



REVISING THE PENALTY GUIDELINES – OFCOM CONSULTATION

1 Executive Summary

The UK Competitive Telecommunications Association (“UKCTA”) is one of the leading voices in the UK fixed telecommunications industry, counting the majority of the market’s main players as our members. Our aim is to foster a more competitive fixed telecommunications market in the UK, based on a regulatory framework that treats all competitors in this field equally and fairly. We believe that this is good news for consumers, the industry and the economy. Consumers will benefit from greater choice of more competitive, innovative products; network companies will be in a better position to compete; and the economy will benefit from greater investment.

UKCTA welcomes this opportunity to comment on Ofcom’s consultation “Revising the penalty guidelines” (“the Consultation”). UKCTA members take seriously their compliance obligations and believe that this is demonstrated by the falling number of consumer complaints which Ofcom mentions in the consultation. We believe that there are many factors which drive compliance: penalties form only part of the picture and not as significant a part as Ofcom seems to believe. In response we make four main points of principle: -

- i. UKCTA does not accept the assertion that there is a need for a greater deterrent effect (and the necessary implication that communications providers (“CPs”) regard penalties for regulatory breaches as an acceptable risk).
- ii. The level of complaints is low and does not justify further intervention by Ofcom.
- iii. The current level of fines already create a strong and sufficient deterrent effect.
- iv. Should the proposed draft penalty guidelines (the “Draft Guidelines”) be adopted then:
 - Ofcom should provide greater clarity on levels of fines to promote legal certainty;
 - clarification as to the level of importance of the relevant factors to be considered by Ofcom in assessing the level of a fine is required; and
 - the Draft Guidelines should only apply to future investigations.

Finally, we make a number of suggested changes to the text of the proposed Draft Guidelines set out in the Consultation.

2 Introduction

UKCTA members take their regulatory compliance obligations very seriously. The best interests of our customers is at the heart of what we do and we work hard to continually improve the way in which we meet these. We are therefore proud of the general decrease in telecoms complaints since 2011 referred to in the Consultation.

The ultimate sanction in this competitive industry is letting customers down. For UKCTA members, compliance with the consumer protection obligations enforced by Ofcom is therefore about much more than simply avoiding financial penalties.

We appreciate that the significant financial penalties that Ofcom is empowered to impose under the Communications Act 2003 (“the Act”) have a role to play in incentivising compliance. However, we do not consider that they play the pivotal deterrent role suggested in the Consultation. The literature on incentivising corporate compliance is vast and varied. However it makes clear that even the harshest penalties regime is insufficient to ensure compliant outcomes. Where, for example, breaches are unintentional, education and awareness measures have a far more important role to play in improving compliance than any penalties regime. The resources dedicated by the regulator to monitoring and enforcement are clearly also an important factor.

It is worth noting that UKCTA members also experience issues with non-compliance when dealing with other CPs, often the smaller CPs which perhaps lack a compliance function and therefore have a lower awareness of their obligations than they should. Typically, when our members report such breaches to the regulator they are not regarded by Ofcom as a priority and are therefore not resolved.

The various studies on other corporate compliance penalties regimes also draw attention to the costs to society of those regimes. Whilst Ofcom states that the Consultation represents an impact assessment under section 7 of the Act, in truth very little consideration has been given by Ofcom to the potential costs, both to consumers and to industry, of the revisions to the Penalty Guidelines Ofcom proposes. It is trite to say that the proposed revisions will have no impact on compliant operators (para 1.34): neither in this case will the option of leaving the Penalty Guidelines un-amended have any impact. And whilst the suggestion that the impact on those whom Ofcom regulates should be “relatively small” is to be welcomed, there is no substance to back up this quantification anywhere in the Consultation. Furthermore, this conclusion is very difficult to reconcile with Ofcom’s earlier stated conclusion that larger operators will be more likely to be subject to higher penalties and that other operators too might be subject to higher penalties (para 1.32), especially when it is considered that fines of even 1% of turnover for some operators represent penalties of tens of millions of pounds. Fines that go to Treasury rather than being able to be invested in telecommunications networks, services and staff represent a clear dead loss to telecoms consumers: and this in a highly competitive industry where cost pressures are already keenly felt. The loss of funds will inevitably impact on the choice and quality of services which can be offered by the companies concerned.

3 There is not a general culture of non-compliance

In the Consultation Ofcom has suggested that it needs to make changes to have a much greater deterrent effect on CPs in relation to the General Conditions of Entitlement regime. It has stated that it believes this can be achieved by increasing the level of fines (where appropriate and proportionate to do so) for breaches of regulatory obligations, and that by increasing the deterrence effect this will help reduce the level of complaints to Ofcom and the number of breaches by CPs of regulatory requirements.

UKCTA does not share Ofcom’s view that the current approach to penalties adopted by Ofcom does not have a sufficient deterrent effect on CPs. In most organisations the commercial drivers to gain and maintain customers combined with the possibility of investigation and enforcement action by the regulator already does

deter most CPs from wilful non-compliance with the relevant regulations. UKCTA does not believe that the breaches which come before Ofcom are cases of calculated risk by the CPs involved; there are many factors which lead to breaches of regulations. The proposal that increased fines will have a greater deterrent effect seems to carry the implication that those CPs in breach have weighed up the risk of being in breach and found it to be acceptable. This is not a pattern of behaviour which UKCTA members recognise.

UKCTA members take compliance very seriously and question Ofcom's assertion that there is a "need to create a stronger deterrent effect".

4 The current level of complaints is low

Ofcom does not argue that there is a growing problem of non-compliance. In fact, as Ofcom notes in the Consultation, the level of complaints has been on a downward trend since 2011. However, Ofcom argues there is a need for reform because the rate of decrease has slowed down. Leaving aside the fact that many complaints are unrelated to issues of regulatory compliance, we do not believe even a slow-down in the decline of complaints relating to compliance indicates that companies no longer regard compliance as a necessity. Instead perhaps a slow-down in the rate of improvement ought to have been anticipated. We believe it is unrealistic to expect a constant, linear improvement in compliance. Achieving compliance becomes harder as levels of compliance increase and therefore progress slows. We do not agree that a slowing rate in improving compliance levels can justify Ofcom's proposed change in guidance particularly when the overall context is one of a low level of complaints about communications services. Overall consumer levels of satisfaction with communication services are around 90% and the number of consumer complaints to Ofcom against telecoms and Pay TV providers for Q2 2015 was less than 0.1 per 1,000 customers. UKCTA does not believe that these figures provide sufficient evidence of a degree of consumer harm which would justify the changes to the Penalty Guidelines which Ofcom is proposing.

As noted above UKCTA also does not believe that the slow-down in the decrease in the number of complaints can be blamed on a lack of deterrent effect. The picture is far more complex and can include factors within the CPs themselves as well as the information available to consumers. Ofcom has a role to play in increasing consumer awareness and increased awareness can help to drive up the number of complaints as can increased awareness of consumer rights more generally. The publicity which follows any enforcement action against a CP can also prompt other consumers to bring their own complaints. All of these factors can and do contribute to a slow-down in the rate of improvement in the compliance arena, it is too simplistic to suggest that CPs regard Ofcom's penalties as a less effective deterrent than they did previously.

5 Current levels of fines provide a strong and sufficient deterrent effect

UKCTA members do not consider there is any lack of deterrence caused by the current penalties regime. There have been examples of penalties amounting to millions of pounds in recent years. We do not believe that any company operating in the market today, regardless of its size or turnover, would be indifferent to a penalty counted in millions of pounds. Indeed, fines of hundreds of thousands of pounds cause the companies concerned to take remedial action to rectify the behaviour which caused the problem and to ensure that there are no further breaches. The current levels of fine do therefore have the desired deterrent effect and already incentivise management to seek to ensure their operations are compliant: were this not the case then Ofcom would be able to point to rising levels of dissatisfaction and complaints rather than falling numbers. Ofcom's impatience with the rate of improvement does not in our view justify the changes proposed.

Ofcom also seems not to factor into its assessment of the deterrent effect of the current regime the significant reputational damage which can occur to a company when enforcement action is taken by a regulator. This adds a significant additional element of deterrence that ought to be borne in mind. One need only look to the current scandal engulfing Volkswagen to realise that the regulatory fines faced by a company are not the sole concern of a company in any sector. If a company's reputation is tarnished, undermining the confidence of

consumers, then that is every bit as serious as the formal action taken by regulators. Taken together these two factors already do enough to foster a culture of compliance in most established CPs.

The UK consumer communications market is competitive and consumers have high expectations of their providers. If a CP is not meeting the needs of its customers then they can and do migrate to alternative providers. A poor compliance record is one factor which can contribute to poor customer satisfaction and the consequent loss of customers. This we believe is just as much of a deterrent as the likely level of potential fines from the regulator.

6 Ofcom should set out clearer guidance on penalties levels

In the Consultation Ofcom has indicated that, dependent on the circumstances of each case, it may depart from precedent and may set higher penalties under the Draft Guidelines.

As noted above UKCTA fundamentally disagrees with the notion that there is a need to increase the level of penalties. We also strongly disagree with the suggestion that Ofcom is under no duty to consider relevant precedents, just because of the age of the case.

However, if Ofcom is minded to proceed with the proposals set out in the Draft Guidelines to set higher penalties than in past cases where this is appropriate and proportionate, we believe that greater clarity is needed as to how this will be done. In particular, UKCTA members are concerned that a simple open-ended departure from the hitherto constraining factor of previous penalties imposed would cause a significant degree of legal uncertainty due to the inherent lack of transparency. We believe this concern might be addressed by the publication of further details regarding the penalty levels that might be appropriate in different cases, depending on the relevant circumstances. It would also help Ofcom to adopt a consistent approach to setting penalties, consistent with its regulatory duties under the Act. This already happens at an EU level in competition law cases and in the Enforcement Guidelines of the Financial Conduct Authority and we believe it would be helpful if Ofcom were to mirror best practice in this regard.

7 Factors to be considered by Ofcom in assessing the level of a fine

In the Draft Guidelines Ofcom lists some examples of what it might consider relevant in deciding the level of penalty. Ofcom also proposes amending the order of these factors. UKCTA members would like Ofcom to clarify whether the re ordering of the relevant factors reflects the weighting to be attached to the different factors in Ofcom's assessment of what level of penalty to impose. It is not clear from the consultation whether this is intended.

8 New Guidelines not to have retrospective effect

Ofcom states in the Consultation that "the intention of these proposed changes is to make clear that Ofcom will not necessarily be constrained by the amounts of penalties imposed in previous cases, from the point at which revised penalty guidelines are published."

Should Ofcom decide to adopt the Draft Guidelines, UKCTA believes that they ought to state explicitly in the interests of procedural fairness that they apply only to enforcement action resulting from Ofcom investigations initiated after the date that the new guidelines come into effect and will not be applied to any enforcement which may stem from current investigations or to any conduct engaged in prior to the amendments coming into effect.

In addition to the above comments on points of principle we suggest a number of changes to the text of the proposed Draft Guidelines.

- a) Paragraph 2 – as noted above we believe that as a matter of established legal practice, this paragraph ought to state that the new guidelines will not have retrospective effect and will not apply to any penalties arising from current investigations or imposed in relation to conduct engaged in prior to the amendments coming into force.
- b) Paragraph 3 – the words “they are likely to become less relevant to future enforcement work over time” ought to be deleted. If precedents are relevant then they ought to be considered as part of the decision making process; the age of the precedent should not preclude it from consideration.
- c) Paragraph 4 – UKCTA suggests that Ofcom ought to delete the words “The level of the penalty must be sufficient to deter the business from contravening regulatory requirements, and to deter the wider industry from doing so”. As noted above the causes of non-compliance are varied but breaches are seldom deliberate. So while we understand the wish to use penalties to reduce the deliberate contravention of regulations we fear that increased fines alone will not prevent future breaches. We do not think it is appropriate for Ofcom to factor into the level of fine a wish to make an example of any one CP to encourage the others to greater compliance efforts. As noted above the impact on a CP of compliance action goes beyond the size of the penalty, indeed the bigger an organisation the greater the potential reputational damage.
- d) Paragraph 5 – We suggest that the final sentence of this paragraph should be prefaced with the words “In cases of intentional or negligent breach,” to reflect the fact that mistakes can and do happen. As noted repeatedly throughout this response, we believe that deliberate, wilful breaches of regulation are not the norm and that despite compliance programmes and processes, breaches can occur due to error or lack of understanding. These circumstances need to be reflected in the level of penalty to distinguish them from deliberate breaches or those where there was a reckless disregard for the need to comply with regulatory requirements.
- e) Paragraph 6 – UKCTA is concerned that paragraph 6 seeks to enshrine the principle that the penalty should be determined by the size of the company in breach rather than the extent of consumer harm caused. The draft text seems unduly prescriptive and leaves Ofcom little discretion as to how to apply this factor. Were a breach to occur involving two companies of differing size but committing the same breach, the draft text would seem to oblige Ofcom to levy a penalty determined by the turnover of each company. We think this is wrong in principle. While it is right and proper for Ofcom to ensure that its penalty is not so severe that it prevents a CP from continuing to provide services, it is quite another for the guidelines to impose a penalty on the basis of a multiplier of the penalty level imposed on another CP purely based on the relative turnovers of the various CPs involved. The extent of consumer harm caused by any breach and whether the level of fine is likely to be an effective deterrent ought to be the main determining factors. An approach based on fine determined by turnover is likely to hinder rather than enhance any wider industry deterrence since the means by which the level of fine was determined will lack transparency. The risk is that CPs (and consumers) will form their own views as to the gravity and consumer harm caused by any given breach and these conclusions may be at odds with those which Ofcom reached in determining the penalty imposed. This is surely at odds with Ofcom’s objective of encouraging future compliance.
- f) Paragraph 7 – we do not believe that looking at past precedents should be discretionary. In line one of this paragraph it should therefore state that “Ofcom WILL have regard to precedents”.
- g) Paragraph 8 – as noted above we dispute the suggestion that current penalty levels do not deter compliance. However, if Ofcom is minded to adopt these proposals then we consider it essential that paragraph 8 be amended such that Ofcom is required to set out its justification and reasoning for believing that an increased penalty will deliver greater compliance. In short we believe that Ofcom should show evidence setting out the means by which an increased fine has been calculated and how this will deter further breaches rather than a simple assertion that a bigger punishment is required.

- h) Paragraph 9 – we believe this could usefully be expanded to make clear that not only might a company with a smaller turnover receive a higher fine, but also that a large turnover need not always mean a higher fine – such as in cases where the breach or the consequences are more minor.
- i) Paragraph 10 – as noted above we believe that the extent of consumer harm caused is more relevant than the size of an offender’s turnover, so we are concerned that this paragraph appears to give Ofcom discretion over whether to take into account the extent of harm caused. We believe this should state that Ofcom *will* rather than *may* take this into account.
- j) Paragraph 11 - This is the mirror image of our point on Paragraph 10. We believe that in the new sentence at the end of paragraph 11, it should grant Ofcom discretion by saying “may” not “will”. The size and turnover of the CP will not always be relevant to providing effective deterrence. We do not believe the guidelines should fetter Ofcom’s discretion to determine what penalties that are appropriate and proportionate in each case.
- k) Paragraph 13 - As set out above in our comment on paragraph 10, UKCTA suggests that the new proposed paragraph 13 should say that Ofcom **WILL** seek to quantify rather than may seek to quantify the degree of harm caused to consumers.
- l) Paragraph 14 - As set out in our comments above in relation to paragraph 7, we believe the word “will” in the first sentence of this paragraph should be retained.
- m) Annex 1 – UKCTA does not object to the deletion of this Annex in its current form. However the Annex covers certain practical matters such as Ofcom’s approach to assessing compliance where third parties are involved in the breach and on the role of risk assessment when the effectiveness of preventative measures is being considered, which we consider to be of sufficient wider relevance to warrant continued inclusion in the Penalty Guidelines in an amended form.



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