Ofcom consultation: revising the penalty guidelines

EE Limited consultation response

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[Non-confidential version]

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Introduction and executive summary

EE Limited ("**EE**") appreciates the opportunity to comment on the proposals included in Ofcom's consultation dated 30 July 2015 on potential revisions to Ofcom's current penalty guidelines (the "**Consultation**").

Ofcom has a duty under section 392 of the *Communications Act* 2003 ("**Act**") to prepare and publish a statement containing the guidelines Ofcom proposes to follow in determining the amount of penalties to be imposed by Ofcom under the Act or any other enactment apart from the *Competition Act* 1998 ("**Competition Act**") and to then have regard to those guidelines in determining the amount of penalty to be imposed.

The guidelines that Ofcom issues under s. 392 of the Act are an extremely important procedural fairness check and balance on the exercise of Ofcom's powers to impose penalties under the Act. Of particular note in this respect are:

- The magnitude of the penalties Ofcom is empowered to provide – e.g. up to 10% of the turnover of a provider's relevant business under s. 96 of the Act;
- The absence of any other upfront check or balance on the exercise of these powers – for example, no obligation upon Ofcom to commence civil proceedings in order to enforce compliance (cf. the position regarding Ofcom's enforcement of undertakings under the *Enterprise Act* 2002);
- The materiality of the guidelines in interpreting Ofcom's obligations under s. 97 of the Act to only impose penalties that are "appropriate" and "proportionate"; to have regard to the representations of the notified provider; and to have regard to the steps taken by the notified provider to comply with its obligations and to remedy the consequences of its contraventions;
- The absence of other express legislative restrictions on the exercise of Ofcom's powers to impose penalties – e.g. no requirement under s. 97 of the Act for Ofcom to be satisfied that any breach was committed intentionally or negligently such as applies under s. 36 of the Competition Act;
- The ability of Ofcom to impose penalties in respect of historic contraventions, including in respect of conduct engaged in by a provider when previous iterations of the penalty guidelines may have been in force; and
- The important role played by the guidelines in creating legitimate expectations of regulated entities regarding Ofcom's approach to compliance when making decisions to invest and participate in the supply of regulated networks and services in the UK.

In light of the above points and also in view of Ofcom's general duties to promote investment and innovation and to ensure that its activities are consistent, transparent, accountable and targeted only at cases in which action is needed, EE considers that Ofcom should exercise extreme care and caution in amending its penalty guidelines, and should do so only where there is a clear and pressing need for Ofcom to do so.

Ofcom's current penalty guidelines (the "**Penalty Guidelines**") were updated only four years ago, in June 2011. There have been no changes to the terms of

either s. 392 or 97 of the Act since then – indeed no changes to those provisions since their original enactment in 2003 and the issuance of Ofcom's original penalty guidelines in the same year. At the same time, levels of consumer satisfaction are high[1], and the Consultation notes that the level of consumer complaints has been on a downward trend since 2011 (para 1.14).

Prima facie, EE does not believe that Ofcom's current consultation document refers to any evidence justifying a clear or obvious need for amendment. Making changes in the absence of such drivers poses an inherent risk to investment in the UK telecoms market by undermining regulatory certainty and stability. It also violates Ofcom's own Better Policy Making Guidance (the "**BPMG**")[2], cross-referred to the Consultation, which states that "*One of our key regulatory principles is that we have a bias against intervention. This means that a high hurdle must be overcome before we regulate*." (para 1.1).

Ofcom's BPMG also states that, when developing policy proposals, Ofcom will "*think widely about the possible impacts, taking account of the whole value chain and knock-on effects across the communications sector*" and will thus seek to minimise any unintended consequences (para 1.5). EE does not consider that Ofcom has adequately thought through the potential negative consequences, for industry, for consumers and indeed for Ofcom itself, of Ofcom's reform proposals. Specifically:

- EE considers that Ofcom has provided insufficient evidence that a change the current Penalty Guidelines is required. In particular, EE considers that change is required neither by current customer complaint levels, nor by the experience of applying the current Penalty Guidelines. We also do not agree with Ofcom's view that the current level of penalties is "too low" in any objective sense.
- EE considers the expected benefits of Ofcom's proposals to be insufficiently considered and insufficiently quantified.
- EE considers the potential costs and risks associated with Ofcom's proposals to be many and high in value. EE considers it to be a serious flaw in Ofcom's analysis that only token regard has been had to the potential costs to consumers, competition and investment of the higher, turnover-based penalties Ofcom appears to be advocating in suggesting these reforms.
- EE considers that there a number of lower cost and lower risk alternatives to the proposals Ofcom is putting forward that Ofcom needs to assess. These include in particular heightened efforts to improve CP awareness and understanding of regulatory obligations.

In terms of the core drafting changes to the Penalty Guidelines proposed by Ofcom, EE's views in summary are that:

- The amendments signalling an intention by Ofcom to higher, turnover-based penalties are unnecessary and inappropriate;

1 At around 90% as per Ofcom's latest 2015 Communications Market Report.
2 See http://stakeholders.ofcom.org.uk/binaries/consultations/better-policy-making/Better_Policy_Making.pdf

- The suggested de-emphasis on the importance of harm and gain caused by contraventions risks seriously breaching Ofcom's proportionality obligations;
- The proposal to disregard precedents based on age risks seriously breaching Ofcom's obligations of consistency, transparency and regulatory certainty;
- The proposed addition of "seriousness" as a penalty factor in its own right would be a seriously retrograde step, involving both a very important loss in transparency and a risk of double jeopardy.

EE expands on these concerns below. Whilst we remain of the view that no amendment to the text of the current Penalty Guidelines is required, we also provide below comments on the drafting of the amendments proposed by Ofcom, which are designed to reduce the risk of unintended negative consequences otherwise caused by Ofcom's proposed drafting.

Justification for Ofcom's Proposals

Inadequate impact assessment

Ofcom claims that its Consultation represents an impact assessment under section 7 of the Act (para 1.26). The evidence and analysis included in the Consultation as to the potential costs and benefits of Ofcom's proposals and as regards any lower cost and risk alternatives are so lacking in detail as to make this claim farcical. For the reasons set out below, EE considers that it is clear that Ofcom's proposals would fail to meet the requirements of even a half-rigorous application of the cost-benefit assessment process set out in Ofcom's own BPMG. EE is accordingly of the view that Ofcom has failed to establish that its proposed revisions to the Penalty Guidelines would comply with Ofcom's objectives and duties under the Act.

Insufficient evidence that change is required

1. Customer complaint levels

EE considers that Ofcom has failed to justify a need for any change to its current approach to penalties on the basis of customer complaints levels. The most positive way of representing Ofcom's evidence in favour of a change is to say that whilst complaints levels have fallen since the current Penalty Guidelines came into force in 2011:

- "*since 2013 the rate of decrease has generally slowed*"; and
- that, in the specific area of complaints about silent and abandoned calls in relation to which Ofcom's fining powers are limited to the imposition of a fixed maximum penalty of £2 million rather than a turnover based penalty, complaints "*have remained at broadly constant, and high, levels since 2012*" (para 1.14)

EE agrees with the submissions in response to the Consultation made by the UK Competitive Telecommunications Association ("**UKCTA**") in this regard that,

where the overall context is one of a low level of complaints (i.e. with the number of consumer complaints to Ofcom against telecoms and Pay TV providers for Q2 2015 being less than 0.1 per 1,000 customers), it is unrealistic to expect a constant, linear improvement in compliance. A slow-down in rates of improvement accordingly provides no evidence of any failings with the current enforcement regime. EE also agrees with UKCTA that it is clear that levels of customer complaints are driven by many factors unrelated to the deterrence effect of the penalties imposed by Ofcom for non-compliance with its regulations – including consumer awareness campaigns.

Of course it also must not be ignored by Ofcom that many consumer complaints stem from causes of dissatisfaction unrelated to regulatory compliance – such as high bills. Neither should it be ignored that vast majority of the UK's communications providers ("**CPs**"), in particular all of those such as EE who have managed to achieve a degree of market success reflected in their larger size and turnover, already place the best interests of their customers at the heart of what they do and strive to continually improve their performance in this area. EE is working and investing to reduce complaints and improve its customer satisfaction levels not through fear of regulatory sanctions, but because we want to keep and gain happy customers.

Lastly, EE considers it wrong in principle for Ofcom to seek to lump together in the Consultation under the rubric of "consumer protection in the telecoms sector" (paras 1.7-1.8) the diverse contraventions of:

(i) persistent misuse under section 128 of the Act (which by definition must involve either a pattern of repeat behaviour or recklessness as to the harm caused by the conduct in question; in relation to which a maximum fixed penalty of £2 million only can be imposed); and

(ii) breaches of the General Conditions ("**GCs**") (which are strict liability contraventions involving no necessary intent, harm or repeat conduct and in relation to which Ofcom is empowered to impose materially larger fines of potentially hundreds of millions of pounds, depending on the turnover of the operator concerned).

Achieving compliant outcomes and even higher customer satisfaction levels than those experienced today requires Ofcom to apply different regulatory tools tailored to the circumstances of different non-compliance and customer dissatisfaction concerns. Penalty levels, and in particular penalties linked to the size and turnover of the regulated CP, are not a one size fits all panacea for further improving customer complaint levels.

2. Ofcom's experience of applying the current Penalty Guidelines

The key justification put forward in the Consultation for Ofcom's reform proposals is that Ofcom's "*experience*" of applying the current Penalty Guidelines "*suggests that the level of penalties imposed may not have created a sufficient deterrent effect to ensure effective compliance*" (para 1.7).

It is accordingly important to examine in some detail the evidence on Ofcom's "experience" included in the Consultation.

Cases concerning the GCs

As Ofcom notes in the Consultation, since the current Penalty Guidelines came into force, Ofcom has imposed penalties in seven cases for contraventions of the GCs:

- TalkTalk and Tiscali both for breach of GC11 in August 2011;
- Axis Telecom for breach of GC24 in May 2012;
- Supatel for breach of GC24 in June 2013;
- Three for breach of GC14 in October 2014;
- BT for breach of GC15 in March 2015; and
- EE for breach of GC14 in July 2015.

In addition to these cases, Ofcom also mentions several ongoing investigations and enforcement programmes into compliance with the GCs (para 1.9). EE considers it inappropriate for Ofcom to rely on these ongoing investigations as evidence of the inadequacy of the penalties imposed under the current Penalty Guidelines. Compliance monitoring is a very important Ofcom enforcement function and many investigations (both industry wide and into individual CPs) are legitimately opened and closed without any consequent breach findings.

EE also finds it inappropriate and unpersuasive for Ofcom to refer, as claimed evidence of inadequate deterrent effect the penalties it has imposed under the current Penalty Guidelines, to the cases in which Ofcom has determined either to impose no penalty, or only to take informal action but not to proceed to formal notification (paras 1.9-1.10; 1.12). It is open and indeed highly appropriate for Ofcom to adopt such an informal / non-penalisation approach in view of its objectives and duties under the Act. However it is not correct for Ofcom to then rely on the lack of deterrence effect created in these cases as evidence of the inadequacy of the deterrence effect of the penalties it has decided to impose pursuant to the current Penalty Guidelines.

In terms of the impact of the GC breach cases in which Ofcom has determined it appropriate to impose a financial penalty under the current Penalty Guidelines, Ofcom places emphasis on its claim that "*where we have taken action against one provider for a particular breach, there have been subsequent cases involving the same breach by other providers*" (para 1.12). However this claim does not withstand scrutiny of the facts involved in the relevant cases. It is true that the cases have concerned two violations of GC11, the two violations of GC14 and two violations of GC24. However:

- The penalties imposed on TalkTalk and Tiscali for violation of GC11 were determined and imposed contemporaneously. Accordingly, there is no basis for any claim that the penalty imposed for the first breach failed to deter the second.
- Similarly, whilst the final contravention decision was given to EE regarding its (most regrettable) breach of GC14 in July 2015, some nine months after a penalty was imposed on Three for a very similar breach of GC14 in October 2014, EE's breach related to conduct engaged in between July 2011 and April 2014. It was accordingly chronologically impossible for the penalty imposed on Three in October 2014 to have had any kind of influence on EE's conduct.

- In the case of Supatel's breach of GC24, it is true that this case related to conduct engaged in after Ofcom's earlier penalisation of Axis Telecom for a breach of GC24. However, Ofcom's Confirmation Decision in the Supatel case states that "*although the Axis case also involved contraventions of GC24, the conduct in question in that case was not factually similar or analogous in terms of scale and seriousness to the present case*".[3] In such circumstances it is not necessarily to be expected that a higher penalty imposed on Axis Telecom would have had any greater deterrent effect on Supatel than the actual penalty imposed.

Cases concerning other regulatory violations

As noted above, EE does not consider it appropriate to reply upon any lack of deterrence effect of penalties imposed for breaches where a fixed statutory cap applies to the penalty (such as for persistent misuse) (para 1.10) as justification for Ofcom's proposal to "*make explicit the link between the objective of deterrence and the size and turnover of the regulated body subject to the penalty*" (para 1.21).

A penalty subject to a low fixed cap may not, in and of itself, have as much of a financial deterrent effect on a larger organisation with a larger turnover than it does on a smaller organisation. Such a penalty cap may nevertheless be entirely appropriate for a range of different reasons including the seriousness of the consequences of the contravention and the types of entities most likely to engage in the misconduct. These are matters for parliament to determine, not Ofcom.

It also should not follow that the larger the organisation is, the more likely Ofcom should be to impose a penalty at the top end of the fixed penalty cap. As the Australian Investment and Securities Commission ("ASIC") observes:

> "*Maximum penalties are meant to address the worst possible wrongdoing for the relevant contravention, and, as such, are reserved for egregious examples at the far end of the spectrum of wrongdoing*".[4]

For the reasons given by ASIC, the penalties imposed by Ofcom subject to fixed caps (and indeed also those subject to caps based on turnover) would in fact *lose* an important element their deterrence effect if larger organisations knew that they would always be subject to penalties at the top of the cap, no matter how egregious their conduct.

3. Levels of penalties relative to turnover

Ofcom notes in the Consultation that in five of the seven cases involving penalties for breaches of the GCs since the current Penalty Guidelines came into force and five of the seven cases involving penalties for persistent misuse, the penalty imposed was less than 1% of the relevant provider's relevant

[3] See Supatel Confirmation Decision, para 7.137 - http://stakeholders.ofcom.org.uk/binaries/enforcement/competition-bulletins/cases-in-compliance/cw_01096/Supatel_s96C_Confirmation_D1.pdf

[4] ASIC, REPORT 387: Penalties for corporate wrongdoing, http://download.asic.gov.au/media/1344548/rep387-published-20-March-2014.pdf, para 41.

turnover (paras 1.9-1.10). Ofcom concludes that, "*As a proportion of the relevant providers' turnovers, the penalties imposed are at a low level*." (para 1.11). EE disagrees:

- Firstly, Ofcom's comment ignores the fact that in the case of the UK's major CPs such as EE, fines of even a full 1% of relevant turnover amount to many tens of millions of pounds, in EE's case [**EE confidential**]. The imposition of penalties of this magnitude may be expected to have a huge negative impact on the concerned CP and its ability to compete, invest and serve the best interests of consumers and can thus in no sense be regarded as "low".
- Secondly, in terms of the economic incentives provided by the penalties Ofcom imposes, EE agrees with the views of London Economics that:

> "*Other things being equal, it is socially desirable that enforcement policy creates marginal deterrence. This suggests that sanctions should rise with the magnitude of harm and, therefore, that most sanctions should be less than maximal*".[5]

It is entirely consistent with both of the above points that penalties Ofcom has imposed to date fall at the lower end of the very high maximums Ofcom is empowered to impose and that, in the absence of compelling evidence of a need for a change in approach (none of which is provided in the Consultation), they should continue to do so.

Furthermore, even if it were to be established that the penalties imposed under the current Penalty Guidelines *had* failed to have a sufficient deterrent effect, this would not be enough on its own to establish a case for higher penalties. For Ofcom's proposals to be justifiable in accordance with Ofcom's duties under the Act, Ofcom would then need to establish that increasing penalties would result in benefits to consumers, that these benefits would be likely to outweigh the costs and risks, and that there were no lower cost or risk alternatives that would be likely to achieve the same level of benefits. For the reasons set out in the following sections of this response, EE considers that Ofcom has failed to provide compelling evidence or analysis on any of these considerations.

Stated benefits inadequately considered or quantified

The Consultation is extremely light on detail regarding Ofcom's anticipated benefits of its proposed reforms to the Penalty Guidelines. EE considers it incumbent upon Ofcom to provide much more evidence and analysis on this point before taking any decision whether or not to proceed. In particular, whilst EE accepts that it is not always possible to quantify consumer benefits, given that the potential costs of increased penalties to industry and to the consumers it supplies are readily quantifiable, EE considers that Ofcom is required to establish consumer benefits clearly outweighing these costs.

5 OFT, "An assessment of discretionary penalties regimes - Final report October 2009: A report prepared for the Office of Fair Trading by London Economics", para 3.18.

The main consumer benefit claim Ofcom puts forward in support of its proposals is that "*the flexibility to impose higher fines in appropriate cases may secure more effective enforcement and deterrence, thereby reducing harm to citizens and consumers as a result of contraventions of regulatory requirements*" (para 1.36, emphasis added). Ofcom's use of the qualifying term "may" in this claim is both appropriate and important.

All other factors being constant, it is logical that higher penalties are likely to have a stronger deterrent effect than lower penalties. However whether this impact is experienced in practice depends also on other factors, such as the awareness of relevant CPs of the penalties imposed, their understanding of reasons for them, and their ability to relevantly apply those penalties to their own circumstances. It could, for example, be the case that heightened awareness of CPs regarding the maximum penalties Ofcom can impose and regarding those it has imposed to date for silent and abandoned calls would have as much if not more of a deterrent effect than imposing higher penalties in future cases.

Furthermore, when it comes to strict liability regulatory obligations such as those imposed by the GCs, it is clear that deliberate, wilful breaches of regulation are not the norm and that violations are rather due to factors such as inadvertent human, technical or process errors or lack of understanding. In short, the attainment of compliant outcomes depends on the use of Ofcom's whole range of regulatory tools – not just on the deterrence effect of the penalties it imposes in cases where it has failed to achieve its compliance goals. Unlike Ofcom's Consultation, Ofcom's BPMG acknowledge this practical reality, stating that "*We should also consider the risk of non-compliance with our decision. Our assessment of the costs and benefits that would flow from an option should therefore be based on a realistic level of likely compliance. This will involve exploring the incentives to comply, whether compliance will be practically possible and the costs of enforcement*" (para 5.33).

In this real world environment, greater use of Ofcom's resources towards improving CP awareness and understanding of their obligations combined with the proportionate continued use of its monitoring powers are, in EE's view, likely to have at least if not a much greater impact on improving compliance to the benefit of consumers than the imposition of higher penalties.

It is also notable that the Consultation makes no mention of Ofcom's powers to protect consumers and to ensure compliant outcomes by use of its enforcement powers other than the imposition of financial penalties – for example the power to require CPs to remedy the consequences of any contraventions under s. 94 of the Act and the power to suspend or restrict the CP's entitlement to provide services under s. 100. The use of such powers in appropriate cases clearly has the power to create a very strong deterrent effect, and to provide strong protection to consumers. Ofcom is not limited to achieving these outcomes through the setting of penalties under the Penalty Guidelines and should keep in mind the wider context when considering whether any reforms to the penalties regime are justified.

Material potential costs of proposals ignored

EE welcomes the suggestion in the Consultation that the impact of Ofcom's proposals on those whom Ofcom regulates should be "relatively small" (para 1.34). Unfortunately, there is no substance to back up this quantification anywhere in the Consultation. It is also very difficult to reconcile with Ofcom's statement that the effect of its proposals "*would be that larger operators…will be more likely to be subject to higher penalties*" and that other operators too "*might also be subject to higher penalties*" (para 1.32), especially when it is considered that fines at maximum levels in the case of larger CPs such as EE could be in the [**EE confidential**].

EE considers that much more work needs to be done by Ofcom to comply with the self-guidance its gives in its BPMG: "*The decisions which Ofcom makes can impose significant costs on our stakeholders and it is important for us to think very carefully before adding to the burden of regulation*" (para 3.7).

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. 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. It is inevitable in the highly competitive UK telecommunications market that such a loss of funds has the potential to materially negatively impact the choice and quality of services any affected CP could provide.

Furthermore, the vast economic literature on the impact of corporate civil penalties regimes outlines a range of very important costs and risks of large turnover related penalties that Ofcom fails to even consider in the Consultation. These include, but are not limited to, the following:

- The risk of consumer price increases. A study by Professors Yannis Katsoulacos and David Ulph, published in the November 2013 issue of the Economic Journal, which finds that fines based on revenues rather than profits lead companies to reduce the amount they produce and sell, thereby driving *up* prices for consumers.[6]
- The fact that, unlike conduct such as street crime, which is almost always intentional, regulatory violations by CPs tend to be the bi-products of otherwise socially beneficial activities and are also stochastic in nature. These features raise the potential harm to consumers of over-deterrence. In particular, over-deterrence in such circumstances can stifle socially desirable activities, and even more so when it comes to "strict liability" offences requiring no element of intentionality such as many enforced by Ofcom, increasing the severity of punishments for which might deter providers from engaging in the regulated activities at all.[7]

[6] See http://www.res.org.uk/details/mediabrief/5599391/fines-for-corporate-crimes.html

[7] See for example the analysis on this point by Mark A Cohen in "*Empirical Research on the Deterrent Effect of Environmental Monitoring and Enforcement*", 2000, 30 ELR 10245. See

- The potential distortive impact of Ofcom's proposals on competition. Ofcom's BPMG states: "*Given Ofcom's commitment to promoting open and competitive markets, it will normally be appropriate to identify any impacts which each of the options would have on competition*". Ofcom's Consultation does not do this. For example:
    - Ofcom does not consider the fact that the definition of relevant turnover as used in s. 97 of the Act is very broad, involving no mandatory requirement for Ofcom when considering the maximum fine of 10% of all relevant turnover to take into account the specific activities covered by the regulatory breach[8]. However, there are many enforcement cases brought to date by Ofcom that relate to less than the full set of regulated activities engaged in by the concerned CP (for example, the fine imposed on BT in relation to regulatory compliance failings concerning its text relay service). There is a real risk that in imposing fines based on the entire relevant turnover of the regulated body, without taking a more nuanced approach to the revenues generated by the activities relevant to the breach, Ofcom's proposed new approach will unfairly penalise diversified CPs, as compared to those with a more niche focus. This in turn creates an obvious risk of distorting the ability of diversified firms to compete with special interest providers, and could in principle induce firms to inefficiently under-diversify to reduce their potential liability.
    - Ofcom also fails to consider the fact that a stronger turnover based rationale to the imposition of fines such as Ofcom is proposing, will cause CPs with a high revenue/profit ratio (e.g. firms at the end of a vertical production chain), to face larger penalties relative to the same profits which may be generated by any contravention than firms that have a lower revenue/profit ratio (e.g. because of the fact that they are at the beginning of the production chain). Empirically-based simulations conducted by V. Bageri, Y. Katsoulacos and G. Spagnolo in November 2013 regarding this issue in the context of turnover based anti-trust fines suggest that the welfare losses produced by these distortions can be very large, and that they may generate penalties differing by over a factor of 20 for firms that should instead have the same penalty.[9]
    - It is implicit in Ofcom's proposals that it may apply an uplift factor to the penalties it imposes over and above any imposed

also the observation that "*Excessively high fines may over-deter by discouraging potential investors away from markets and practices that could raise the possibility of infringement actions*" in OFT, "An assessment of discretionary penalties regimes - Final report October 2009: A report prepared for the Office of Fair Trading by London Economics", para 1.4

8 In contrast, note the position for example under the FCA penalty guidance where "Relevant revenue" is narrowly defined as "the revenue derived by the firm during the period of the breach from the products or business areas to which the breach relates" – see https://www.handbook.fca.org.uk/handbook/DEPP/6/5A.html

9 See http://www.voxeu.org/article/eu-antitrust-fines-and-economic-distortions

based on the harm caused by the CP in question or intentionality of its conduct, for the main purpose of sending a deterrence signal to other industry players. Ofcom fails to consider the fairness of such an approach for the CP concerned, nor does Ofcom consider the potential negative impact on the ability of the unlucky "sacrificial lamb" CP to compete. This is a violation of Ofcom's BPMG, which states that "*As far as possible, it should be made clear who bears the costs and who receives the benefits, including those flowing from the impacts on the interests of particular groups or sub-groups of stakeholders*…" (para 5.30).

- The higher costs of regulatory errors associated with higher penalties. As noted by London Economics in their report for the OFT:

  "*Whilst raising fines can increase the level of deterrence it is not necessarily the only way nor is it without associated costs. Higher fines can increase the cost of errors ….No enforcement agency can rule out the possibility of errors and this is one reason why authorities seek to avoid setting fines higher than necessary to achieve deterrence…. Schinkel (2006) and Schinkel and Tuinstra (2006) found when competition law enforcement is imperfect, welfare is greater if competition authorities are less 'zealous'. They speculate that the criminal system in the US is less prone to erroneous decisions than the new administrative law regime in Europe. The authors' arguments suggest that an enforcement regime that relies too heavily on merely imposing high fines is unlikely to be optimal. The relationship between high fines and deterrence is not a linear one nor does it apply in the same way for all types of regime. This effect is likely to be larger the greater the probability of error.*"[10]

  Ofcom's failure to consider the heightened risk of regulatory error associated with its proposed reform proposals is another breach of Ofcom's BPMG, which state that "*It is also important to consider the risks relating to particular options, for example, the risk that the intended impact would not be achieved…. An option which has a high net benefit, but which carries a high risk, might be less attractive than a lower risk option which has a lower net benefit*" (para 5.31)

- The potential for heightened administrative costs. Ofcom's BPMG states that: "*Another consideration is the cost to Ofcom of implementing an option. In considering an option which would carry significant implementation costs, we would need to bear in mind that these costs would place a burden on stakeholders in terms of increased administrative fees. Other things being equal, this might make the option less attractive than an option with lower implementation costs*" (para 5.35). So far as EE is aware, none of the penalties that Ofcom has imposed on CPs for telecommunications related breaches under

10 OFT, "An assessment of discretionary penalties regimes - Final report October 2009: A report prepared for the Office of Fair Trading by London Economics", para 1.4

the current Penalty Guidelines have been appealed. In contrast, it is commonplace for there to be appeals of the larger turnover based fines imposed by bodies such as the CMA and its predecessor the OFT. Any marked change in approach by Ofcom to the level of penalties it imposes would need to factor in the marked change in administrative costs it (and industry) may face in defending such penalties on appeal.

Failure to consider alternatives

Ofcom's BPMG states that:

> "*We will start by considering the option of not changing the regulatory framework, either by not introducing regulation or by retaining existing regulation. This option – no new intervention – will generally be the benchmark against which other options are judged i.e. what costs and benefits would be incurred additional to those which would be incurred if there were no new intervention*?" (para 3.3)

Ofcom's Consultation doesn't do this. Specifically, it doesn't consider at all the potential costs and benefits of leaving the current Penalty Guidelines unchanged and instead dedicating resources to alternative means of improving compliance levels and customer welfare. Ofcom makes a good start on the issue by stating that "*As the resources available to us are not unlimited, it is necessary to consider how we should optimise the effect of those that are available to best achieve that improvement*" (para 1.17), but then it fails to consider any alternative means to which Ofcom's resources could be put other than in investigating and penalising future incidences of non-compliance.

As noted above in this response, there are many other ways such as improving CP awareness and understanding of their obligations, in which Ofcom could dedicate its scare resources likely to have at least if not a much greater impact on improving compliance to the benefit of consumers than the imposition of higher penalties. As discussed below in this response, there are also other alternative reforms to the Penalty Guidelines such as offering discounted penalties for self-reporting and compliance programs which have a high potential to further improve compliant outcomes that Ofcom also fails to consider. EE considers it incumbent to consider these options further.

Principles covered in Ofcom's Proposals

In addition to the concerns EE raises above in section 3 of this response regarding the lack of justification for Ofcom's reform proposals, we also have serious concerns regarding the principles underpinning the revisions to the Penalty Guidelines that Ofcom has proposed. We set these out in summary form below. More detailed comments are then provided as against the actual proposed revised text of the Penalty Guidelines in section 5 of this response.

Higher, turnover based penalties

The two key reform principles that appear to EE to be driving the textual changes Ofcom has proposed to the Penalty Guidelines are that:

- "*…penalties we impose in future cases may need to be higher than those which have been imposed in previous cases*" (para 1.20); and
- "*…changes that, amongst other things, make explicit the link between the objective of deterrence and the size and turnover of the regulated body subject to the penalty. This would reflect that, although there is not necessarily a direct linear relationship between these variables, the larger the regulated body, the greater the penalty may need to be, in appropriate cases, in order to achieve a deterrent effect on it and others*" (para 1.21)

For the reasons set out above in section 2 of this response, EE considers that Ofcom is mistaken in its views that (a) current penalty levels provide an insufficient deterrent effect and (b) the likely benefits of increasing penalties and in particular linking them more explicitly to turnover will outweigh the likely costs, in particular when considered as against other alternatives with a lower risk of regulatory failure – such as enhanced education and awareness initiatives.

Gain

EE is highly concerned about Ofcom's proposals to "clarify" its approach to calculating the harm and/or gain caused by a contravention, by stating in the revised Penalty Guidelines that it won't necessarily even try to do this in all cases, and will not consider the level of harm or gain (if any) to be determinative of the level of the penalty it imposes.

We set out further comments on this point in section 5 below. In summary, we consider these proposals to seriously risk non-compliance with Ofcom's duties under the Act, and in particular under s. 97(1) of the Act to only impose penalties that are proportionate, and under s. 97(2)(c) to have regard when setting penalties to the steps taken to remedy the consequences of the contravention. It is clear to EE that parliament would not have included s. 97(2)(c) in the Act if it agreed with Ofcom's proposed view that proportionate penalties could be set without Ofcom having strong regard to the harm and/or gain caused by the contravention. It is a further logical consequence of this that, when determining the level of any penalty, Ofcom is obliged to endeavour to quantify the level of harm and/or gain caused wherever possible, and to have regard to this quantification in its penalty calculations.

We also note that Ofcom's proposal in this regard is completely out of line with its stated aims to ensure that "*…management recognises that it is not more profitable for a provider to break the law and pay the consequences, than it is to comply with the law in the first instance*" (para 1.18) and to "*ensure that those regulated by us do not or are less likely to engage in conduct which causes citizens and consumers to suffer harm*" (para 1.28).

Lastly, we consider Ofcom's proposed amended text to be out of line with regulatory best practice. For example, we note the views of the OFT, confirming our own views as to the crucial link between harm and proportionality, that:

"*Proportionality suggests fines should be related to the harm caused. That is, account should be taken of illegal profit and the costs imposed on others as a result of the illegal conduct***"**[11]

Disregard for precedents

For the reasons set out in further detail in section 5 below, EE considers Ofcom's proposal to "*only consider precedents where appropriate*" and to expressly state that "*the older the precedent the less value it has*" (para 1.22) to represent a very dangerous move away from transparency, consistency and regulatory certainty risking clear abrogation of Ofcom's regulatory duties. We consider that Ofcom is obliged by these duties to continue to have due regard to all relevant precedents, regardless of their age.

We do not consider that this means that past penalties must be seen as acting as an upper threshold for the level of penalties in future (cf para 1.23), although we do maintain a view that it would be very difficult to see how a future higher penalty could be objectively justifiable in circumstances which were otherwise identical to a previous case in all relevant respects.

To the extent that Ofcom has considered the current version of its Penalty Guidelines to constrain it so as to consider past penalties to be an upper threshold for future penalties and to the extent that CPs may have had legitimate expectations along these lines, this does also raise an important procedural fairness point. Specifically, as the Penalty Guidelines are intended to shape CP conduct and as CPs do in fact rely on them when making decisions relating to their regulated behaviour, we consider that it would be procedurally unfair for Ofcom to apply any revised version of the Penalty Guidelines to any conduct engaged in prior to the revisions taking effect. Apply the revisions only to future conduct would also be consistent with Ofcom's stated primary objective of deterrence – as it is clearly impossible for an organisation to be retrospectively deterred. We therefore strongly advocate that any revisions are only applied with prospective effect.

Even less transparency

Ofcom states that it is adding "seriousness" as an explicit consideration in a penalty assessment "*for clarity and completeness*", suggesting that this is only a minor change proposal (para 1.25). EE is strongly opposed to this amendment, which we consider to represent far more than a minor clarificatory change.

For the reasons set out below in section 5 of this response, EE is very worried about the lack of clarity created for the industry regarding how Ofcom might regard conduct to be "serious" when it didn't fall for assessment under any of the other factors already going to seriousness (e.g. harm, gain, intent, repeat offence). In particular, EE considers that such a proposal would be liable to only either (a) create a risk of double penalisation for the same factors or (b)

[11] OFT, "An assessment of discretionary penalties regimes - Final report October 2009: A report prepared for the Office of Fair Trading by London Economics", para 3.15

risk Ofcom imposing penalties on the basis of a subjective view of "seriousness" not underpinned by any objectively verifiable evidence.

EE also notes the concerns raised by BT in response to Ofcom's consultation on the 2011 amendments to the Penalty Guidelines that those revisions already represented a worrying move by Ofcom away from certainty of approach as per Ofcom's original 2003 guidelines, to a less clear approach of looking at all of the facts of the case "*in the round*". EE agrees with BT Penalties are likely to have the greatest deterrent value if parties clearly understand the factors that will influence Ofcom's penalty decisions, so that they can adjust their behaviour accordingly.[12] We also agree with BT that decisions taken "in the round" risk a lack of accountability (and hence being appealed).[13]

EE therefore urges Ofcom to refrain from making this amendment to the Penalty Guidelines.

Lastly on clarity EE notes that Ofcom states that it has engaged in a "*Re-ordering certain other factors for the sake of clarity*" (para 1.25). It is actually very unclear to EE how a re-ordering either adds to or detracts from the clarity of the stated factors. To the extent that the ordering implies some implicit weighting, then EE considers that Ofcom should make this clear in the Penalty Guidelines, and explain further its rationale for the order.

Deletion of Annex 1

EE does not object to the deletion of this Annex relating to the Channel 3 Licensee per se. However, the Annex covers a number of practical matters such as Ofcom's approach to assessing compliance where third parties are involved and on the role of risk assessment when the effectiveness of preventative compliance measures is being considered, which are not currently covered anywhere else in the Penalty Guidelines. As set out in detail in section 5 of this response, we consider these matters to be of sufficient wider relevance to warrant continued inclusion in the Penalty Guidelines in an amended form.

12 See http://stakeholders.ofcom.org.uk/binaries/consultations/penalty-guidelines/responses/BT.pdf p. 1.

13 Ibid, p.4.

Proposed revisions to the text of the current Penalty Guidelines

New explanatory note

4. Paragraph 2

As stated above in section [2] of this response, for reasons of procedural fairness EE considers that it is important for Ofcom to clarify in this paragraph or elsewhere in the amended Penalty Guidelines that Ofcom will only apply the amendments *prospectively*, in relation to conduct engaged in after the amendments come into force.

5. Paragraph 3

EE suggests to delete the words "*they are likely to become less relevant to future enforcement work over time*" from paragraph 3. As set out above, much of the UK's case law is of enduring relevance today in spite of the elapse of very considerable periods of time (centuries even) since those cases were first decided. EE considers it neither necessary nor appropriate for Ofcom to establish a principle under the revised Penalty Guidelines that a precedent is likely to be less relevant to a current case purely based on the age of the precedent.

6. Paragraph 4

EE suggests 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*" from paragraph 4. Whilst deterrence is an acceptable *objective* for imposing a penalty, it is not appropriate to base the level of penalty on such an *outcome*. There are a number of different causes for compliance failures including lack of awareness or understanding of the relevant regulatory requirements. Accordingly, whilst penalties may be set sufficiently so as to deter any *desire* by providers to engage in contraventions, this approach alone may prove inadequate to deter actual future contraventions. As noted by the ASIC, enforcement action is only one of several tools regulators use to respond to potential compliance breaches and other important regulatory tools include education, policy advice, guidance, surveillance and stakeholder engagement.[14]

Furthermore, it may in particular circumstances be inappropriate in light of all of Ofcom's duties under the Act to make a particular provider a scapegoat purely in order to send a signal to the wider industry. Moreover, depending on the size and situation of the organisation in question, even exacting the harshest possible penalty may be inadequate to do so. EE therefore strongly

[14] See ASIC REPORT 387: Penalties for corporate wrongdoing, http://download.asic.gov.au/media/1344548/rep387-published-20-March-2014.pdf, para 25 and footnote 2.

recommends that Ofcom does not fetter its approach in the revised Penalty Guidelines.

7. Paragraph 5

EE suggests edits to paragraph 5 as follows:

"*In particular, the level of the penalty must be sufficiently high to ~~have the appropriate impact on the regulated body at an organisational level. It should~~ incentivise the management (which is ultimately responsible for the conduct and culture of the regulated body) to ~~change the conduct of the regulated body as a whole and~~ bring it into compliance, achieving this, where necessary, by changing the conduct at different levels within the organisation. In cases of intentional or negligent breach, ~~T~~the level of the penalty should be high enough that the management recognises that it is not more profitable for a business to break the law and pay the consequences, than it is to comply with the law in the first instance, and that it should therefore discourage bad conduct and encourage good practices and a culture of compliance across the organisation*."

The change to the first sentence of paragraph 5 is recommended in view of our comments above regarding the inappropriateness of setting penalties tied to outcomes, rather than objectives.

The change to the second sentence of paragraph 5 is proposed in view of the fact that it is clear from Ofcom's penalty decisions to date that not all contraventions are intentional or designed to produce gains. No stakeholder in the UK telecoms industry, not even Ofcom, is perfect. Ofcom's Penalty Guidelines need to, as Ofcom's Impact Assessment Guidelines do[15], recognise the reality of the difficult commercial environment in which communications providers strive to deliver the best outcomes for consumers. Cases stemming from other causes such as misunderstandings and inadvertent breach in spite of robust processes and a culture of compliance need to be distinguished from those which are deliberate or reckless.

8. Paragraph 6

For the reasons set out above and in section [2] of this response, EE recommends to delete the second and third sentences from paragraph 6. In terms of the third sentence, EE reiterates the points made above that penalties alone are unlikely to, and should not be expected to, ensure compliant outcomes.

In terms of the second sentence of paragraph 6, EE agrees with Ofcom that a relevant factor in securing Ofcom's objective of deterrence is the turnover of the regulated body subject to the penalty. However this is where EE considers prescriptiveness set out in the revised Penalty Guidelines should stop – leaving Ofcom the flexibility to apply this principle in each case as appropriate, considering the terms of s. 97 of the Act and Ofcom's other statutory duties under the Act.

15 See the acknowledgement of the need for Ofcom to base its policy on "a realistic level of likely compliance" and considerations of "whether compliance will be practically possible" at paragraph 5.33.

EE is also very concerned that penalties which are aggravated based purely on the large size of the turnover of the contravening provider risk sending the wrong signals to other providers, and to consumers. Taking the recent £1m fine imposed on EE for contravention of General Condition 14 for example, it is clear from the details of Ofcom's confirmation decision[16] that the key reason why a fine four times the size of the £250,000 imposed on Hutchison 3G UK Limited ("**Three**") for a very similar contravention in relation to which Ofcom formed the view that "*the overall effect is such that we consider both cases to be of a similar level of seriousness*"[17] was purely the size of EE's turnover. Specifically, Ofcom considered that "*EE's relevant turnover shows that it is a very large CP, with a significant presence in relevant communications markets. In particular, EE's relevant turnover is substantially greater than Three's*"[18]. Accordingly, notwithstanding EE's submissions that *"the fact that we're a large organisation overall hasn't resulted in a greater degree of harm caused or gain to EE"*[19] and Ofcom's own view that the overall levels of seriousness of the contraventions were similar, Ofcom concluded that "*the key differentiating factor between the two cases in our consideration of the appropriate penalty is the relevant turnover of the two companies under investigation and this accounts for the difference in the levels of the penalties imposed in each case*".[20]

EE remains strongly of the view that this approach to penalties by Ofcom is wrong in principle. It is clearly correct for Ofcom to check to ensure that any penalty will not be set so high as to impair the ability of the organisation to carry on engaging in regulated communications activities to the benefit of consumers having regard to its relevant turnover. It is also right to ensure that any level of penalty will have the appropriate deterrent effect, taking into account the relevant turnover of the provider in question. However it is not right to impose a penalty that is a multiple of that imposed on another organisation for a contravention of highly similar detail and seriousness, purely based on the fact that the turnovers of the concerned organisations are multiples apart. Unless and until it is established by Ofcom that the lower penalty would be insufficient to have the required deterrent effect, then the additional penalty amount is simply arbitrarily punitive. As a consequence, it is liable to trivialise the stigma otherwise associated with harm-based penalties, and also to harm the best interests of consumers – given the productive purposes to which the provider would otherwise have been able to put the funds in question.

Furthermore there is also a concern, at least based on the way in which Ofcom has applied the current Penalty Guidelines in EE's case, that Ofcom's proposed approach of imposing different fines for different sized organisations for offences of comparable seriousness will be insufficiently transparent to send the industry the deterrence signals intended by Ofcom.

As ASIC notes:

16 See http://stakeholders.ofcom.org.uk/binaries/enforcement/competition-bulletins/closed-cases/all-closed-cases/cw_01120/Confirmation_Decision_under_s96C_of_a_contravention_under_GC14.4_(non-confidential).pdf

17 Para 7.188, emphasis added.

18 Para 7.184.

19 Para 7.184.

20 Para 7.188, emphasis added.

> *"Central to effective enforcement are penalties set at an appropriate level, and having a range of penalties available for particular breaches of the law. Having a range of penalties allows ASIC to calibrate our response with sanctions of greater or lesser severity commensurate with the misconduct"*[21]

There is a real risk that the intended deterrence signals to be sent through such a calibration exercise based on severity will be lost if the key determining factor for the level of penalty set becomes the relevant turnover of the body in question. This risk is compounded where there is insufficient transparency regarding the drivers for the fines imposed.

In EE's case, Ofcom's turnover based rationale for quadrupling the fine imposed on EE relative to that imposed on Three only appears at page 92 of Ofcom's 97 page Confirmation Decision. EE would accordingly be highly surprised if barely any industry participant other than EE has even noticed it. Ofcom's Competition Bulletin update in this regard simply states "*The Confirmation Decision also imposes a financial penalty of £1,000,000 on EE*"[22] and even the executive summary of Ofcom's Confirmation decision omits to make any reference to this key reason for the huge uplift in fine relative to that imposed on Three, stating only that "*Ofcom's view is that this penalty amount is appropriate and proportionate to the contravention in respect of which it is imposed. In taking that view Ofcom has had regard to EE's responses to Ofcom's First, Second, Third and Fourth Information Requests, CISAS's Information Request Response, the Representations and Ofcom's published Penalty Guidelines*"[23].

If Ofcom considers, having regard to all of its relevant duties under the Act, that it is necessary, appropriate and proportionate to "gross-up" a fine based on the turnover of the concerned organisation in furtherance of its objective of deterrence, then Ofcom needs to be transparent to both the concerned provider and to industry and consumers that this is what it is doing. Specifically, it would seem to be appropriate for Ofcom to clearly outline the level of fine it would have otherwise considered appropriate based purely on seriousness and harm, and then to explain the rationale and process followed in its turnover based grossing up exercise. The same is true where Ofcom decides that a lower level of fine is appropriate and proportionate based only on turnover. Otherwise, there is a very real risk that industry stakeholders and consumers[24] will form an incorrect view of the seriousness and harm caused by relevant contraventions, and also regarding Ofcom's enforcement priorities.

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21 See ASIC REPORT 387, http://download.asic.gov.au/media/1344548/rep387-published-20-March-2014.pdf, para 2.

22 http://stakeholders.ofcom.org.uk/enforcement/competition-bulletins/closed-cases/all-closed-cases/cw_01120/

23 Para 2.13, emphasis added.

24 See for example the unqualified reference in Ofcom's latest customer complaints publication at http://consumers.ofcom.org.uk/news/telecoms-pay-TV-complaints/ that "Ofcom fined Three UK £250,000, and in July this year EE was fined £1,000,000 by Ofcom for failing to comply with rules on handling customers' complaints", which EE considers to give a damagingly misleading impression of the seriousness of EE's offence in comparison with that engaged in by Three.

By way of a relevant example, EE notes that the FCA's Enforcement Guidance includes as a clear and separate "Step 4" in its penalty setting process any adjustment required for deterrence. This Step is conducted only after a figure has been arrived at through Steps1-3 which assess disgorgement, seriousness and mitigating and aggravating factors.[25]

9. Paragraph 7

EE considers that Ofcom can only satisfy its general duties under s. 3(3)(a) of the Act to ensure that its activities are transparent, consistent, proportionate and accountable where it has regard to all relevant previous cases. This is particularly true in cases concerning breaches of the General Conditions of Entitlement, which EE notes is one the stated areas to which Ofcom plans to apply the revised Penalty Guidelines. EE also considers that Ofcom is required as a matter of procedural fairness to have regard to all such precedent cases, given that breaches of the General Conditions carry some of the harshest potential and considering that there are relatively few precedent cases.

EE therefore strongly recommends that the word "may" in the first sentence of paragraph 7 is replaced with the word "will". EE also strongly recommends that the third sentence is paragraph 7 is deleted in its entirety. It is clearly inconsistent with Ofcom's duties of transparency, consistency and accountability for Ofcom to seek to give itself the discretion to simply pick and choose the precedents it will or won't cover in its decisions. Where such precedents are, objectively considered, relevant, then Ofcom has a duty to consider them.

10. Paragraph 8

For the reasons set out in EE's comments above in relation to paragraph 6, EE recommends to add an additional sentence to the end of this paragraph to the following effect: "*In such cases, Ofcom will clearly set out the reasons why it considers the penalty needs to be increased to ensure effective enforcement and/or deterrence, the amount of the increase to the penalty imposed for this purpose, and the process that Ofcom has followed to determine the increase amount*."

11. Paragraph 9

EE considers that it is important to add a further example to this paragraph to clarify that a larger penalty will not always be appropriate, just because an organisation has a larger turnover. This may, for example, be contrary to Ofcom's obligations of consistency when imposing fixed penalties for lower level contraventions where the ability to comply and consequences of breach do not differ based on the size of the provider. It may also be unnecessary to achieve either compliance or deterrence – for example a very significant penalty previously imposed on another large body may be more than adequate

[25] See https://www.handbook.fca.org.uk/handbook/DEPP/6/5A.html. The FCA's approach is consistent with the recommendations of Treasury the as to the importance of transparency in this area – see e.g. paras 2.7-2.11 of its "Review of enforcement decision-making at the financial services regulators: final report", December 2014.

to achieve this purpose, notwithstanding that a subsequent case involves a body with a slightly larger turnover.[26]

We note in this respect that the FCA's penalty guidance states:

"…the FCA recognises that there may be cases where revenue is not an appropriate indicator of the harm or potential harm that a firm's breach may cause, and in those cases the FCA will use an appropriate alternative"[27]

EE therefore recommends to add a sentence before the last sentence of paragraph 9 to the following effect: "*There may also be cases where it would be inappropriate to impose a larger fine on a body just because it has a larger turnover*."

12. Paragraph 10

EE finds the proposed addition of paragraph 10 into the Penalty Guidelines to be highly concerning. This particularly so given the stated intended application of the amendments to Ofcom's enforcement work regarding consumer protection in the telecoms sector[28]. In such cases, consumer harm is the primary if not sole justification for Ofcom's activities, and the issue of gain is clearly highly material to consideration of the required deterrent effect of any penalty imposed. In such circumstances, it is likely to involve an abrogation of Ofcom's duties for Ofcom to simply decline to take such matters, including quantification of the harm and gain where possible, into consideration.

Given that these matters are already in EE's view adequately covered the contents of paragraph 12 of the Penalty Guidelines, EE's preferred course would simply be to delete proposed paragraph 10 in its entirety.

In the event that Ofcom still feels strongly that further clarification is needed in this area, then EE would suggest amendments to the current proposed text as follows:

> *"Amongst the other relevant considerations we ~~may~~ will take into account, Ofcom will~~may~~ consider the degree of harm caused by the contravention and/or any gain made by the regulated body as a result of the contravention. We will~~may~~ seek to quantify those amounts ~~in appropriate cases~~where possible. However, the amount of any such quantification ~~Ofcom will not necessarily do so in all cases and, even where it does, the calculation~~ does not necessarily determine or limit the level of the penalty, ~~which, as explained above, is to ensure that the management of the regulated body is incentivised to modify the behaviour of that body (and deter other regulated bodies accordingly). That is~~and~~,~~ any quantified harm/gain is only one of the factors in determining the appropriate and proportionate level of the penalty"*

26 Note that, given the manner in which Ofcom conducts investigations, a subsequent case may cover conduct which is contemporaneous with or even pre-date that covered by an earlier case. Hence it cannot be assumed that the prior penalty was an ineffective deterrent simply because there are subsequent cases involving the same type of contravention.

27 See https://www.handbook.fca.org.uk/handbook/DEPP/6/5A.html

28 See Consultation, paragraphs 1.7-1.8; 1.32.

How Ofcom will determine the amount of a penalty

1. Paragraph 11

In the new sentence inserted at the end of paragraph 11, EE strongly recommends to replace the word "will" with "may". As set out above, there may be cases in which the size and turnover of the regulated body is not relevant to attainment of Ofcom's central deterrence objective, and others where an undue focus on this issue may distort the outcome of Ofcom's analysis. Use of the word "will" rather than "must" this risks Ofcom fettering its discretion under the Penalty Guidelines and preventing it from freely fulfilling its obligations to impose penalties that are appropriate and proportionate in all of the relevant circumstances.

2. Paragraph 12

EE suggests to delete the first new proposed bullet point of paragraph 12 for the following reasons:

a) The use of the term "seriousness" in paragraph 11 is acceptable, as a short hand way of summarising the combined effect of all of the different factors listed in paragraph 12 of the current Penalty Guidelines. However the proposed inclusion of "seriousness" as a separate standalone factor in paragraph 12 risks dangerous ambiguity and a potential lack of transparency in Ofcom's decision making going forwards. In particular, EE does not see how an offence could be classified as "serious" if it did not cause harm, did not result in gain, was not intentional/deliberate/reckless, was limited in duration and/or was engaged in by a body with no prior history of contraventions as per the existing factors listed in paragraph 12 of the Penalty Guidelines.
   EE accordingly considers that the making of this amendment to the Penalty Guidelines would risk non-compliance with Ofcom's general duties under the Act, including those of transparency and for its activities to represent regulatory best practice. In contrast in terms of regulatory best practice, EE notes that the FCA's Enforcement Guidance sets out in an extremely clear and detailed way in which the FCA will determine penalties based on relevant seriousness factors.[29]

b) As noted above in section [2] of this response, it is unclear whether the listing of a factor earlier in paragraph 12 is intended to denote increased importance or not. To the extent that there is some implied weighting, EE considers it inappropriate to list duration in advance of harm and therefore recommends that the original placement for this factor is retained.

Given the express emphasis placed in s. 97(2)(c) of the Act on Ofcom's consideration of any steps taken by the body for remedying the consequences of the contravention, EE recommends that at a minimum the original placement

[29] See https://www.handbook.fca.org.uk/handbook/DEPP/6/5A.html

of this factor in paragraph 12 is retained. However there is also a good case for prioritising this factor, along with consideration of whether in all the circumstances appropriate steps had been taken by the regulated body to prevent the contravention, given their focus in s. 97(2) of the Act.

EE understands that Ofcom's current approach to considering penalties includes a consideration of the extent to which the regulated body in breach has cooperated with Ofcom's investigation and on that basis does not object to including this as a factor at the end of those listed in paragraph 12 of the Penalty Guidelines. However EE considers that it would be very helpful to include additional details in the Penalty Guidelines as to the kinds of matters Ofcom may consider under this factor. This would aid both in Ofcom's consistent and transparent application of this factor in different cases, and in industry seeking to meet Ofcom's expectations. A related issue which is not covered in the Penalty Guidelines currently nor in Ofcom's reform proposals, but which may lead to more efficient enforcement by Ofcom, would be if Ofcom were to expressly consider discounts from penalties for self-reporting of compliance incidents by a body.

EE notes in this regard that the Financial Conduct Authority's ("FCA's") Enforcement Guide expands on the FCA's approach to co-operation in the context of its enforcement activities as set out below.[30] In addition, the FCA's Enforcement Guide refers to an article published by the FCA detailing some practical examples of the FCA's approach to co-operation.[31]

> *"An important consideration before an enforcement investigation and/or enforcement action is taken forward is the nature of a firm's overall relationship with the FCA and whether, against that background, the use of enforcement tools is likely to further the FCA's aims and objectives. So, for any similar set of facts, using enforcement tools will be less likely if a firm has built up over time a strong track record of taking its senior management responsibilities seriously and been open and communicative with the FCA. In addition, a firm's conduct in response to the specific issue which has given rise to the question of whether enforcement tools should be used will also be relevant. In this respect, relevant matters may include whether the person has self-reported, helped the FCA establish the facts and/or taken remedial action such as addressing any systems and controls issues and compensating any consumers who have lost out. Such matters will not, however, necessarily mean that enforcement tools will not be used. The FCA has to consider each case on its merits and in the wider regulatory context, and any such steps cannot automatically lead to no enforcement sanction. However, they may in any event be factors which will mitigate the penalty."*

The FCA's current approach is consistent with the findings of the Parliamentary Commission into Banking Standards, which concluded that:

30 See https://www.handbook.fca.org.uk/handbook/document/EG_FCA_20140401.pdf, para 2.33

31 See http://www.fca.org.uk/firms/being-regulated/enforcement/how-we-enforce-the-law/cooperating referred to at para 2.34 of the FCA Enforcement Guide

"…Cooperation by firms in bringing issues to regulators' attention and assisting with their investigation should be a given. Regulators should make full use of the flexibility in their penalty policy to punish cases where this does not occur. However, regulators should also make it clear to firms that the same flexibility will be used to show leniency where inadvertent and minor breaches are swiftly brought to their attention and rectified, so that the fear of over-reaction does not to stifle the free flow of information."[32]

It is also consistent with recent international thinking on the importance to effective enforcement of economic crimes of providing adequate inducements to firms to self-report and adopt effective compliance programs.[33]

3. Paragraph 13

For the same reasons set out above in relation to paragraph 10, EE recommends to amend the text in the new proposed paragraph 13 as follows:

"*When considering the degree of harm caused by the contravention and/or any gain made by the regulated body as a result of the contravention Ofcom will~~may~~ seek to quantify those amounts ~~in appropriate cases but will not necessarily do so in all cases~~where possible*".

4. Paragraph 14

For the same important reasons set out above in relation to paragraph 7, EE considers that the word "will" in the first sentence of this paragraph needs to be retained.

5. Paragraph 16

EE does not object per se to the replacement of this paragraph with the new factor regarding cooperation proposed to be included in paragraph 12. However, EE is somewhat concerned that this change in approach could potentially lead to a loss of transparency in the way in which Ofcom applies increases for lack of cooperation or discounts for cooperation. Where Ofcom proposes to do this, EE considers it important for Ofcom to be transparent in the *value* of the increase/discount applied – rather than simply weighing all factors in the round. This is necessary both to ensure compliance by Ofcom with its statutory duties and also to ensure that the correct signals are provided to industry and consumers regarding Ofcom's views on the seriousness of the offence, prior to consideration of the element of cooperation. By way of a relevant example of regulatory best practice in this respect, EE notes that the FCA's Enforcement Guidance sets out clearly as a separate "Step 3" in the

32 See http://www.publications.parliament.uk/pa/jt201314/jtselect/jtpcbs/27/27ii12.htm, para 1133

33 See for example, Jennifer Arlen, Norma Z. Paige Professor of Law, NYU School of Law Director, NYU Program on Corporate Compliance and Enforcement, "*Proposal to the U.S. Sentencing Commission to Reform the Mitigation Provisions of the Organizational Sentencing Guidelines and the Definition of Effective Compliance*", 2015 - http://www.ussc.gov/sites/default/files/pdf/amendment-process/public-comment/20140729/NYU.pdf

FCA's process for setting penalties the impact of any aggravating or mitigating factors, including those relating to cooperation.[34]

6. Paragraph 18

This paragraph seems somewhat redundant, given the terms of paragraph 11. However, EE does not object to its inclusion for clarity and emphasis, provided that the words "where appropriate" are inserted at the end of this proposed new paragraph. This is for the same reasons set out above in relation to EE's comments on paragraph 11.

Annex 1

EE agrees with Ofcom that it would seem to be no longer necessary or appropriate to include in the Penalty Guidelines an annex dealing solely and exclusively with its approach to penalties for breaches of licence conditions in relation to network programming complied on behalf of the regional Channel 3 licensees.

However, the current Annex deals with a number of practical matters that are not otherwise dealt with in the body of the Penalty Guidelines, which EE considers it is beneficial to retain in the Penalty Guidelines – whether in an annex or in the main body. These matters are as follows:

- The current Annex deals with the circumstances Ofcom is likely to consider relevant when deciding whether to impose a penalty on a Channel 3 licensee for broadcasting programming in breach of its licence but which it did not comply itself. The situation where a regulated body can be liable for acts performed by third parties is not unique to the Channel 3 licensee. For example, this may be true in many cases under the General Conditions where third parties are involved in the supply of the regulated telecommunications services and networks by the regulated communications providers.
- Ofcom's focus set out in A1.5 on non-compliance by regulated bodies in circumstances where the body has "*seriously, repeatedly, deliberately or recklessly breached*" its obligations would seem to have wider application to breaches involving primary conduct by third parties. The same is true of Ofcom's stated approach in this paragraph to examine "*the nature of the breach and the extent to which the breach can be attributed to the fault of the licensee*".
- Ofcom's approach set out in A1.6 of considering the extent to which it was reasonable for the regulated body to rely on the third party to ensure that its acts were compliant is also likely to have wider application, in particular the factors stipulated of:
    - The extent to which the activity or type of activity represented a known compliance risk;

[34] See https://www.handbook.fca.org.uk/handbook/DEPP/6/5A.html

- The steps, if any that the regulated body took to satisfy itself that the measures implemented by the third party were sufficient to address that risk; and
- Whether the regulated body did or should have taken additional measures to address the risk given the facts of which it might reasonably be expected to be aware.

- The guidance provided by Ofcom at A1.7 on regulatory compliance systems would appear to be very relevant and helpful to regulated bodies both in relation to their direct compliance, and when using third parties for activities. For example, the guidance that:
  - The more serious the risk that the activity represented (either because of the nature of the activity or because of a previous relevant history of compliance failings), the more likely it is that Ofcom will expect that a regulated body either knew or should have known of the risk and should have taken steps to mitigate it.
  - Ofcom would expect regulated bodies to be able to demonstrate that they had implemented a risk-assessment system for identifying potential compliance risks. Ofcom would expect such a system to be risk based and derived from available information.
- Again, the guidance at A1.8 would seem to have general application. EE considers that in nearly all breach cases the steps that Ofcom may expect a regulated body to have taken should depend on the nature of the risk in question. Further, in most cases where third parties are involved, Ofcom's example in A1.8 would seem to be relevant - e.g. where the nature of the particular activity raises a material risk of breach but there are no other grounds for concern, the regulated body might be expected to have sought confirmation from the third party, prior to engaging in it, that the activity is compliant.
- A1.10 also seems to be of general relevance to situations involving previous compliance issues – i.e. that where risk arises because of previous compliance failings on the part of a third party, greater intervention by the regulated body may be appropriate to assure itself that there should be no recurrence of similar failings. That intervention could, for example, be obtaining comfort from the third party that previous weaknesses in its compliance processes have been addressed.
- In line with our comments above in relation to A1.7, the further details provided at A1.13 on the practical measures Ofcom might expect to take into consideration when considering the appropriateness of any steps taken to prevent contravention or the timeliness and effectiveness of steps taken to bring it to an end are also very helpful. In particular that Ofcom might expect to consider:
  - the application of a system of risk-based assessment to determine the appropriateness of additional compliance

measures and/or further compliance checks on individual activities deemed to represent a particular compliance risk;

- evidence of periodic audits of compliance processes followed;
- evidence of spot checks on activities identified as being a higher risk;
- demonstrable evidence showing the allocation of adequate resources to compliance; and
- evidence that regulated bodies had taken account in their compliance practices findings reported in Ofcom's relevant bulletins.

In fact, EE considers that amendments to the Penalty Guidelines could beneficially go further, in offering discounts to penalties for compliance programs. Compliance literature suggest that such credits, if awarded, would increase companies' incentives to implement such programs to detect and prevent compliance violations.[35]

35 See for example http://corporatecomplianceinsights.com/corporate-wrongdoing-and-deterrence/