City of Westminster

Licensing Committee

Date:	**27 June 2013**
Classification:	**For General Release**
Title:	**The Hemming Judgment – Outcome and implications**
Report of:	**Head of Legal and Democratic Services**
Wards Involved:	**Not Applicable**
Financial Summary:	**No financial implications**
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1. Summary

1.1 The purpose of this report is to summarise the outcome of the litigation brought by the licensees of sex shops in Soho (and elsewhere in Westminster), in which the legality of the fee charged for a sex shop licence was challenged. The Court of Appeal gave judgment on 24 May, dismissing Westminster's appeal against the judgment of the High Court in June last year. The immediate effect of the judgment is that the City Council is required to re-set the fee charged on applications for sex establishment licences for the years 2010/11 onwards, in the light of the Court's judgment, repaying to the claimants any excess fees they have been charged as a result.

1.2 In the longer term, the judgment, unless overturned on appeal, will have significant implications for the fee charged by the City Council under other licensing regimes, and similar implications for other licensing authorities. There are also implications for a range of other regulatory bodies.

1.3 An application to the Supreme Court for permission to appeal the decision of the Court of Appeal has been submitted. The contents of this report are subject to the outcome of any such appeal, should permission be granted.

1.4 A separate report before this Committee makes recommendations with respect to the re-setting of fees, to comply with the Order made by the Court of Appeal.

2. Recommendation

2.1 The Committee is asked to note the report.

3. Background

3.1 Sex establishments are licensed under the Local Government (Miscellaneous Provisions) Act 1982. That legislation was enacted, at least in part, as a result of lobbying by the City Council, which was concerned in the 70s and 80s with the proliferation of the sex industry in Soho, and with the inadequacy of the controls in place at the time under planning and licensing legislation.

3.2 One of the purposes of the Act was to confer more power on the licensing authority to control the number of sex establishments in a particular locality. Under the Act the authority may determine a maximum number of establishments in a particular area, and may refuse to grant more than that number. Westminster has determined such a maximum number for Soho.

3.3 The Act provides that a person wishing to operate a sex establishment must apply for a licence, and a licence may be granted for a period of up to one year (when an application for renewal may be made). In Westminster, licences have been granted for an annual period commencing on 1 February, and expiring on 31 January the next year.

3.4 Importantly in this context, the Act provides

> “An applicant for the grant, variation, renewal or transfer of a licence ... shall pay a reasonable fee determined by the appropriate authority”.

3.5 An annual fee for a sex establishment licence of £29,102 was set by the Licensing Sub-Committee in September 2004. That fee is obviously very much greater than the fee charged to applicants under other licensing regimes. The fee is high because it includes an element designed to recover the cost to the Council of enforcement action taken to close down sex establishments which operate without a licence, and because the number of those granted a licence is small.

3.6 Before 2009, there was no doubt that the law permitted a licensing authority to calculate a fee in this way. As the High Court held in a case concerning licences for street traders:

> "[Local authorities] may take into account the costs which they will incur in operating the street trading scheme, *including the prosecution of those who trade in the streets without licences*." (Emphasis supplied).

Indeed, the fees charged by Westminster were the subject of a legal challenge in 1985. In that case the Court noted that it was not disputed that the Council could calculate the licence fee for sex establishments, "not only [by reference

to the cost of] processing licensing applications, but also [by reference to the cost of] inspecting premises after the grant of licences and … [the] vigilant policing of establishments within the city in order to detect and prosecute those who operated sex establishments without licences." In other words, it was not disputed that the sex establishment licensing regime could be self-financing.

3.7 In fact it has been regarded as a basic principle of most licensing regimes for many years that the “polluter pays” principle should apply and that the regime should be self funding. As set out below, that principle has, in the case of the Licensing Act 2003, been formally enacted by the current government, in the Police Reform and Social Responsibility Act 2011.

4. The legal challenge

4.1 In April 2011 Mr Timothy Hemming, trading as Simply Pleasure Ltd, and six other holders of sex establishment licences, began proceedings for a judicial review of the licence fee demanded by the City Council for the licensing year 2010/11. The claim followed a number of requests made under the Freedom of Information Act for financial data relating to expenditure incurred by the Council, and for information about how the fee charged for the years 05/06 onwards had been decided upon.

4.2 The basis of the claim was that no fee had ever been determined for 2010/11, even though an annual fee of £29,102.00 was demanded of, and paid by, the claimants for each of the sex establishments they operated. The claimants' case was that a reasonable fee should now be determined for 2011/12, and they sought an order requiring the Council to do so.

4.3 But it was the claimants' case that the fee to be determined by the Council should reflect two considerations. The first and most important related to the effect of the Provision of Services Regulations 2009.

4.4 On 28 December 2009, The Provision of Services Regulations 2009 came into force. These Regulations implement the European Services Directive 2006/123/EC.

4.5 The purposes of the Services Directive are set out in its Recitals, and in general terms are to create a free market for services within the EU, and to promote a competitive market.

4.6 Article 4 of the Services Directive sets out the following definition;

> “*(6) “authorisation scheme” means any procedure under which a provider or recipient is in effect required to take steps in order to obtain from a competent authority a formal decision, or an implied decision, concerning access to a service activity or the exercise thereof;”*

4.7 Article 13 deals with authorisation procedures and states;

"*(2) Authorisation procedures and formalities shall to be dissuasive and shall not unduly complicate or delay the provision of the service. They shall be easily accessible and any charges with the applicants may incur from their application shall be reasonable and proportionate to the cost of the authorisation procedures in questions and shall not exceed the costs of the procedures."*

4.8 In the 2009 Regulations these provisions have been transposed as follows;

Regulation 4 provides

"*authorisation scheme" means any arrangement which in effect requires the provider or recipient of a service to obtain the authorisation of, or to notify, a competent authority in order to have access to, or to exercise, a service activity;"*

4.9 Part 3 of the Regulations deals with authorisations, and regulation 14 sets out general conditions that must be met in respect of the establishment of such schemes. Regulation 15 sets out requirements for conditions that can be attached for the granting of authorisations. Regulation 15(2) states;

(1) An authorisation scheme provided for by a competent authority must be based on criteria which preclude the competent authority from exercising its power of assessment in an arbitrary manner.
(2) The criteria must be—
(a) non-discriminatory,
(b) justified by an overriding reason relating to the public interest,
(c) proportionate to that public interest objective,
(d) clear and unambiguous,
(e) objective,
(f) made public in advance, and
(g) transparent and accessible.

4.10 Regulation 18 provides;

18.— Authorisation schemes: general requirements
(1) Authorisation procedures and formalities provided for by a competent authority under an authorisation scheme must—
(a) be clear,
(b) be made public in advance, and
(c) secure that applications for authorisation are dealt with objectively and impartially.
(2) Authorisation procedures and formalities provided for by a competent authority under an authorisation scheme must not—
(a) be dissuasive, or
(b) unduly complicate or delay the provision of the service.

(3) Authorisation procedures and formalities provided for by a competent authority under an authorisation scheme must be easily accessible.
(4) Any charges provided for by a competent authority which applicants may incur under an authorisation scheme must be reasonable and proportionate to the cost of the procedures and formalities under the scheme and must not exceed the cost of those procedures and formalities.

4.11 The claimants' first and main point was therefore that since the coming into force of the 2009 Regulations, the fee should no longer reflect the costs of enforcement against unlicensed operators, since such costs were not part of the costs of the "procedures and formalities" under the "authorisation scheme.

4.12 Their second point was that because (as is undisputed) the Council is not entitled to make a profit out of the fees it charges, the fee to be determined by the Council for 2011/12 should reflect the extent to which the fees which the Council demanded over the previous years exceeded the costs of administering and enforcing the licensing system. Any surplus which the Council should have taken into account should, it was argued, now be passed on to the current licence holders in the fee which should now be set for 2011/12.

4.13 The claimants, in addition, made a restitutionary claim on the basis that the Council had not determined the appropriate licence fee for the five previous years, i.e. the years ending on 31 January 2007, 31 January 2008, 31 January 2009, 31 January 2010 and 31 January 2011. The demands for licence fees for those five years were therefore said to be unlawful and the claimants sought the return of the sums they paid. It was accepted that they should not be able to recover the whole of the sums they paid for those years. The claim was for the difference between the sums they paid and whatever would have constituted reasonable fees for those years.

4.14 When commencing proceedings, the claimants offered to settle the claim on the basis that they would abandon their claims relating to previous years if the Council determined a licence fee for 2011/12 leaving out of account the cost of enforcement against unlicensed operators. That offer was not accepted.

4.15 The Council's response to the claims was (very briefly summarised) that the fee had been lawfully set on an ongoing basis by the Licensing Sub-Committee in 2004, and that officers had, as required by Financial Regulations, reviewed the fee on an annual basis since then, and had not submitted a report recommending the fee be varied because, broadly speaking, income from fees had continued to match expenditure.

4.16 In relation to the claim that fees could no longer reflect the cost of enforcement action against unlicensed establishments, the Council's position was that when the regulations relied upon by the claimants were interpreted, as they should be, to give effect to the European Directive which they sought to implement, it could be seen that they did not prohibit the recovery of

enforcement costs as permitted by long established domestic legislation. This issue is discussed in more detail below.

5. The High Court judgment

5.1 The claim was heard in the High Court before Keith J over two days in March 2012, with judgment following in June.

5.2 By Judgment handed down on 16th May 2012, Keith J concluded that:

a. The Council had not determined a licence fee for any year after the year ending 31 March 2006; and
b. Since the coming into force of the 2009 Regulations, the Appellant had not been permitted, when determining the reasonable licence fee for sex establishments, to reflect in the fee which it determines the cost of enforcing the licensing system .

5.3 In relation to the first point, the Judge accepted that the Council was entitled lawfully to determine a licence fee which rolled over from year to year, and that it was not necessary as a matter of law for there to be a separate decision each year. However, he held that that is not what the Council had done. Because of the terms of the report considered by the Licensing Sub-Committee in September 2004, which referred to an “annual” review of licensing fees, the costs to be incurred “in the year ahead”, and “the next annual review” in February 2005, he held that the Sub-Committee had decided on a fee only for the one year period 05/06. That meant no fee had been lawfully set for subsequent years.

5.4 On the second point, the Judge said:

“Whatever domestic law had permitted in the past, there had in the future to be, not only a proportionate relationship between the fee which was charged and the cost of the "authorisation procedures", but the fee could not exceed the costs of those procedures. Those procedures are the steps which an applicant for a licence has to take if he wishes to be granted a licence or to have his licence renewed. And when you talk about the cost of those procedures, you are talking about the administrative costs involved, and the costs of vetting the applicants (in the case of applications for a licence) and the costs of investigating their compliance with the terms of their licence (in the case of applications for the renewal of a licence). There is simply no room for the costs of the "authorisation procedures" to include costs which are significantly in excess of those costs”.

5.5 By a second judgment handed down on 12th June 2012 Keith J determined the question of relief and consequences of the Respondents’ pre-action settlement offer.

5.6 The formal Order made by the Court on 17th June 2012:

(i) declared that when determining under paragraph 19 of Schedule 3 to the Local Government (Miscellaneous Provisions) Act 1982 what is a reasonable fee for the grant or renewal of a licence to operate a sex establishment, the Council had not, since December 2009, been permitted to take into account the cost of investigating and prosecuting persons, firms or companies who operate sex establishments within Westminster without a licence;

(ii) ordered the Council to determine a reasonable fee for the years ending 31 January 2007 through to 31 January 2010 for the renewal or grant of a licence to operate a sex establishment, having regard to the need to carry forward from year to year any previous surpluses or deficits;

(iii) ordered the Council to determine a reasonable fee for the years ending 31 January 2011, 31 January 2012 and 31 January 2013 for the renewal or grant of a licence to operate a sex establishment, having regard to (1) the need to carry forward from year to year any previous surpluses or deficits and (2) the declaration at (i) above; and

(iv) ordered the Council to pay to the claimants for each of the years referred to above the difference between (a) the sums demanded by way of licence fees and paid by the claimants and (b) the sums which the Appellant determined to be a reasonable fee to operate a sex establishment, such monies to be paid within six weeks of the date of determination;

5.7 The Order also made provision for the payment of interest and costs, pursuant to the learned Judge's decision on the consequences arising from the pre-action offer. The claimants were awarded their costs. Because the Council did not accept the pre-action offer, the claimants were awarded costs on an indemnity basis from the date of the offer.

6. The Court of Appeal judgment

6.1 The Court of Appeal gave the Council permission to appeal the High Court judgment on three grounds. The first ground was that the Court had erred in concluding that on a proper construction of the Services Directive and the Services Regulations the Council has not been permitted, since December 2009, to include in the licence fee any costs of investigating and prosecuting persons, firms or companies who operate sex establishments within Westminster without a licence. The second ground related to the costs award – Westminster should not be penalised for not accepting an offer that would not have resolved the issue between the parties, nor for resisting a claim when it was clearly in the wider public interest that the point should be determined. The third ground related to the restitutionary relief ordered by Keith J.

6.2 The Appeal was heard by the Master of the Rolls, Lady Justice Black and Lord Justice Beatson on 14th January 2013. By Judgement handed down on 24th May 2013, the Court of Appeal dismissed the appeal on 2 grounds but upheld the second ground of appeal concerning the restitutionary relief ordered by Keith J. Permission to appeal to the Supreme Court was refused by Order dated 24th May 2013.

6.3 By Order dated 24th May 2013, the Court of Appeal varied that High Court Order in part to reflect the Council's successful appeal on the form of restitutionary relief, and ordered that the Council pay 90% of the claimants' costs of the appeal, and that the claimants 10% of the Council's costs of the appeal. A copy of the final Order made by the Court is attached to this report as Appendix I.

7. Implications

7.1 Hemming is a case of significant importance.

7.2 This is the first time that Directive 2006/123/EC on Services in the Internal Market ("the Services Directive"), has been considered by the UK courts, and the point in issue is a hugely important one for local authorities and for other regulatory bodies. Professional regulatory bodies, including the Law Society, have already expressed concern to the Appellant as to the potential implications of the Judgment for their own regimes.

7.3 The approach taken by the Court of Appeal leads to the reversal of the very long standing domestic powers to set fees within a licensing regime, It also casts doubt on the compatibility of provisions of primary legislation post-dating the implementation date of the Directive which places a duty on licensing authorities to seek to ensure that licence fees are set so as to equate as closely as possible to the costs of discharging specific functions and a reasonable share of the authority's general licensing costs, including enforcement. In fact, the Court of Appeal itself acknowledged that the result of the interpretation by Keith J "*sits uncomfortably with the history, in the United Kingdom, of self-regulation largely financed by those working in the regulated area."*

7.4 Moreover, there is no evidence that this outcome was the intended effect of the EU in enacting the Directive, or of Parliament in implementing it through the Regulations. In respect of the latter, such intention is completely inconsistent with the later enactment of section 121 of the Police Reform and Social Responsibility Act 2011, intended to provide for "full cost recovery" under the Licensing Act 2003. This section (which is not yet in force) provides for the insertion of new sections 197A and 197B into the Licensing Act 2003 which sections expressly require a licensing authority to seek to ensure the income generated from the licence fees equates as closely as possible to its costs, including general licensing costs. There is a clear and inescapable

tension between the full cost recovery requirement of these statutory provisions and the conclusions of the Court of Appeal.

7.5 For Westminster, the case has immediate financial consequences, as set out in detail elsewhere on the agenda. The consequences are not limited to the sex establishment regime. The Licensing Act 2003, and the street trading regime (including tables and chairs on the highway) are “in scope” for the purposes of the Services Directive, as are special treatment premises.

7.6 But the outcome also obviously impacts on all other licensing authorities, and a wide range of regulatory bodies (of which the Law Society, mentioned above, is one example). For some bodies, who have no alternative means of raising funds other than a licence fee, the effect of the judgment may be to critically undermine the regime and make it impossible to run.

7.7 There are also implications for central government – in particular the Home Office, which must decide on what effect the judgment of the Court of Appeal has on its plans to consult on draft Regulations providing for full cost recovery under the 2003 Act, as mentioned above. The Home Office is understood to have been watching the case with interest, but has not sought to intervene, or even comment, thus far.

8. Financial Implications

8.1 The financial implications are set out in detail in the report elsewhere on the agenda dealing with the re-setting of licence fees.

9. Legal Implications

9.1 These are set out in the body of the report.

If you have any queries about this report please contact Peter Large on 020 7641 2711, or email plarge@westminster.gov.uk