share the control powers and the greater the number and diversity of actors to be held accountable. These different actors may be held accountable using different accountability mechanisms. The four main mechanisms are:

1. political, being accountability to an oversight body such as the legislature;
2. legal, being accountability via the courts (civil suits or judicial review);
3. social, being constituency relations to the media or community groups; and

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38 Linda Senden, ‘Soft Law, Self-regulation and Co-regulation in European Law: Where Do They Meet?’ (2005) 9(1) *Electronic Journal of Comparative Law* <<http://www.ejcl.org/91/art91-3.html>>, quoting *Interinstitutional Agreement on Better Law-Making* [2003] OJ C 321/1, art 18.

39 See Peter Barberis, ‘The New Public Management and a New Accountability’ (1998) 76 *Public Administration* 451, 452.

40 Marci A Hamilton, ‘Power, Responsibility and Republican Democracy’ (1995) 93 *Michigan Law Review* 1539, 1545.

41 Michael Power, *The Audit Explosion* (White Dove Press, 1996).

42 Fritz Morstein Marx, ‘Comparative Administrative Law: A Note on Review of Discretion’ (1939) 87 *University of Pennsylvania Law Review* 954, 956.

4. economic, via accountability through market mechanisms.<sup>43</sup>

Under a centralised model, the state, through the government of the day, is the actor exercising the majority of control power. Hence, it is the state that should bear the brunt of any accountability obligation. This obligation traditionally takes two forms: political and legal accountability mechanisms. In a political sense, the government will be accountable to the legislature in the first instance and ultimately to the electorate (largely through the media). In a legal sense, government decision-making is reviewable by the courts within administrative law frameworks.

With a greater delegation of control powers to regulators, the accountability obligations also change even though the nature of those accountabilities remains the same. One key difference is that rather than being politically accountable to the electorate, the regulator is politically accountable to the government – usually in the form of some sort of oversight obligation.<sup>44</sup> In addition, the regulator will be accountable to the courts within the framework of administrative law. Finally, the regulator is accountable to the public opinion via the news media.<sup>45</sup> Problems arise under decentralised models where control power is placed in the hands of non-public actors such as private inspectors and auditors. These actors may fall outside the scope of legal accountability remedies and certainly fall outside the scope of political accountability mechanisms.<sup>46</sup>

Where a delegation of control powers is made to non-public economic actors to self-regulate under distributed models, or where community stakeholders are more actively involved in the regulatory process, in addition to an accountability to the regulator and possibly the courts, private actors may also find themselves accountable to ‘the market’ or other interest groups. These include non-government organisations dedicated to what amount to private oversight activities through the process of information dissemination. Market-based accountability is a notion fashionable among economists who assert that given adequate disclosure of information, production, distribution and pricing decisions

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- 43 Accountability is a complex and contested concept. For the purposes of this article, we focus on that aspect of accountability that correlates with the exercise of conferred ‘legal’ powers: see Bruce Stone, ‘Administrative Accountability in the “Westminster” Democracies: Towards a New Conceptual Framework’ (1995) 8 *Governance* 505; Colin Scott, ‘Accountability in the Regulatory State’ (2000) 27 *Journal of Law and Society* 38; Richard Mulgan, ‘“Accountability”: An Ever-Expanding Concept?’ (2000) 78 *Public Administration* 555; Richard Mulgan, *Holding Power to Account: Accountability in Modern Democracies* (Palgrave MacMillan, 2003); Julia Black, ‘Constructing and Contesting Legitimacy and Accountability in Polycentric Regulatory Regimes’ (2008) 2 *Regulation & Governance* 137.
- 44 Jonathon B Wiener and Barak D Richman, ‘Mechanism Choice’ in Daniel A Farber and Anne Joseph O’Connell (eds), *Research Handbook on Public Choice and Public Law* (Edward Elgar, 2010) 363.
- 45 The problem with using social institutions such as the media or markets is that there is no formal accountability framework that sets out systemic accountability relationships. Social institutions that provide informal accountability frameworks do not possess systematic oversight obligations and where abuses are not brought to their attention, those abuses go unaddressed.
- 46 Kenneth A Bamberger, ‘Regulation as Delegation: Private Firms, Decisionmaking, and Accountability in the Administrative State’ (2006) 56 *Duke Law Journal* 377, 378.

influenced by markets will produce optimal outcomes in terms of efficiency, satisfaction of consumer wants and producer profits.<sup>47</sup>

### C Coherence and Structure

A significant source of incoherence contributing to regulatory failure arises when the characterisation of a social problem requiring a regulatory response is not coherently matched to the structural model (distribution of decision-making power) chosen to deal with that problem. Is the problem more in the nature of a social coordination problem (a social issue), a collective action problem (a risk) or some sort of social enabler (an opportunity)? For example, the provision of public childcare can be characterised as a universal public good. Providing enough childcare spaces where geographically required poses a coordination problem.<sup>48</sup> It may be that a powerful central controller, and hence a more centralised model, is required to coordinate demand and supply in various locations. If a decentralised structure is chosen where the power to make allocation decisions (volume, price and location) is delegated to private childcare suppliers, the likelihood of regulatory failure increases. The absence of a centralised control power that better matches the universal supply objectives to geographically and demographically dispersed demand may result in the objective of the regulatory system not being achieved.

Secondly, the choice of structural model and hence power relationships must also bear a tightly coherent relationship to the accountability component. A regulator granted greater control powers should be subject to greater oversight controls than those that are not. Traditional accountability arrangements – political and legal accountability – that apply to powerful public actors such as governments and empowered regulators are well developed and do, broadly speaking, adequately balance the control and accountability relationship.<sup>49</sup> An incoherent relationship between control and accountability arises under more decentred and distributed control models, particularly if the regulatee is granted significant control powers (such as with self-regulation permitting quasi rule-making and administrative powers). More distributed models shift power outside the public sphere, putting self-regulating actors outside the reach of traditional accountability mechanisms such as legislative oversight and judicial review. Regulatees that are only weakly accountable to the regulator, interest groups and the market can more easily circumvent accountability obligations, such as mandatory disclosure requirements, particularly where the economic benefits of

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47 Daniel F Spulber, *Regulation and Markets* (MIT, 1989).

48 Grahame Thompson et al (eds), *Markets, Hierarchies and Networks: The Coordination of Social Life* (Sage, 1991); Adrian Webb, 'Coordination: A Problem in Public Sector Management' (1991) 19 *Policy & Politics* 229; Randall L Calvert, 'Leadership and Its Basis in Problems of Social Coordination' (1992) 13 *International Political Science Review* 7; H Peyton Young, 'Social Coordination and Social Change' (Working Paper, Department of Economics, Johns Hopkins University, June 1996); Barry R Weingast, 'The Political Foundations of Democracy and the Rule of Law' (1997) 91 *American Political Science Review* 245.

49 Sheehy and Feaver, 'Designing Effective Regulation', above n 4.

doing so exceed the costs of non-compliance.<sup>50</sup> In the absence of adequate accountability mechanisms, this optimisation decision is a discretionary power in the nature of a lax administrative/enforcement power.

From the above discussion, two general patterns can be identified:

1. the more centralised the control power, the more centralised the structural model. The centralisation of control power, in turn, is measured by the degree of coordination that must be retained by a central controller (that is, government) in order to achieve the regulatory objective; and
2. the more distributed the control power, the more important an accountability obligation that avoids regulatory failure through circumvention becomes.

Where an organising problem is multifaceted, the structure of a regulatory system may be simultaneously centralised in relation to regulating one aspect of a problem and decentralised – giving the appearance, overall, of a decentralised structure – an alternative way of looking at it is as two separate regulatory systems encompassed within one statutory arrangement.

#### IV THE GOVERNANCE LEVEL

Whereas the structural level identifies the critical linkages between actors based on the distribution of control powers and accountability obligations, the governance level, by contrast, specifies the legal content of those linkages. Like the structural level, the governance level is also comprised of two interdependent components:

1. the substantive component (governing the regulatee); and
2. the powers and functions component (empowering the regulator).

These components take the form of rules that impose obligations on regulated actors. These obligations are of differing types and directed towards altering a social practice in different ways to achieve a particular social effect (that is, regulatory objective). As mentioned in Part II, the different ways of altering a social practice are to mandate, prohibit, modify, guide or discipline behaviour. Each of these behaviour changes is aligned to a particular rule type.

The relationship between social practices, social effects and the corresponding rule type chosen requires some engagement with theories of legal power. Early in the 20<sup>th</sup> century, Yale law professor, Wesley Hohfeld, sought to determine what is meant by the phrase ‘legal rights’ in order to clarify the ‘chameleon-hued words [that] are a peril both to clear thought and lucid

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50 Robert D Cooter, ‘Economic Analysis of Punitive Damages’ (1982) 56 *Southern California Law Review* 79, 86.

expression'.<sup>51</sup> He produced a taxonomy of legal relationships consisting of what he called: claims, privileges, powers or immunities. He defined a *power* as 'one's affirmative "control" over a given legal relation as against another'.<sup>52</sup> '[P]erson (or persons)', states Hohfeld, 'whose volitional control is paramount may be said to have the (legal) power to effect the particular change of legal relations that is involved in the problem'.<sup>53</sup> Power, he also explained, can be understood in relation to its *jural correlative* and its *jural opposite*. The jural 'correlative' to a power results in the imposition of a 'liability' in the person over whom control is exerted, or in other words, a 'subjection' or 'responsibility'.

Although Hohfeld's power/liability relationship is a helpful starting point, the focus of his analysis is the content of private legal relations. A 'private law' understanding of power is inadequately applied in the context of public law conceptualisations of power. The nature of public power and the obligations that flow from its exercise is quite different from that of private power. Bentham, by contrast, had two conceptions of power – the power of concretion, 'which permit[s] the physical handling of persons or inanimate things', and the power of imperation.<sup>54</sup> The power of imperation is the power of 'either the sovereign, or a lesser body taking a "share" in the sovereign's command ... to affect the legal positions of individuals by subjecting their behaviour to sanction or reward'.<sup>55</sup> Hart subsequently expanded on Bentham's notion of public power by referring to public power as a power to create three types of system-generating rules: rules of change, adjudication and recognition. He alludes to his 'rule of recognition' as being some ethereal power-conferring rule and provides examples of the different expressions of public power.<sup>56</sup>

In more recent work, Halpin attempts to reconcile Hohfeld, Bentham and Hart's differing conceptions of a public power.<sup>57</sup> For Halpin, the core characteristic of legal power is *decision*. If this core characteristic is accepted, it permits a definition of legal governance power to be advanced: *legal governance power is the legal authority to make decisions (including the creation of rules) that effect a change in the legal relationship between persons and between the state and persons*. This change in legal relationship corresponds to the changing of the social practices that sits at the core of regulation. This definition also steers

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51 Wesley Newcomb Hohfeld, 'Some Fundamental Legal Concepts as Applied in Judicial Reasoning' in Walter Wheeler Cook (ed), *Fundamental Legal Concepts as Applied in Judicial Reasoning and Other Legal Essays* (Yale University Press, 1919) 35, 35.

52 Ibid 60.

53 Ibid 51.

54 Andrew Halpin, 'The Concept of a Legal Power' (1996) 16 *Oxford Journal of Legal Studies* 129, 131.

55 Ibid.

56 H L A Hart, *Essays on Bentham: Studies in Jurisprudence and Political Theory* (Oxford University Press, 1982). Eg, Hart refers to: (1) a police officer's power of arrest; (2) a parliament's power to legislate; (3) a minister's power to make regulations; (4) a corporation's power to make by-laws; (5) a judge's power to make an order; (6) a judge's power to sentence; (7) a judge's power to vary a settlement; and (8) the Lord Chancellor's power to appoint county court judges. These examples of the power of imperation can be roughly divided into *judicial* (examples 5–8) and *governance* (examples 1–4). It is the examples of governance powers that are of primary concern here.

57 Halpin, above n 54.

a path through the contradictions of Hohfeld, Bentham and Hart, without requiring the absolute dismissal of any of their helpful appraisals of power. The power to make authoritative decisions, whether that be in a policymaking, legislative, adjudicative or executory capacity, is consistent with the discussion below.

### A Substantive Component and Obligations of Regulatee

The substantive component is comprised of a body of rules that govern or change the conduct of a regulatee – that is, a social practice. Prior to the introduction of the new regulatory technologies in recent decades,<sup>58</sup> there was little controversy regarding the ‘juridical relation’ and ‘type’ of rule used to effect this change. The traditional command-and-control approach imposes the juridical relation that Hohfeld describes as a ‘duty’. The rule type that these duties take is, usually, specific and prescriptive.<sup>59</sup> As such, the substantive core of the command-and-control approach is commands made in the form of prescriptive duties, created by the state and imposed upon regulatees.

However, as Black points out, alternative regulatory approaches such as the risk and principles-based approaches use different rule types, such as technical standards and general principles.<sup>60</sup> These regulatory approaches and their relationship to corresponding structural models affect the composition of the substantive content of the legal relations between regulatory actors. In other words, jural relations and rule types different to strict and prescriptive duties may be required. For example, where the state delegates governance powers to actors in addition to a regulator, such as a power to make rules being granted to the regulatee in the distributed model, the correlation between how an organising problem is characterised, the juridical relation created and the type of rule communicating that jural relation must be coherent. If incoherent, the regulation may fail. A generalisation of those relationships is summarised in Table 1 below.

Table 1 begins with the type of organising problem, that is, whether the problem is characterised as a social issue, a risk or an opportunity.<sup>61</sup> If the organising problem is a broad social issue affecting the whole of society, the most efficient way of regulating that issue is by using the traditional command-and-control approach. Under that approach, the state exercises its sovereign *right* to exercise its *power* to enact a rule in the form of a legal *duty*. Given the breadth of application and to enable effective and efficient enforcement, the content of that duty will be framed in specific and precise language. The rule type used will take the form of a prescriptive rule imposing a primary obligation on a regulatee to modify its behaviour.<sup>62</sup>

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58 Robert Baldwin and Julia Black, ‘Really Responsive Regulation’ (2008) 71 *Modern Law Review* 59.

59 Vivienne Brown, ‘Rights, Liberties and Duties: Reformulating Hohfeld’s Scheme of Legal Relations?’ (2005) 58 *Current Legal Problems* 343.

60 J M Black, ‘“Which Arrow?” – Rule Type and Regulatory Policy’ [1995] *Public Law* 94.

61 Sheehy and Feaver, ‘Designing Effective Regulation’, above n 4.

62 Nicholas Bamforth, ‘Hohfeldian Rights and Public Law’ in Matthew H Kramer (ed), *Rights, Wrongs and Responsibilities* (Palgrave, 2001) 1.

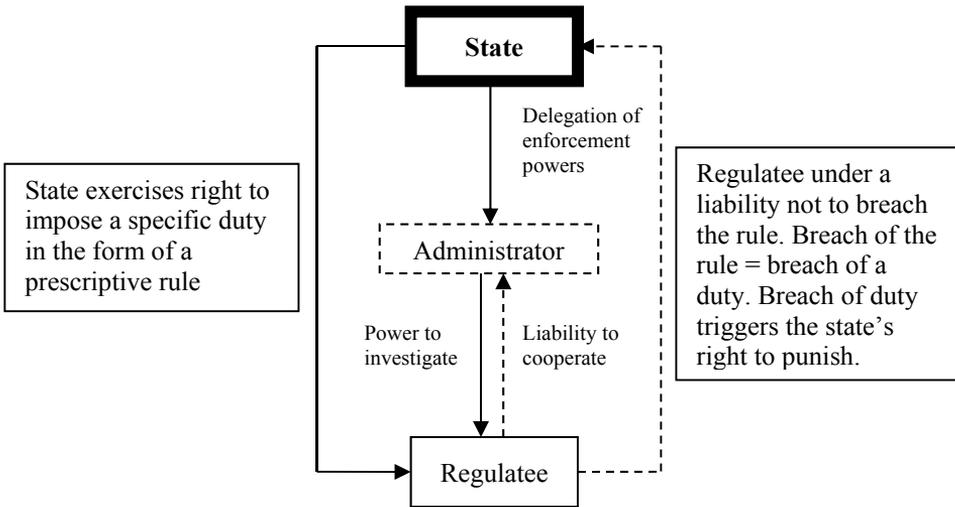
Table 1: Summary of Juridical Relationships

<b>Structural Configuration and Method</b>	<b>Rule Type</b>	<b>Behavioural Change/ Change in Social Practice</b>	<b>Juridical Relations</b>
Centralised (command and control)	Prescriptive	Mandate or prohibit a social practice	Specific duty
Decentralised distributed (risk-based approach)	Technical/performance standards	Modify a social practice	General duty/ specific liability
Distributed (principles-based approach)	General principles	Guide a social practice	Privilege/liability
Market-based approach	Social institutions (markets and media)	Discipline a social practice	None

A simple example, illustrated in Figure 3 below, is the imposition of a strict legal duty to prohibit a specific type of behaviour. A primary juridical relationship is established between the state and the regulatee. In addition, the regulatee may be subject to a secondary juridical relation where the state delegates some *power* to a regulator to perform investigatory, quasi-adjudicative and enforcement functions. A suspected breach of the primary duty by the regulatee may trigger the regulator's power to investigate. In exercising its power, the regulatee becomes subject to a liability to submit and/or cooperate with the commands of the regulator (discussed further in Part V below).

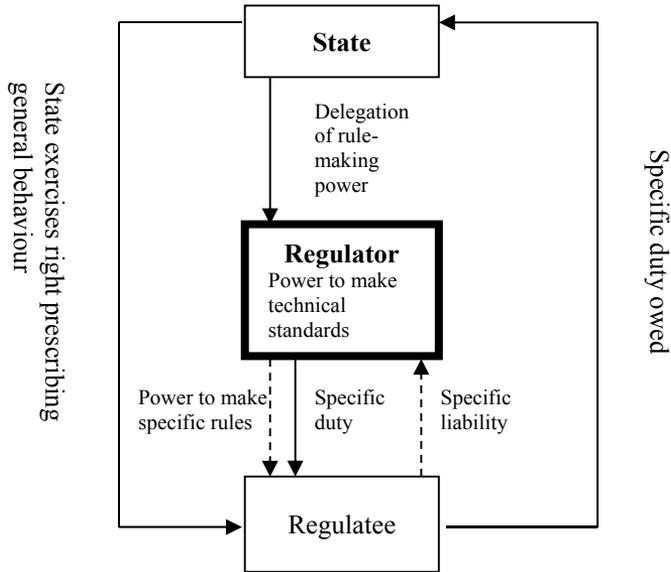
If an organising problem is characterised as a risk and a decentralised or distributed model is chosen, the juridical obligations owed by the regulatee also change. Although the state's right to impose a duty on the regulatee remains the same, rather than a prescriptive duty, the content of the duty is more general. For example, rather than making it a strict offence to maintain a certain specified unsafe work practice, a more general duty to maintain a safe workplace can be created. That general duty is supplemented by a power granted to the regulator to make additional rules in the form of technical standards specifying what constitutes 'safe' in the context of different workplaces.

Figure 3: Centralised Structural Configuration



The regulator’s rule-making power to create and impose more specific standards upon the regulatee is exercised in the form of a second more specific duty – namely the duty to comply with the specific standards. In addition to the second duty, the regulator may be empowered to impose further legal liabilities such as providing evidence to the regulator that the second duty has been fulfilled (thereby also fulfilling the primary duty). Alternatively, a further liability requiring that access be given to public inspectors, or that third-party auditors must be engaged to permit the gathering and verification of evidence to be presented to the regulator, may also be imposed. If third parties are engaged, they may be required to obtain a licence granted by the regulator (or another regulator) to perform verification functions. In return, the third-party auditors will also be under a liability to demonstrate qualification and competency as well as an undertaking to provide these services in an honest manner.

Figure 4: Decentred Structural Configuration



A decentred structural configuration will also be coherent with a ‘principles-based’ approach or method, which requires a corresponding change in the type and composition of rules. Rather than highly prescriptive rules that accord with the enactment of command and control-driven legal duties, principles-based approaches are fashioned using more general or even aspirational language. Regulatees often have some flexibility in determining the methods by which to achieve an internally created standard that is consistent within the broad intent of the principle. Although the juridical relation is more permissive, the structural characteristics are similar to risk-based approaches where compliance-related Hohfeldian liabilities are, nevertheless, owed to the regulator in much the same way as described above.

Finally, where the organising problem presents an opportunity, a distributed structural configuration may be used. In such configurations the state may choose an approach such as a general licence, which grants permission to individuals or industries to engage in some form of self-regulation. In these instances, the juridical relation between the state and regulatee broadly conforms to a Hohfeldian privilege where the state grants the regulatee something less than an absolute right in that the state retains the immediate right to intervene if the terms and conditions attaching to the granting of the privilege are not met.

### B The Delegation Component

A second body of rules that make up the governance level specifies the content of the powers and functions conferred by the state to the regulator – referred to as the delegation component. The delegation of functions and powers by the state to the regulator is, after the choice of regulatory approach, one of the

most contentious aspects of the regulatory process.<sup>63</sup> The question surrounding what functions to confer and how much power is required to fulfil those functions is complex for two reasons. First, the relationship between functions and powers is often conflated or poorly articulated in regulatory statutes.<sup>64</sup> Secondly, the boundary of a regulator's authority is frequently poorly defined in terms of scope and depth.<sup>65</sup>

A properly formulated delegation of governance powers should identify this boundary of authority by specifying:

1. what governance functions (rule-making, administrative or quasi-judicial) the regulator is required to perform; and
2. what powers are required to carry out each function as defined by:
  - a. the scope of the subject matter jurisdiction conferred, and
  - b. the depth of decision-making discretion required to perform those functions.

### **1 Range of Regulator's Functions**

The core of a delegation can be determined by identifying the functions that a regulator is required and authorised to perform. Determining what functions a regulator should be delegated turns on the definition of what constitutes a function. This question has long been the subject of debate – largely because functions (tasks) and powers (authority) are frequently conflated. Under United States constitutional law, the consensus is that the three branches of government each perform a specific class of function: legislative, adjudicative or administrative. Each function requires analogous *powers*.<sup>66</sup> A similar approach taken by Canadian and Australian courts describes a function as the exercise of a power within the context of a specific governance task resulting in a situation where power follows a function.<sup>67</sup> Where powers conferred are not consistent with the functions, the result is an incoherent delegation of either functions or powers. An 'over-delegation' can result in mission creep: 'the systematic shifting

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63 Elizabeth Magill and Adrian Vermeule, 'Allocating Power within Agencies' (2011) 120 *Yale Law Journal* 1032, 1039.

64 Robert A Anthony, 'Which Agency Interpretations Should Bind Citizens and the Courts?' (1990) 7 *Yale Journal on Regulation* 1.

65 For a general discussion of scope and depth or breadth, see Anne Twomey, 'Pushing the Boundaries of Executive Power – *Pape*, the Prerogative and Nationhood Powers' (2010) 34 *Melbourne University Law Review* 313, 316–17; George Winterton, 'The Limits and Use of Executive Power by Government' (2003) 31 *Federal Law Review* 421, 426–7.

66 M Elizabeth Magill, 'The Real Separation in Separation of Powers Law' (2000) 86 *Virginia Law Review* 1127, 1133.

67 *R v Kirby; Ex parte Boilermakers' Society of Australia* (1956) 94 CLR 254; M J C Vile, *Constitutionalism and the Separation of Powers* (Liberty Fund, 2<sup>nd</sup> ed, 1998) 13; George Winterton, *Parliament, the Executive and the Governor-General: A Constitutional Analysis* (Melbourne University Press, 1983) 58–9.

of organizational activities away from original mandates'.<sup>68</sup> An under-delegation can result in anaemic regulatory bodies and weak regulatory efficiency. Similarly, an improper or incorrect interpretation of the governance powers or functions delegated, can produce incoherent results.

## 2 Powers

Power can be measured by 'scope and depth'.<sup>69</sup> Although used slightly differently in the context of constitutional law, for the purposes of this analysis, scope is used to mean jurisdictional authority and depth refers to the discretionary powers conferred upon a regulator.

### (a) Scope of Powers: Jurisdictional Authority

The first aspect of power concerns the jurisdictional scope of the regulator's decision-making space applied in the context of an authority to make decisions relating to a defined subject matter. Within that definition:

Certain cases involve agency *assertions* of jurisdiction, while others present *disclaimers* of jurisdiction. Some disputes concern the *existence* of agency jurisdiction, others the *scope* of jurisdiction. Still others concern the presence (or lack) of a *factual predicate* necessary to trigger agency jurisdiction. A final type of case involves an agency interpreting a *statutory silence* – ie, a statute's failure to expressly grant or deny a proposed power – as a [legislative] conferral of jurisdiction.<sup>70</sup>

Where the scope of jurisdiction is taken to mean the breadth of subject matter, also referred to as the 'quantum of authority', it is frequently the case that the breadth is uncertain. Delegations are frequently couched in vague terms and give rise to the need for an agency to exercise implied powers to interpret a statutory silence. 'In such cases, the agency interprets its grant of jurisdiction to entail another [function], or to permit it to exercise its [discretionary] power in a particular way'.<sup>71</sup>

### (b) Depth of Discretion

The term 'discretion' is also used in many different ways in administrative law. Koch has identified five different uses:

authority to make individualizing decisions in the application of general rules [which] can be characterized as 'individualizing discretion.' Freedom to fill in gaps in delegated authority in order to execute assigned administrative functions may be called 'executing discretion.' The power to take action to further societal goals is 'policymaking discretion.' If no review is permitted, the agency is

68 Sarah Babb and Ariel Baira, 'Mission Creep, Mission Push and Discretion: The Case of IMF Conditionality' in Ariel Baira (ed), *The IMF and the World Bank at Sixty* (Anthem Press, 2005) 59, 59.

69 Also referred to as breadth and depth: Winterton, *Parliament, the Executive and the Governor-General*, above n 67; Cheryl Saunders, 'The Sources and Scope of the Commonwealth Power To Spend' (2009) 20 *Public Law Review* 256, 261–2.

70 Nathan Alexander Sales and Jonathan H Adler, 'The Rest Is Silence: *Chevron* Deference, Agency Jurisdiction, and Statutory Silences' [2009] *University of Illinois Law Review* 1497, 1502 (emphasis in original).

71 *Ibid* 1505.

exercising ‘unbridled discretion.’ Finally, if the decision cannot by its very nature be reviewed, the agency is exercising ‘numinous discretion.’ Different judicial functions flow from these distinctions.<sup>72</sup>

In this Part we are concerned primarily with the notion of ‘depth of discretion’ being the first and third of the uses that Koch describes above.<sup>73</sup> The legislature, in delegating power to a regulator, may choose to expressly limit the depth of discretion a regulator may exercise. For example, a regulator granted a shallow rule-making discretion is restricted to making procedural rules. By contrast, a regulator granted a deeper discretionary power is authorized to take any action that is deemed appropriate provided that the exercise of that discretion is within the regulator’s jurisdictional scope of authority.

Braithwaite has shed light on the important role of discretion in regulatory practice.<sup>74</sup> His studies indicate that the most effective regulators are those granted greater discretion and allowed to negotiate and shape compliance strategies (discussed further in Part V below) to suit the relationship between regulator and a particular regulated party. In a similar vein, Sparrow suggests that, in addition to Braithwaite’s enforcement discretions, effective regulators need power to exercise discretion on:

1. mission determination (a sub-determination made after the overall policy determination is made by politicians – consistent with Koch’s third use of discretion identified above);
2. the power to exercise discretion in terms of selecting which issues within their mandate to focus on; and
3. the power to exercise discretion regarding how to work on them.<sup>75</sup>

### C Coherence Implications of the Governance Components

Several relationships, particularly between the structural and governance levels and between the governance level components, have important coherence implications. The most straightforward is the need to appropriately match the structural model, the juridical relation and rule type. These relationships sit at the core of the substantive obligation (already shown in Table 1 and discussed in Part IV(A) above). The more centralised the model, the stricter and more prescriptive the primary substantive obligation will need to be. The more decentralised the structure and the more distributed the allocation of control powers, the less

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72 Charles H Koch Jr, ‘Judicial Review of Administrative Discretion’ (1986) 54 *George Washington Law Review* 469, 470.

73 Note that the second ‘use’ identified by Koch is more closely aligned with the notion of ‘scope of jurisdiction’ being the subject matter.

74 Ian Ayres and John Braithwaite, *Responsive Regulation: Transcending the Deregulation Debate* (Oxford University Press, 1992); John Braithwaite, Toni Makkai and Valerie Braithwaite, *Regulating Aged Care: Ritualism and the New Pyramid* (Edward Elgar, 2007) 226; John Braithwaite, *Restorative Justice and Responsive Regulation* (Oxford University Press, 2002); John Braithwaite and Peter Drahos, *Global Business Regulation* (Cambridge University Press, 2000).

75 Malcolm K Sparrow, *The Regulatory Craft: Controlling Risks, Solving Problems and Managing Compliance* (Brookings Press, 2000) 238–54.

prescriptive the primary obligation imposed on the regulatee will need to be. The logic underlying the general propositions becomes even clearer when examining the coherence implications of the relationship between the substantive and delegation components.

The composition of the substantive obligations should align coherently with the functions and powers granted to the regulator. Several general propositions can be made in this regard:

1. the stricter the primary obligation, the fewer or less ‘powered-up’ the functions need to be delegated to the regulator. For example, the imposition of a strict and prescriptive duty reduces the need for a technical rule-making function. Furthermore, only simple adjudicative and enforcement functions and powers need be delegated to the regulator, owing to the black-or-white framing of the rule indicating compliance or breach;
2. the more general the primary obligation, the greater the need for the delegation of a secondary rule-making function to the regulator or a self-regulating actor;
3. the greater the rule-making function, the more discretionary power delegated to the rule maker is required; and
4. the more general the rule, the more sophisticated the adjudicative and enforcement functions are required.

Decentring the control powers within a regulatory system increases the complexity of administration, adjudication and enforcement. Where the technical relationships between these components are not coherently aligned, the potential for incoherence, and hence regulatory failure, increases.

## V THE OPERATIONAL LEVEL

The operational level is the most visible aspect of a regulatory system and is made up of the compliance and enforcement components as illustrated in Figure 1 above. Frequently conflated in the literature, compliance and enforcement are very distinct concepts.<sup>76</sup> Of the two, compliance is the more complex. Compliance is a behaviour that the regulatee is required to perform – a statutorily directed social practice – that is set by and measured in relation to the substantive obligation.

The compliance component is that aspect of a regulatory system directed towards motivating, testing and demonstrating conforming social practice. Enforcement, on the other hand, is an executive function performed by the regulator in response to compliance or non-compliance – that is, reward or

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<sup>76</sup> Anthony G Heyes, ‘Making Things Stick: Enforcement and Compliance’ (1998) 14 *Oxford Review of Economic Policy* 50.

punishment. In brief, compliance is the responsibility of the regulatee; enforcement is the responsibility of the regulator.

Before a more sophisticated examination of the compliance and enforcement relationship is considered, it is instructive to briefly discuss compliance/enforcement in a traditional context. Earlier approaches to regulation, though advocating the need to find a socially optimal balance between acceptable rates of compliance on the one hand, and the cost of enforcement on the other, assumed that compliance is achieved by emphasising and resourcing the enforcement function.<sup>77</sup> This emphasis on *ex post* enforcement has been rejected by the newer approaches towards regulation. Instead, alternative approaches draw upon a more sophisticated use of psychology to encourage *ex ante* compliance using more innovative and strategic methods of controlling and managing human behaviour – hence the emergence of the term ‘compliance strategy’.<sup>78</sup>

The use of psychology to shift the emphasis from *ex post* enforcement to *ex ante* compliance begins by recognising that human behaviour is both extrinsically and intrinsically motivated. Behaviour is extrinsically motivated when an actor responds to external stimuli such as threats that cause fear, or the promise of a reward for good behaviour. However, even though extrinsic motivators may change behaviour, they may or may not impact on or alter the beliefs underlying the behaviour they influence. Furthermore, as explained below, extrinsic motivators must be used cautiously because they can undermine more deeply embedded intrinsic motivators that can be even more powerful in influencing behaviour.<sup>79</sup> Intrinsic motivators are stimuli that appeal to a person’s internal desire to engage in a social practice. These stimuli can include feelings of autonomy and mastery reinforced by the need to seek acknowledgement. Intrinsic motivators are triggered when a person is granted some degree of discretion to determine the course of action best suited to their circumstances, or through opportunities that lead to social acknowledgements.

The use of psychology to motivate compliance component has two aspects, the psychological lever and a legal device, the mechanism that formalises the lever.

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77 Compliance may be compliance with a subsidy scheme to receive a cheque or a tax credit. Hence, enforcement costs are limited to the administration of an account adjustment. For an excellent discussion, see Peter J May, ‘Performance-Based Regulation’ in David Levi-Faur (ed), *Handbook on the Politics of Regulation* (Edward Elgar, 2011) 36; Christine Parker and Vibeke Nielsen (eds), *Explaining Compliance: Business Responses to Regulation* (Edward Elgar, 2011).

78 John T Scholtz, ‘Voluntary Compliance and Regulatory Enforcement’ (1984) 6 *Law & Policy* 385.

79 Katharine T Bartlett, ‘Making Good on Good Intentions: The Critical Role of Motivation in Reducing Implicit Workplace Discrimination’ (2009) 95 *Virginia Law Review* 1893.

## A The Compliance Component: Levers and Devices

What motivates regulatees to change their behaviour (and hence, a social practice) in compliance with the substantive obligations imposed upon them?<sup>80</sup> Suchman argues that ‘[m]uch of the sociology of law (like much social science in general) rests on certain implicit and explicit assumptions about how people make decisions, and ... how people respond to the law’.<sup>81</sup> These assumptions have been popularised as ‘carrots, sermons and sticks’.<sup>82</sup> Psychologically, sticks correspond to fear, sermons to persuasion and carrots to inducements and incentives.<sup>83</sup> All three are informed by culture and cognition in that they are culturally determined and socially and psychologically constructed.

Each of the three methods of motivating compliance is emphasised by the different theoretical approaches identified in the literature. The three approaches can be summarised as:

[t]he instrumental [rationalist] approach [which] implies that responses to the law reflect a calculated assessment of the rewards and punishments embodied in legal sanctions; the normative approach implies that responses to law reflect the internalisation of social norms and moral principles; and the cognitive approach implies that responses to law reflect the ability of legal rules to define, constitute and construct a shared reality in which certain behaviours become socially nonsensical.<sup>84</sup>

The relationship between the psychological lever that motivates compliance and the more mechanistic legal device that encapsulates that lever is best distinguished by examining the difference between regulating a social practice and regulating the social effects of that practice. Levers are directed towards the social practice itself whereas devices focus on the effects of that practice. To be effective, there must be a coherent relationship between the lever chosen to alter a social practice and the device used to produce the desired social effect.

### 1 Psychological Levers and Compliance Strategies

A psychological lever is intended to motivate a change of social practice directed towards encouraging compliance. These psychological levers can be broadly classified as fear, anxiety, inducement, persuasion or incentive.

Regulatory systems that rely upon fear to motivate compliance do so by threatening punishment for a failure to comply.<sup>85</sup> This compliance strategy is the

80 Christopher Hood, ‘The Tools of Government in the Information Age’ in Michael Moran, Martin Rein and Robert E Goodin (eds), *The Oxford Handbook of Public Policy* (Oxford University Press, 2006) 469.

81 Mark C Suchman, ‘On beyond Interest: Rational, Normative and Cognitive Perspectives in the Social Scientific Study of Law’ [1997] *Wisconsin Law Review* 475, 475.

82 Marie-Louise Bemelmans-Videc, Ray C Rist and Evert Vedung (eds), *Carrots, Sticks, and Sermons: Policy Instruments and Their Evaluation* (Transaction Publishers, 1998).

83 Evert Vedung, *Public Policy and Program Evaluation* (Transaction Publishers, 1997).

84 Suchman, above n 81, 476.

85 John T Scholz and Neil Pinney, ‘Duty, Fear, and Tax Compliance: The Heuristic Basis of Citizenship Behavior’ (1995) 39 *American Journal of Political Science* 490. It is important to realise that fear itself is not a singular concept and hence, care must be taken when designing regulation: Robert A C Ruiter, Charles Abraham and Gerjo Kok, ‘Scary Warnings and Rational Precautions: A Review of the Psychology of Fear Appeals’ (2001) 16 *Psychology and Health* 613.

classical *ex post* approach most commonly associated with command-and-control regulation. A negative *ex ante* compliance strategy leverages anxiety and insecurity to motivate compliance by generating psychological unease and instability. Anxiety driven compliance strategies are especially ubiquitous owing to the popularity of the risk-based approaches and, for example, the reliance on audit mechanisms resulting in what Power refers to as the ‘audit society’.<sup>86</sup> This strategy is central to the risk-management objectives inherent in New Public Management and the corporate risk management processes designed to prompt compliance through a sense of oversight anxiety.<sup>87</sup> A negative long-term psychological effect of pervasive anxiety is depression and lethargy, an effect evident in workplaces subject to relentless performance measurement audits.

Compliance strategies that leverage positive *ex ante* motivators rely upon inducement and persuasion. Although inducement and persuasion are closely related, they are subtly different. Inducements may be economic, social or cognitive. For example, regulatees may be paid a certain amount to do X or Y. Socially, regulatees may be admitted or honoured as members of a club that is dedicated to cleaning up X or Y. Cognitively, regulatees may be persuaded to go and clean up X or Y. Persuasion, while distinct, works similarly to inducement in that it relies on volition positively influenced to achieve the outcome. Checkel ties together inducement and persuasion, describing persuasion as:

a social process of interaction that involves changing attitudes about cause and effect in the absence of overt coercion. It [persuasion] is thus a mechanism through which preference change may occur. More formally, it is ‘an activity or process in which a communicator attempts to induce a change in the belief, attitude, or behavior of another person ... through the transmission of a message in a context in which the persuadee has some degree of free choice’.<sup>88</sup>

Here, persuasion is not manipulation but a process of *convincing* someone through argument and principled debate.<sup>89</sup>

As opposed to inducements, which are *ex ante* motivators, incentives are *ex post* rewards – a ‘carrot’. Incentive driven compliance strategies are frequently linked to market-oriented devices such as subsidies, competitive grants or tradeable permits as a means of prompting behaviour using self-interest.<sup>90</sup> One creative example of the use of incentives is mandatory disclosure, which creates an incentive structure that pressures firms to alter their behaviour.<sup>91</sup> The provision of information may impact positively or negatively share prices or other market

86 Power, *The Audit Society*, above n 26.

87 Ibid.

88 Jeffrey T Checkel, ‘Why Comply? Social Learning and European Identity Change’ (2001) 55 *International Organization* 553, 562, quoting Richard M Perloff, *The Dynamics of Persuasion: Communication and Attitudes in the 21<sup>st</sup> Century* (Erlbaum Associates, 1993) 14.

89 As Checkel notes, a focus on persuasion may thus be a productive way of building bridges between rationalists and constructivists: Checkel, above n 88, 553.

90 P N Grabosky, ‘Regulation by Reward: On the Use of Incentives as Regulatory Instruments’ (1995) 17 *Law & Policy* 257.

91 Some mistake the fine for failure to disclose as the mechanism. It is not. It is the disclosure itself which changes the behaviour and the fine is merely related to the act of disclosure, thus combining two mechanisms.

behaviour. The psychological assumption in using the disclosure mechanism is that positive share prices will re-enforce desired behaviour whereas negative share market performance is a strong incentive for a firm to change its behaviour.<sup>92</sup>

## 2 Devices

A device is a legal tool such as a prison sentence, fine, tax, audit, licence, subsidy, rebate or education and information.<sup>93</sup> They are a highly visible connection between the actor regulated and regulator, and this connection as two aspects. First, a device operationalises the psychological lever selected to change a social practice. Secondly, the device should effect a change in behaviour such that it alters a social practice by producing a social effect that is consistent with the objective of the regulation. Stated another way, while the psychological lever is directed towards changing the behaviour underlying a social practice, the device should be the legal manifestation of the psychological lever.

Legal devices that operationalise fear as the lever often do so by *commanding* a specific change in behaviour. Devices that rely on anxiety, such as standards based regulation reinforced with audit or inspection, tend to be better directed towards *modifying* behaviour. Principles-based regulation, which utilises inducement and persuasion to encourage compliance, can be described as *guiding* behaviour. Finally, a further device that falls outside the scope of this article is the use of social institutions such as markets and the media to *discipline* behaviour.

All of the devices have the potential to address a range of issues, but they also have a range of unintended consequences. Thus, caution needs to be used, in all of these hypotheses. For example, the dollar of a poor person is not the same as a dollar of a rich person. A fine of \$1 million is insignificant to a business which generates a profit of \$10 billion – that is, a fine of 0.01 per cent of profit. Nor is a prison sentence necessarily a loss of social status in a society where clothing designers have been allowed to glamorise gangsters and criminals for commercial purposes.<sup>94</sup> As a result of these interdependencies, the choice of device requires a clear understanding of hypotheses about human psychology and the relationship that psychology has to the human behaviour underlying compliance.

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92 John Braithwaite, 'Rewards and Regulation' (2002) 29 *Journal of Law and Society* 12, 24; Coglianese and Lazer, above n 35.

93 See, eg, Robert Baldwin and Martin Cave, *Understanding Regulation: Theory, Strategy, and Practice* (Oxford University Press, 1999); Anthony Ogus, *Regulation: Legal Form and Economic Theory* (Clarendon Press, 1994); Bronwen Morgan and Karen Yeung, *An Introduction to Law and Regulation: Text and Materials* (Cambridge University Press, 2007).

94 Vern Kenneth Baxter and Peter Marina, 'Cultural Meaning and Hip-Hop Fashion in the African-American Male Youth Subculture of New Orleans' (2008) 11 *Journal of Youth Studies* 93.

## B The Enforcement Component

Enforcement is that aspect of a regulatory system that connects the regulator to the legal control device. Enforcement is primarily an administrative task; however, it is not without significant and necessary discretions. As Ayers, Braithwaite, Sparrow and others have advocated, effective enforcement – that is, enforcement that improves compliance – requires deft handling of the regulatee and the discretionary power to do so. This understanding of enforcement makes it clear that before enforcement can occur, the regulator must make a determination as to whether or not there has been compliance prior to either reward or punishment being meted out. Thus administration of enforcement is the act of determining compliance and allocating consequences among the regulatees – either rewarding those who comply or punishing those whose social practice falls outside of the parameters of the regulated social practice. A large body of literature that examines law enforcement focuses on the concepts of deterrence and punishment, as in the work of Bentham,<sup>95</sup> Hart<sup>96</sup> and others, as well as much criminology.<sup>97</sup> More recent thinking, however, has introduced the notion of incentive and inducement in addition to punitive measures as a means of enforcing, or perhaps more accurately, re-enforcing behaviour.

### 1 Enforcement Tools

Enforcement is the use of the tools of government (authority, treasure<sup>98</sup> and organisation) that validate the psychological levers (fear, anxiety, persuasion and incentive) to provide visible behavioural outcomes that conform to the objectives of a regulatory system. In other words, enforcement is the taking of action to encourage or force the regulatee to comply or to punish for past non-compliance with a view to securing future compliance or preventing future non-compliance. As such the enforcement response needs to be carefully chosen and wisely administered.

Consider the following examples. Where a fear of punishment is to be the motivator, the tool of authority must be used to respond by punishing through the denial of some right. That right may be the right to freedom (jail), the right to hold property (fine), or the right to act (rescind a licence). Incentives to encourage must also be granted. Using an incentive as motivator, the tools of treasure or organisation as the promised reward must be delivered. A punishment that is threatened or an incentive that is promised but not granted undermines this type of enforcement. Finally, punishments and incentives must be commensurate with compliance or non-compliance. Punishments and rewards that are incommensurate or disproportionate to the compliance or non-compliance are

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95 Jeremy Bentham, 'Principles of Penal Law' in John Bowring (ed), *The Works of Jeremy Bentham* (William Tait, 1843) vol I, 365.

96 H L A Hart, *Punishment and Responsibility* (Clarendon Press, 1968).

97 John Hagan, A R Gillis and David Brownfield, *Criminological Controversies: A Methodological Primer* (Westview Press, 1996).

98 See Hood, above n 80.

incoherent and will cause unintended consequences, including undermining the legitimacy of the regulatory system as a whole. In sum, enforcement is used to secure compliance on an ongoing basis.

## VI COHERENCE OF THE LEGAL ARCHITECTURE

In Part I, the question was posed whether it is possible to identify characteristics within and between the components of a regulatory system that can be reduced to general patterns or principles, thereby providing a guide for a more coherent design of regulation. In Part II, it was explained how the normative dimension of regulation is directed towards addressing the question of how best to respond to the social effects of a social problem. By contrast, the positive dimension deals with the question of how best to alter or encourage social practices that generate a desired social effect. In the course of the discussion following, four ways to alter or encourage social practices were identified: commanding, modifying, guiding and disciplining behaviour. These four approaches of influencing social practices broadly align with corresponding normative characterisations of organising problems as social coordination problems, risk/collective action problems and social opportunities/enablers. These four will be discussed below.

### A Commanding Behaviour

There are a range of social circumstances where policymakers recognise that the nature of an organising problem is sufficiently ubiquitous, salient and urgent that social actors must be *commanded* to do or not do something specific (mandate or prohibit behaviour),<sup>99</sup> or where the organising problem is sufficiently complex that a coordinated and centralised response is required to achieve the desired social outcome. Given the potential breadth and universality of application – potentially the whole of society – a ‘blunt instrument’ that mandates or prohibits a social practice is both an easier and more effective means of designing, implementing and administering a regulatory response.

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99 Eg, social practices that cause death or serious injury may warrant prohibition (criminal aspects of occupational health and safety law generally applicable to all enterprises). Alternatively, where it is politically accepted that a social issue such as climate change requires immediate attention, commanded behaviour may be a political choice (used in conjunction with more medium-term behaviour modification strategies).

Table 2: Social Coordination Problems

Organising Problem	Objective of Change of Practice	Structure	Substantive	Psychological Lever	Device	Consequence
Social issues and social coordination problems	Prohibit or command specific social practice	Centralised	Imposition of strict duty and prescriptive rule	Fear of punishment	Legal command	Prison/fine
	Prohibit or command specific social practice	Centralised	Imposition of general duty and prescriptive rule	(1) Fear (2) Fear and anxiety re: negative incentive	(1) Tax (non-regulatory) (2) Regulatory tax	Prison/fine
	Prohibit or mandate social practice	Decentralised	Imposition of general duty and specific liability	Anxiety and fear of non-compliance and potential punishment	Inspection/audit	Fine

A good example of such a situation is where some form of conscription is necessary to answer a threat to a society. Citizens can be conscripted to engage in military service, emergency responses to natural disaster or other threats to the nation. Market or voluntary approaches may fail to bring adequate resources or cause a (unjust or otherwise) mal-distribution of the response's burden.

Where the regulatory response is to change a social practice by commanding behaviour, the imposition of strict, prescriptive duties negates the need for a legislature to delegate rule-making powers to a regulator; hence, a centralised control structure is not only sufficient, but is the only logical choice of structure. Delegating a rule-making function and powers to a regulator that does not need to exercise a 'gap-filling' rule-making discretion is an incoherent outcome. Furthermore, the imposition of strict, prescriptive rules in the form of a legal command implies that the social imperative is sufficiently urgent that compliance related levers such as persuasion through education or information dissemination may take too long or be regarded as too soft to achieve the objective of the regulation. Hence, more blunt and extreme compliance levers such as fear or anxiety will be the only coherent option. Finally, the legal devices that complement and reinforce these technical linkages are the threat of prison or a fine.

## B Modifying Behaviour

The characterisation of an organising problem as a risk often has the effect of narrowing the targets of a regulatory system to more specific classes of actors – often determined by geography or complexity of the social practice those actors are engaged in that requires change. More importantly, however, it may be that policymakers recognise that a modification of an existing social practice rather than prohibiting or mandating a completely different social practice is required. Hence, the development and setting of standards of performance is a more

appropriate way to alter a social practice. The development and setting of behavioural standards provides a stronger justification for delegating rule-making functions and powers to a regulator. The regulator, having specialist skills, knowledge and expertise, will be better positioned than a legislature to formulate specific standards or performance measures. Hence, control power is diffused when greater governance powers are delegated to the regulator and hence, a more decentred structural model logically accords with greater delegation.

Environmental regulation of industry may fall into this category. Where industry is engaged in certain activities, the products of which benefit society, the prohibition of the activity is not appropriate. Further, given the complexity of the various actors, technologies and procedures involved in production, it is unworkable for government to mandate certain processes – a matter which has greatly hampered the development of communist industries and economies. Accordingly, the better approach is to set out the performance standards and allow managers to manage their enterprises in such a way that the standards are met while continuing to produce the socially beneficial product.

The diffusion of control powers requires a corresponding change in the nature of the substantive obligations imposed. The legislature enacts a more general obligation, thereby permitting the regulator the discretion to impose further, more specific obligations in the form of technical standards. Further, the regulator’s discretion allows the regulator to better target different standards to different classes of actors in the form of more easily changed executive-made ‘regulations’, rather than the less flexible statutory rules.

Table 3: Collective Action and Risk

Organising Problem	Objective of Change of Practice	Structure	Substantive	Psychological Lever	Device	Consequence
Collective action problem	Modification of social practice by standards or performance measures	Decentred	Imposition of general duty and specific liability	Anxiety flowing from oversight and performance measurement	Inspection, disclosure	Fine and social penalty (ie, reputation)
Specific and private risks	Modification of social practice by standards or performance measures	Decentred	Privilege and liability	Incentive and anxiety	Licence and inspection	Loss of privilege and fine

The relationship between levers and devices that flows from the imposition of behaviour modifying standards is driven primarily by the regulatee’s anxieties connected to oversight and/or performance measurement obligations.

### C Guiding Behaviour

Under certain circumstances, the nature of the organising problem may afford policymakers an opportunity to advance society by generating a beneficial social effect. Regulation that guides behaviour by encouraging a desired social practice may be an effective means of achieving a positive social outcome – provided that the organising problem is not salient or urgent. The granting of an opportunity in the form of a licence or a privilege enabling self-regulation seeks to induce regulatees to comply through the granting of this privilege. The implicit threat is that if the responsibilities associated with the granting of the privilege are not met, the privilege will be revoked.

Table 4: Social Opportunities

Organising Problem	Objective of Change of Practice	Structure	Substantive	Psychological Lever	Device	Consequence
Social opportunity and/or enabler	Guiding social practice	Decentred (Meta-regulation)	Privilege	Inducement or incentive	Licence or subsidy	Loss of privilege
	Guiding social practice	Distributed (Co-regulation)	Privilege	Incentive and inducement	Self-regulation	No grant of privilege
	Guiding social practice	None	Privilege	Persuasion	Information (media and markets)	Reputation

The classical model of professional regulation falls into this category. Professions are traditionally justified as having a public service aspect. The medical profession, for example, once organised set standards for admission and practice. Government has allowed the profession to self-perpetuate; however, it is never far in the background, supervising admission standards, practice and institutions dedicated to health care.

Because the state imposes rules in the form of general principles, the regulatee is given some power to further specify those rules through the development of more specific rules or procedures, which are authorised or approved by a regulator that functions more as an oversight body. A decentred structure, combined with general ‘principles’ as the dominant rule type, aligns with inducement and persuasion as the psychological levers, which are manifest in some form of conditional licence, subsidy or authority (to self-regulate, for example).

### D Disciplining Behaviour

A further means of influencing social practices that largely falls outside the scope of this article is through the use of social institutions. Institutions such as the media play an important role in society as an accountability mechanism. Indeed, traditionally the media have been called ‘the fourth estate’.

Other social institutions, such as markets, can have an important role in influencing behaviour in economic activities. Or social institutions, such as cultural or religious institutions, can have the effect of shaping and disciplining behaviour through social incentive structures. Actors that do not conform to cultural or religious norms and expectations may be ostracised by a given community.

In the private sector, the media can influence negative social practices where the disclosure or risk of disclosure of such practices could result in reputational harm. Similarly, product, service and financial markets all can play a role in shaping the social practices of economic actors who rely on giving and receiving signals from other market participants who react to those economic actors' decisions and performance.

More recent public use of social media campaigns around issues from seatbelt use and drink-driving to changing attitudes about domestic violence are significant examples. The use of social disciplining mechanisms such as social media and markets, although important, can also be described as blunt tools. Whereas the highly centralised behavioural command-and-control approach to change behaviour is positioned at one end of the behavioural change continuum, the use of social institutions to discipline behaviour and instigate behaviour change falls at the opposite extreme. Rather than being highly decentralised, using media and markets as a method of disciplining behaviour is uncoordinated and often ineffective in inducing long-term and stable change.

## VII CONCLUSION

In the Introduction, it was suggested that regulation may be failing more frequently because of the use of new, untested, methods of regulating such as the principles or management-based approaches. For example, it has been suggested that bankers' privilege of self-regulation, and their failure to exercise this privilege responsibly, were major contributors to the Global Financial Crisis.<sup>100</sup> This explanation, however, is far too simplistic. Regulatory systems are a form of social system. Social issues and problems that warrant public attention arise as a social consequence of individual human behaviours – social practices. Ultimately, the purpose of regulation is to alter human behaviour by mandating, prohibiting, modifying, guiding, or disciplining human or organisational social practices in order to achieve a different social effect.

The positive dimension of a regulatory system is directed towards operationalising the method of altering a social practice in a manner that achieves the normative objective (that is, a desired social effect). As outlined above, the four main methods of achieving regulatory objectives are: mandating or prohibiting human behaviour which aligns with the traditional command-and-control method; modifying behaviour which aligns with risk-based methods;

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100 Black, 'The Rise, Fall and Fate of Principles-Based Regulation', above n 3.

guiding behaviour through the use of principles-based methods; and disciplining behaviour through the use of social mechanisms such as the media, markets or other institutions.

Regulation fails, as it did with principles-based banking regulation, when the linkages between components of a regulatory system are mismatched or incoherently aligned. Where structure is mismatched with obligations or operational choices, frictions within the system arise. For example, although it is self-evident that the banking and the financial systems are extremely important social institutions affecting everyone in society (industries that serve the public good), banking regulation in several countries was reformed in the 1990s using risk-based and principles-based approaches. Rather than mandating or prohibiting behaviour, use of the less prescriptive and operationally rigorous principles-based approach (guiding behaviour) resulted in near catastrophic consequences. The near failure of the banking system, it can be argued, arose from regulating the social practices of bankers using more benign ‘principles and persuasion’ rather than stricter commands and prohibitions.

In addition, the selection of how a social practice is altered influences the way in which a range of regulatory burdens (such as cost, administration and compliance requirements) are distributed between the state and other actors involved in the regulatory process. A critical feature of this allocation of burdens is the corresponding structural changes that flow from a centralised or decentralised distribution of governance powers and functions. The shift towards more decentralised models has the effect of increasing the technical complexity of regulatory systems where a broader distribution of powers among a greater number of actors results in the creation of a greater number of juridical relations and accountabilities. Finally, aligning a change in social practice with the operational aspects of a regulatory system requires coherence between the method of altering a social practice and the psychological levers and legal devices employed to effect that change. For example, a market-based approach, which is suitable as a means of inducing general behaviour, is not an appropriate device to use to mandate a specific social practice.

The design of a coherent regulatory system is a complex endeavour. Nevertheless, the likelihood of regulatory success is increased by an understanding of a logical relationship between components of a regulatory system and how those components may be better designed to alter social practices in a manner that achieves the desired social effects of regulation.