



BT response to Ofcom's consultation on revising the penalty guidelines

24 September 2015

Executive summary

- BT supports Ofcom's goal of ensuring that the threat of penalties for non-compliance can act as an effective deterrent, especially in relation to potential cases of direct consumer harm, or where unscrupulous operators seek to unfairly gain from non-compliance
- However, we are concerned that Ofcom's proposals are too broad brush: they are not sufficiently targeted, and do not have adequate regard to the wide range of sectors regulated by Ofcom, the different levels of the value chain that may be involved, and the differing amounts of deterrence that may be needed in differing circumstances
- We believe Ofcom's changes, especially in respect of the value of precedent, may reduce certainty and clarity for industry, with potentially negative consequences
- The blunt threat that in any circumstances a company, if non-compliant, may in future be fined more is, in itself, of limited deterrent value. Ofcom should seek to provide industry with more information, not less, to help it design the best possible compliance processes which can ensure that the maximum compliance focus can be applied to the issues that are potentially of the greatest concern.
- It would be in the interests of consumers and competitors for Ofcom to provide additional clarity on how it will assess breaches which cause consumer harm. Similarly, companies would benefit from being given clearer guidance on how Ofcom will calculate the turnover for regulated bodies in a multi-product environment
- Ofcom should consider how it can align itself better with other sectoral regulators, as well as ensuring it does not create a disconnect with the CMA's guidance on penalties which apply under competition law
- If these issues are not addressed, there is a risk that Ofcom's well-meant proposed changes could have unforeseen and negative effects on the competitive environment and on innovation – which in the longer term could harm the interests of consumers. BT is ready to work with Ofcom and industry to discuss improvements to the draft guidelines which would provide safeguards against this.

Introduction

BT welcomes the opportunity to comment on Ofcom's proposed amendments to its penalty guidelines. BT's view is that Ofcom's ability to impose robust but fair penalties are a key part of Ofcom's regulatory toolkit, and that clear guidance that sets out the sanctions that companies can expect in the event of non-compliance can act as a welcome deterrent to those who might be minded to contemplate non-compliance for commercial reasons, and to those who may not be willing to commit sufficient resources to avoid the risk of negligently failing to comply with their regulatory obligations. In particular, we support Ofcom in its overall aim of discouraging those companies who are willing to break the rules for their own commercial ends, and profit from consumer harm.

BT's firmly held view is that compliance should be at the heart of any business, and inherent in its commercial culture. BT is a strong advocate of the proposition that rigorous adherence to compliance brings commercial benefits in the form of enhanced customer satisfaction, trust and brand reputation. We also believe that companies must always be aware of the potentially significant consequences that follow where the required standards are not met.

BT therefore supports the goal of reducing the level of compliance-related complaints received by Ofcom, and of reducing contraventions of regulatory requirements. We agree that deterrence is a key tool in achieving this, and that it is in the interests of consumers and providers of services to be made aware through penalty guidelines of the consequences they can expect if non-compliant. However, whilst it is appropriate for Ofcom to impose penalties which have a deterrent effect, each and every penalty imposed must still be appropriate and proportionate in all the circumstances.

We are concerned that the current draft guidelines are unlikely to achieve the intended aims, and that they do not provide appropriate certainty that financial penalties will be imposed in a proportionate way. In order to foster a compliance culture which is fully integrated in a business, BT's view is that the penalties regime must be sufficiently transparent and certain to allow providers to understand fully the possible consequences of non-compliance. Ofcom's proposed changes to the penalties guidelines may have the opposite effect, with potentially counterproductive effects.

BT's view is that the proposed draft guidelines leave industry as a whole under the threat of higher penalties, without giving them clarity on how to embed effective compliance in their businesses. We believe there is scope to improve the draft guidelines to address these issues, and we are ready to work with Ofcom and the rest of industry to deliver those improvements. We believe the starting point should be to increase certainty so that organisations have more evidence, not less, on which to base their decision-making.

This response comments on the issues that we have identified in the current draft guidelines. It should be read as our answer to the single question in the consultation document: *'Do you have any comments on the proposed draft penalty guidelines in Annex 4?'*

Achieving effective deterrence

As set out above, BT recognises that deterrence is a key part of the regulatory framework. Clear statements that certain behaviours are unacceptable, together with clarity of the sanctions that are likely to be imposed in the event of transgression can be one of the most effective ways of securing widespread compliance. The ability to impose fines which remove the financial incentive to transgress is a vital tool for dealing with companies who deliberately break the rules, calculating that the gain they make at others' expense will outweigh the potential regulatory sanctions.

A targeted approach is needed

The circumstances in which non-compliance may arise are many and varied. Non-compliance may be unintended, or the consequence of coalescence of "a perfect storm" of unanticipated circumstances. Non-compliance may occur without any intent to cause consumer harm, or indeed where the company in question mistakenly believes that its actions will promote consumer well-being. In short, the extent to which there may be a need to impose a deterrent penalty will vary from case to case and depend on the particular circumstances.

BT's concern is that the changes Ofcom is proposing go beyond what is necessary to address those cases which give rise to the greatest need to impose deterrent penalties, particularly given the relatively narrow basis on which Ofcom has decided there is a need for change, and that they do not have adequate regard to the potential differing situations identified above. For example, it is important to note that the penalty guidelines apply to a very wide range of sectors including telecoms, broadcasting, postal services and spectrum. Even within telecoms, the penalties guidelines apply to every level of the supply chain, including at the network level, and in relation to such matters as financial reporting. In these areas the direct effect on consumers is clearly relatively limited. In its

consultation document, however, Ofcom merely focuses on the consumer-related enforcement action it has taken in the telecommunications sector, along with data around the levels of complaints in telecoms since 2011.

Accordingly, our view is that the proposed changes, apparently designed primarily to reduce consumer harm in the telecoms sector, represent an inappropriate one-size-fits-all approach. They would result in changes across the board, including in areas far removed from the consumer experience, where Ofcom has not identified any specific problems in its consultation. BT's view is that Ofcom should therefore be clearer on how it will distinguish between deliberate breaches by the rogue providers seeking to profit from consumers by non-compliance, as opposed to providers who have sought to be compliant, but who may commit a breach inadvertently.

There should also be increased clarity around how Ofcom will assess the seriousness of breaches which directly harm consumers, in comparison to breaches far removed from the consumer level. We see Ofcom's increased emphasis on quantifying consumer harm and gain as a step in the right direction in this regard, but there is insufficient detail in the draft guidelines to make this genuinely useful to a company seeking to design an effective compliance programme and to put the maximum effort into ensuring compliance with the matters of the greatest concern. This is especially true given Ofcom is also signalling that precedent will be less valuable as a guide to future penalties.

Certainty and precedent value

BT is concerned that Ofcom's proposal to give itself greater flexibility for there to be higher penalties comes with a corresponding reduction in certainty for industry. This is because one of the primary mechanisms by which Ofcom proposes to achieve this is by *'[s]etting out more clearly the value of precedents set by previous cases to our decision-making process'*.

In reality this will bring less clarity, because it appears that Ofcom's ultimate aim is to free itself of the constraints of previous decisions. While this is understandable in relation to particularly old decisions, BT believes the signal this sends will make it unduly difficult for industry to fully assess the potential consequences of their compliance decisions.

BT's view is that the blunt threat that a company might be fined more is, in itself, of limited deterrent value. Communications providers are sophisticated commercial entities who should know the rules and their obligations, and be able to understand clear messages on the potential sanctions for non-compliance. There would therefore be much greater deterrent value in providing more assistance for industry, not less, in understanding how Ofcom will approach its consideration of penalties.

Further, we believe that this more transparent, accountable approach would pay practical dividends beyond deterring breaches. It would reduce the likelihood that Ofcom's penalty decisions would be appealed for being insufficiently clear, with all the attendant inefficiency and cost, if Ofcom is unable to give sufficiently detailed and compelling reasons for the level of penalty it ultimately set and why it is proportionate, non-discriminatory, and in line with legitimate expectations.

Potential improvements

In order to guard against the potentially negative outcomes discussed above, we invite Ofcom to set out in more detail how it intends to approach penalties on a practical, forward-looking basis. In particular:

As set out above, Ofcom could help companies to better understand the potential consequences of failing to meet their regulatory requirements by explaining how it will weigh up the difference

between breaches that cause direct consumer harm, and those which are further removed from the consumer experience, such as at the network level in telecoms.

Further, while we understand the motivation behind Ofcom's proposal to establish a link between deterrence and the size and turnover of the regulated body, this is another area in which more details on how this would apply in practice are needed.

In a commercial environment increasingly characterised by companies that compete by offering products across a range of markets, and including multi-product bundled offerings which span more than one regulated sector (for example in triple-play bundles which include both telecoms and broadcasting services) BT's view is that Ofcom should seek to be more precise and transparent about how it will apply the rules on turnover, given that it proposes to establish a link between deterrence and the size and turnover of a regulated body.

Consistency with other regulated sectors

We have not undertaken a full analysis of the processes used by other sectoral regulators to set penalties. However, we are concerned that Ofcom appears to be moving further away from the emphasis on clarity and transparency that is evident elsewhere in the other regulated sectors.

The relevant policy statement in water, for example, identifies '*precedents set under equivalent provisions for other utilities*'¹ as a relevant factor. BT's view is that this approach of placing more information and cross-sectoral expertise at the disposal of the regulator and industry is a valuable one, and it contrasts with Ofcom's proposal to limit the value of precedent, even from within its own sectors, as a guide on the possible level of future penalties.

The ORR also gives a much clearer picture of how it will set penalties, stating that '*[i]n setting a penalty, our starting point will normally be the seriousness of the offence*'² before going on to explain the practical application of this in much more detail.

Finally, Ofgem's policy statement³ sets out a list of factors that is similar to those identified in Ofcom's guidelines. However, it helpfully sets out the order in which it considers those factors, and provides a detailed breakdown of each.

BT's view is that the more open, transparent approach taken by the other regulators is preferable to Ofcom's proposals, where a range of factors will simply be considered 'in the round' without further guidance on how they will be approached in practice. We are therefore concerned that Ofcom's proposed changes are likely to lead to less consistency across the regulated sectors.

Consistency with competition law

In addition to its role as a sectoral regulator, Ofcom has jurisdiction as a UK competition authority. Although the competition and regulatory regimes can differ significantly in terms of the obligations they impose, there is clearly a significant degree of overlap in the centre.

¹ paragraph 15, *Statement of policy with respect to financial penalties*, Ofwat/Defra/Welsh Assembly, 1 November 2010

² *Economic enforcement policy and penalties statement*, Office of Rail Regulation, July 2012

³ *Statement of policy with respect to financial penalties and consumer redress under the Gas Act 1986 and the Electricity Act 1989*, The Gas and Electricity Markets Authority, 6 November 2014

Behaviour such as discrimination, unreasonable refusal to supply, and certain kinds of pricing practices, may be policed under either regime, and there is some degree of alignment between the maximum level of any penalty.

However, there are clear differences between the approach set out in Ofcom's draft guidelines on regulatory penalties and the Competition and Markets Authority's (CMA) guidance as to the appropriate amount of a penalty in competition law investigations⁴. The CMA guidance identifies a six-step approach, which provides much greater transparency and certainty to industry. The six steps are as follows:

- *'calculation of the starting point having regard to the seriousness of the infringement and the relevant turnover of the undertaking*
- *adjustment for duration*
- *adjustment for aggravating or mitigating factors*
- *adjustment for specific deterrence and proportionality*
- *adjustment if the maximum penalty of 10 per cent of the worldwide turnover of the undertaking is exceeded and to avoid double jeopardy*
- *adjustment for leniency and/or settlement discounts'*

This is much clearer and more transparent approach, with a definite starting point for considering the appropriate level of the penalty, and Ofcom must have regard to this approach when it exercises its competition law functions. If the regulatory approach differs, it could well result in Ofcom finding itself inappropriately incentivised to take a case under its regulatory powers rather than its competition law powers, because the former would allow it more freedom from the principles of transparency and fairness set out in the CMA's guidance.

In these circumstances, any significant variance from the outcome that could have been expected under competition law principles may undermine the primacy of competition law, and could attract a greater risk of appeal and the associated increase in costs. We therefore call on Ofcom to consider how it can better align its approach under its regulatory powers to that required under competition law.

Potentially negative effect on innovation and competition in telecoms, and potentially in other sectors

The UK communications industry is characterised by innovation and competition. This is true from the retail level in telecoms, where consumers are offered a wide range of products at prices which are more competitive than anywhere in the world, to the highest levels of network provision.

We believe that the proposed changes, by decreasing transparency and certainty in respect of how Ofcom will approach the setting of penalties, may mean that providers in this sector (and potentially others) are disincentivised to design innovative solutions to the commercial challenges they face. This is likely to be the case when it is unclear from the guidance how Ofcom will view any inadvertent transgression that occurs in the course of innovation, and also when the decreased value of precedent deprives industry of a key point of guidance to help them understand and mitigate the risks they are taking.

If communication providers are disincentivised from innovating and become overly cautious in designing products and services, it risks chilling competition, thus leading to an overall reduction of

⁴ *OFT's guidance as to the appropriate amount of a penalty* OFT423 as adopted by the CMA.

consumer welfare which outweighs any additional benefit created by Ofcom's increased focus on deterrence. BT believes Ofcom could mitigate these effects by providing more transparency and certainty in its guidance, rather than less, which will help communications providers better understand the risks they face and be more informed about the potential consequences of their actions. This would safeguard the innovation and competition which is such a valuable feature of the sectors which Ofcom regulates in the UK.