

Financial Penalties

A Decision Document and Statement of Policy

February 2002

Summary

1. The Postal Services Act 2000 (the Act) provides that the Postal Services Commission (Postcomm) may impose financial penalties on holders of licences granted under the Act who contravene the conditions of their licences. The Act requires Postcomm to prepare and publish a statement of policy in relation to the imposition of penalties and the determination of their amount and to consult the Consumer Council for Postal Services (Postwatch) and such other persons as Postcomm considers appropriate when preparing or revising its statement of policy.
2. In July 2001 Postcomm published a consultation paper setting out its proposals for a statement of policy on financial penalties. This decision document sets out the points made in response to that paper and Postcomm's decision on its statement of policy in the light of those points. The finalised statement of policy is included as the last chapter to this paper.
3. The major changes that have been incorporated in the finalised statement as compared with the consultation draft are –
 - the introduction of a reference to Postcomm's code of practice on the discharge of its functions,
 - the introduction of reference to a vetting process to ensure that it is recognised that Postcomm will want to satisfy itself that it has good reason to conduct investigations,
 - a reference to the possible announcement of enquiries that may lead to penalties,
 - a reference to the possibility of holding public hearings,
 - a re-casting of the matters to be considered in deciding whether a penalty is appropriate at all, including a reference to matters entirely beyond the control of the licensee,

- a clearer rationale for using gain to the licence holder plus burdens imposed on others as the starting point for assessing the amount of a penalty,
 - the re-casting of the aggravating and mitigating factors to be considered in deciding the amount of any penalty,
 - a reference to deterrence, and
 - the introduction of “proportionality” into the final check.
4. Postcomm is grateful for the effort respondents have made in considering the issues raised in the consultation paper and in making recommendations on them. Postcomm believes that it has been able to adopt a better policy on this difficult issue as a result of the representations it has received.

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1. Introduction

Postcomm and Postwatch

- 1.1 The Postal Services Act 2000 (the Act) established the Postal Services Commission (Postcomm) as the independent regulatory body for the postal services industry in the United Kingdom. Postcomm's Business Plan, which can be found on its website at www.psc.gov.uk, gives details of its duties, functions, objectives and work plan. The Act also established the Consumer Council for Postal Services ("Postwatch") as the body to represent the interests of users of postal services.

Postcomm's powers in relation to financial penalties

- 1.2 Postcomm is responsible under the Act for the licensing of certain postal operators and is able to impose financial penalties in respect of breaches of licence conditions. A full statement of Postcomm's powers in relation to the imposition of financial penalties is set out in the Postcomm consultation document "Financial penalties: statement of policy" published in July 2001.
- 1.3 One of Postcomm's duties in relation to financial penalties is to publish a statement of policy in relation to their application. It is for that purpose that the consultation paper referred to above was published. Responses to the proposed statement of policy were sought by the end of October 2001.

Responses to the consultation paper

- 1.4 Responses were received from the following bodies and individuals. Those who formally made substantive comments that are discussed in this decision paper are shown in bold.

Communication Workers Union (CWU)

Consignia plc

Direct Marketing Association (DMA)

Federation of the Electronics Industry (FEI)

Postwatch

Transport and General Workers Union (T&G)

Ballymena Borough Council

Down District Council

National Association of Citizens Advice Bureaux

National Consumer Council

Office of the First Minister and the Deputy First Minister, Stormont.

The purpose and scope of this decision document

1.5 This decision document sets out the main points made in response to Postcomm's consultation paper and Postcomm's views on the issues that have been raised. It explains the changes that Postcomm has made to the draft statement of policy that it proposed to adopt and sets out the statement of policy that Postcomm has adopted in the light of those points. The finalised statement of policy is included as the last chapter to this paper.

Outline of this document

1.6 This decision document comprises –

- in Chapter 1, this introduction,
- in Chapter 2, a summary of the points made in response to Postcomm's consultation paper, Postcomm's views on those points, and an explanation of the changes that it has made, in response to the consultation, to the draft statement of policy it originally proposed, and
- in Chapter 3, the statement of policy that Postcomm has adopted.

Comments on this document

- 1.7 Postcomm would welcome comments on its statement of policy on financial penalties at any time. They may be addressed to:

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2. Responses to the consultation and Postcomm's views on them

Introduction

- 2.1 Postcomm found the responses to its consultation paper to be very helpful in developing a difficult area of policy. Postcomm thanks all those who have taken the trouble to comment. Postcomm is confident that it is putting in place a more robust and effective policy statement at the end of the consultation period than it was proposing at the beginning of the period.
- 2.2 The responses to the consultation raised a number of important and helpful points. This Chapter considers these points broadly in the order in which the topics to which they relate were set out in the consultation paper. In relation to each there is a summary of the points made by respondents, Postcomm's assessment of the point and an explanation of any changes that Postcomm has made to its draft statement of policy to accommodate the matter. Full copies of all the responses that were received in electronic form will be available for the next six months on Postcomm's website. Two preliminary points are dealt with first, however.

Preliminary Points

Penalties and compensation

- 2.3 Postwatch saw difficulties with how the proposed financial penalty regime would work in practice. It argued that the normal process under which a financial penalty would affect shareholders adversely, so that they would apply pressure on management would not apply because financial penalties are paid to the Treasury which has an interest as shareholder. Postwatch argued that in order to provide adequate management incentives any regime should be framed as a compensation regime with consumers benefiting.

- 2.4 The DMA raised a related point, that the proposed policy does not do enough for those affected by breaches of licence conditions as there is no proposal to take into account “collateral damage” to businesses affected by the licence breach. They suggested that companies affected by the breach should receive compensation in the form of an element of the penalty paid by the licensee.
- 2.5 Postcomm is sympathetic to these suggestions but is limited in what it can do by the terms of the Act. Under the Act, Postcomm is required to pay into the Consolidated Fund any sums received in consequence of the Act, a restraint that was not set out in the consultation paper as clearly as it might have been. Postcomm is working on a scheme under which Consignia is required by its licence to compensate users of postal services for failure to meet standards of service, but this a separate issue under a separate power in the Act from the issue of financial penalties.
- 2.6 Postcomm therefore is unable to take further the suggestion of providing compensation from financial penalty payments and has not altered its proposed statement to accommodate the point.

Postcomm’s code of practice for the discharge of its functions

- 2.7 Postcomm’s consultation paper on its code of practice for the discharge of its functions had not been published before the close of the consultation period on the financial penalties policy. The draft code of practice requires Postcomm to apply best regulatory practice. If this element of the draft code is adopted it will have the effect of requiring Postcomm to have close regard to matters such as –
- o the Guidance issued by the Chairman of the Competition Commission to Groups (of members of that Commission) on public hearings (which was mentioned in the response of the Department of Trade and Industry), and

- o the lead being taken by the President of the Competition Commission Appeals Tribunal in introducing rigorous time disciplines in regulatory procedures (the need for prompt procedures was stressed by the DMA).
- 2.8 Postcomm thinks that it is highly likely that the proposed requirement in its draft code of practice to apply best regulatory practice will be incorporated into the final version of the code. That code of practice is intended to be an over-arching set of principles to be applied in relation to the discharge of all Postcomm's functions. It seems appropriate to Postcomm to recognise the role of the code of practice by reference to it, rather than by repeating it. Two new paragraphs, 6 and 7, have been inserted in the statement of policy to refer to Postcomm's code of practice and proposals Postcomm has published for such a code.

Significant issues raised in response to the consultation paper

- 2.9 As noted above, this section broadly follows the order of issues raised in the consultation document.

Legal and procedural considerations

- 2.10 Consignia was exercised by the possibility that licensees might face retrospective penalties in respect of past breaches. They suggested that this would be unjust as it could lead to uncertain financial exposure for up to 15 years and will "merely raise the cost of capital". Their suggested solution is to limit the imposition of financial penalties to those discovered in the current or immediately past financial year. However, where a breach comes to light within the time period, but the time taken for investigations take it beyond this, Consignia accept that a financial penalty could be levied.
- 2.11 In Postcomm's view, Consignia's concerns are unfounded. Section 34 of the Act imposes tight time limits which must be followed by Postcomm when seeking to impose financial penalties. Postcomm notes that the point

could, at present, only be seen as an issue by Consignia, which is the only operator with the privilege of a 15 year licence.

- 2.12 Postwatch expressed concern that the statement of policy on financial penalties does not amount to guidance about when and how they will be made. Saying that penalties must be applied in the light of Postcomm's statutory duties does not give clear guidance. Postcomm has some sympathy with this point. However, when a penalty issue arises, Postcomm must both discharge its statutory duties and have regard to the nature of the licence breach in question. Postwatch itself has referred to dealing with matters on a case by case basis. Guidance on issues that depend on unknown facts is difficult to give. It may be possible to be more specific in a future statement when we have some experience of the processes involved. This will certainly be our aim. At this stage, however, Postcomm is seeking to state a policy, as required by the Act, rather than to give detailed guidance on its application.
- 2.13 Apart from these points, there was general agreement that all the relevant legal and procedural considerations have been taken into account in the proposed statement of policy. Accordingly, no changes for strictly legal or procedural reasons have been made to the proposed policy statement.

Circumstances giving rise to action by Postcomm

- 2.14 Postcomm's approach to the identification of licence breaches is generally accepted. The FEI suggest that links could be established with trade associations which might also be useful sources of information about licence breaches, and the T&G emphasise the need to maintain relationships with other regulators to ensure the flow of information.
- 2.15 Postcomm accepts these points. The following paragraphs describe changes to the proposed statement of policy to expand on the initial vetting of complaints that may lead to investigation. The suggested links already exist informally to some extent. It will be helpful to develop them for use from the vetting stage of Postcomm's policy onwards.

Obtaining information and investigating

- 2.16 Consignia was concerned that licensees do not face scrutiny over issues that are trivial or have little or no factual basis. Sufficient analysis and questioning should be undertaken to ascertain that the possibility of a contravention is real and not trivial before subjecting the licensee to the information and investigation approach set out in the consultation document.
- 2.17 Consignia highlighted the need for Postcomm to consider carefully the wording of any licence condition in its assessment of whether a breach has occurred, for example the degree of discretion implied by the wording “reasonable endeavours”. Postcomm should also take account of the report provided by the Consignia Compliance Officer rather than investigating from scratch, should the report cover the particular point at issue.
- 2.18 Postcomm accepts the need to ensure that licensees do not face unnecessary investigations. Postcomm flagged up the possibility of malicious complaints in the consultation paper. At the same time, Postcomm needs to ensure that any potential contravention of the licence is taken seriously and that the facts are established. An element of enquiry is therefore likely to be necessary in most cases, if only to determine that a complaint has no factual basis. In practice most bodies charged with functions that involve investigation have an initial vetting stage to ensure that there is good reason to exercise these functions. Postcomm sees such a stage as necessary to ensure that it deploys its scarce resources in a manner that reflects its priorities.
- 2.19 Postcomm therefore has amended its statement of policy to introduce a vetting stage into its processes for deciding whether to take regulatory action. Consignia’s point about the wording of licence conditions is accepted and will be accommodated initially at the vetting stage. It also is a highly relevant consideration at later stages in all enforcement processes, whether in respect of penalties or orders.

2.20 Postcomm would want to take account of any report from the Consignia Compliance Officer that was relevant to a matter Postcomm was considering investigating. But Postcomm cannot bind itself to limiting its investigations to this report and to not undertaking its own enquiries to look at original sources of information.

Announcement of investigations

- 2.21 Postwatch recommended that all investigations should be publicised to allow parties with an interest to come forward with relevant information, unless such publicity would hinder the investigation. In such cases, an announcement should still be made at the earliest possible time. The DMA sees transparency as fundamental to regulatory structures and action and so takes the view that Postcomm must make the licensee aware of the nature of any possible contravention and the details of the investigation. The case should only be made public after Postcomm's initial short investigation to determine if there is a case to answer, thereby avoiding any potential damage from a complaint that really has no merit.
- 2.22 Consignia agreed that licensees should be involved in the process as soon as possible.
- 2.23 Postcomm's thinks, in the light of these comments, that it is appropriate to amend its proposed statement of policy to indicate that Postcomm will announce the conduct of enquiries unless it is inappropriate to do so. Such announcements would be made after the conclusion of the vetting of an issue for possible investigation. If Postcomm's decision is not to take action, it normally would expect not to issue a public statement, in order to avoid unjustified potential damage to the licence holder. The risk of such damage affects private as well as public companies and can go beyond share values.

“Minded to decisions” and hearings

- 2.24 No objections were received to Postcomm’s proposal to announce a “minded to decision” and to offer the opportunity of a hearing to a licence holder before Postcomm finalises its conclusions as to breaches of licence conditions and gives notice of a proposal to impose a penalty. The thrust of comments was on the issue of whether hearings should be in public, a point on which Postcomm sought views, but which is subject to the difficulty of the confidentiality obligations in the Act.
- 2.25 Consignia believe that any hearing should be held in private. The DMA consider that hearings should be held in public, or at least should be open to affected parties, and that details of any hearings should be published on the Postcomm website. The FEI see no necessity for public hearings.
- 2.26 Postwatch believes that although public hearings may be of benefit in some circumstances, the decision to offer one should be taken on a case by case basis. Public hearings might be useful where a significant number of representations have been made or where the breach involves complex issues. Any public hearing should be held as soon as possible and Postwatch would not expect it to last more than a day or two. It should be held at the end of a written consultation process, to give the licensee the opportunity to contest the points made against it by respondents, and to give Postcomm and respondents the opportunity to question the licensee. In considering the format of any public hearing, Postcomm should bear in mind that Consignia has access to significant resources which consumers and competitors may not have. Postwatch highlight that any appeal against the levy of a penalty would be held in front of a court and is therefore both fair and public.
- 2.27 The DTI drew our attention to the Guidance to Groups on Procedures issued by the Chairman of the Competition Commission. This Guidance sets out the circumstances where Groups (of that Commission, conducting investigations) should consider holding public hearings. It also points out

that a Group which holds such a meeting should not include in the agenda anything which would require the provision of confidential information.

- 2.28 Postcomm thinks that this is a very difficult area, in which regulatory practice is developing, as indicated by the relatively recent Competition Commission Guidance to Groups. Postcomm agrees with Postwatch that the question must be considered on a case by case basis. Adherence to good regulatory practice in line with Postcomm's expected code of practice will mean that Postcomm's approach may change over time to reflect changes in best practice.
- 2.29 Following reflection on the points that have been made, changes have been introduced to the statement of policy to clarify the stage at which any hearing might be held and to state that Postcomm will consider whether it should be in public. Postcomm's consideration of this question will take into account the need for speed of investigation (a hearing can accelerate the process, but a prolonged public hearing can cause delay) and for regulatory transparency, the likely level of interest from third parties and the general public and whether confidential information needs to be considered in the hearing.
- 2.30 Postcomm thinks that it is important to make clear that its purpose in suggesting a hearing is to facilitate the investigation process that it has to undertake to establish the facts on which to base its decision as whether or not there has been a licence breach. There is a subsequent statutory process for making representations on any proposal to impose a penalty which, as Postwatch has pointed out, is open to formal legal challenge which is a public process. Postcomm is not seeking to extend that process.
- 2.31 Postcomm agrees with Postwatch that there needs to be a written process to identify the issues to be considered at a hearing. This is vital to ensure that hearings are well managed and conducted in a timely manner. There also is likely to be a written process to deal promptly with issues unresolved at a hearing. Third parties' questions could be accommodated to some extent through these processes. However, the possible hearings that Postcomm

has in mind would be part of an investigation process which it is conducting with a view to considering taking enforcement action and not a process to resolve the respective interests of a licence holder and another party. Postcomm therefore thinks that it would not be appropriate to use such hearings to provide others with the opportunity to question the licensee.

- 2.32 In the light of the representations that have been made, Postcomm has modified its proposed statement of policy –
- o to make it clear that it is proposing hearings as part of its investigation process to establish whether or not a licence condition has been broken, rather than as contributing to its decision as to the amount of a penalty after establishing a breach, and
 - o to include a specific reference to considering whether hearings should be in public.

The imposition of penalties – availability of final or provisional orders and penalties

2.33 Postcomm suggested in the consultation paper that the decision on whether to impose a financial penalty is closely bound up with the decision on whether or not to make a final or provisional order in relation to the same breach of licence condition.

2.34 Postwatch argued forcibly that there is no reason why the issue of an enforcement order should have any impact on the decision about whether to impose a financial penalty. The purpose of an enforcement order is to bring an ongoing breach to an end. The purpose of a penalty, in Postwatch's view, is mainly to act as a deterrent and to promote competition. The issue of an enforcement order should not dilute the case for a penalty. Consignia believe that both Postcomm and the licensee should see a financial penalty as an incentive to compliance rather than as something with a punitive effect.

- 2.35 This is another difficult question, and Postcomm has found it helpful to review the approach to the imposition of penalties under the Competition Act 1998 to decide its approach. The powers to impose penalties under that Act are not constrained by any statutory duties such as those which Postcomm is required to further. The Director General of Fair Trading has not felt it necessary to qualify the extent to which penalties under the Competition Act 1998 may be used to punish and deter. However, sectoral regulators in energy, water and telecomms, in being given concurrent jurisdiction under the Competition Act 1998, have had their statutory duties dis-applied. This is necessary in order for them to be able to adopt the same approach as the Director General of Fair Trading.
- 2.36 Postcomm, in applying the penalty regime under the Act, has to have regard to its statutory duties. There is no dis-application of them. Postcomm sees the strength of Postwatch's representations in respect of deterrence and the promotion of competition. Postcomm has modified its proposed statement to make reference to deterrence (competition is a statutory duty mentioned elsewhere in the statement). But Postcomm has difficulty with the concept of completely detaching any penalty decision from an enforcement decision in relation to the same licence breach. Postcomm has to act reasonably in the contexts of the Act under which it is established and of the requirements of public administrative law. If its actions as a whole in relation to an event are not reasonable it will be open to challenge in relation to each decision within the whole.

Other factors and thinking on the imposition of a penalty

- 2.37 The DMA believe that Postcomm should additionally consider the possibility that no action should be taken where a breach has occurred but it is unlikely that this will recur or continue. The DMA also suggest that the concept of a "trivial" breach needs further explanation, and that use of this term could demean the licence.

- 2.38 Postwatch agree that where a breach is trivial, a penalty would normally not be appropriate, but suggest that a clear explanation of why this is the case should be made available. However, if a trivial breach recurs then it may be appropriate to impose a financial penalty to ensure future compliance.
- 2.39 Postcomm recognises the possibility of taking no action in relation to a licence breach. Postcomm also recognises the need to explain such a decision, especially if the conduct of enquiries has been announced. This is a matter of good practice and for that reason does not need specific mention in the proposed statement. However, Postcomm would not expect to make a statement in relation to an issue which it decided not to take forward at the vetting stage.
- 2.40 Postcomm agrees that the reference to trivial breaches of licence conditions is not very helpful and has removed it from the statement of policy. The alternative would have been to seek to provide a definition of triviality, something that is more difficult than it appears at first sight and involves the risk of a definition that proves inappropriate in the circumstances of a particular case.
- 2.41 The DMA further suggested that Postcomm should consider whether the imposition of a financial penalty will change the behaviour of a licence holder and whether it should increase the penalty or revoke the licence if it does not think that changed behaviour will result. The Act does not provide for the increase of penalties once notice of them has been given. Revocation of licences raises a range of issues beyond the scope of this decision document, except to comment that it can cause as many problems as it solves, not least to customers. However if there was no inclination on the part of a licence holder to alter its behaviour, then further breaches are likely to occur. Postcomm has already proposed the inclusion of similar past breaches of licence as an aggravating factor when determining the amount of a penalty and thinks that this meets the point raised by the DMA.

- 2.42 A key consideration for the CWU is the labour intensive nature of the postal industry and the possible consequence that the imposition of penalties might have for industrial relations if they were seen to threaten Consignia's ability to provide secure employment or fair conditions of service. The CWU concludes that financial penalties should be a last resort, used only when all other measures have been tried and have failed. In the case of Consignia, the CWU would stand ready to be part of any resolution process and would welcome discussion with Postcomm before any consideration was given to the imposition of a penalty. Consignia also raises an industrial relations concern that financial penalties do not cause a perverse outcome, in particular that financial penalties do not become tools used by either party during an industrial dispute.
- 2.43 Postcomm is aware of the sensitivity of postal services to industrial action. Postcomm appreciates the suggestion by the CWU to be part of a resolution process but thinks it gives rise to the risk of Postcomm being drawn into the management of Consignia. There also is a risk, if industrial relations issues are an issue for specific consideration in relation to financial penalties, that companies that have achieved good industrial relations might be treated more harshly than those which have not. Postcomm concludes that that it would not be appropriate to allow industrial relations considerations to have specific and recognised influence in its financial penalties policy.
- 2.44 Consignia believe that penalties should not be applied where an infringement was inadvertent or accidental. Postwatch suggests that there are three broad levels of intention with regard to licence breaches: intentional, negligent or innocent. Their view is that most breaches would arise as a result of negligence and this should be taken as the normal standard. It would be exceptional for a breach to be innocent. In particular, it should not be possible for management to claim that matters are out of their control, such as industrial action or lack of knowledge at a senior level. If Postcomm can show that there was deliberate intention, then enhanced penalties should apply. Postwatch takes the view that the

presumption should be that breaches should be penalised unless there are good and obvious reasons for not doing so.

- 2.45 We do not share Postwatch's view that any form of presumption should apply: Postcomm cannot fetter its discretion and must treat cases on their merits. Apart from this point we do not see that there is a great deal separating Postwatch and Consignia on this issue and do not propose to change the proposed statement in relation to it.
- 2.46 The DMA suggested that in deciding whether or not to impose a penalty, Postcomm should consider the effect on the marketplace and clients and suppliers to the postal service market of the licence breach, as the breach may have financial implications and/or distort the competitive market. The FEI also thought that competition was important, suggesting that penalties should only be applied for anti-competitive behaviour, since imposition of a financial penalty for failure to reach a performance standard or service standard is likely to be counter productive. The DMA also suggest that Postcomm should take account of whether the imposition of a financial penalty will change the behaviour of the licensee. If Postcomm does not think changed behaviour will result, then it should consider an increased penalty or revocation of the licence.
- 2.47 Postcomm regards the promotion of effective competition as just one of a number of matters covered by licences. It is difficult to see how restricting penalties just to breaches of the conditions relating to competition or having an effect on competition can be consistent with Postcomm's consumer duty, although Postcomm is well aware of the possibility that penalties may prove counter-productive. The link between penalties and burdens imposed on other persons in the market is considered below in relation to the level of financial penalties, as is the possibility of change in the licensee's behaviour following the imposition of a financial penalty.

Price controlled and state owned companies

- 2.48 The CWU expressed concern that Postcomm has not shown an adequate understanding of the different nature of this regulated industry and of the limited role that penalties are likely to play in practice. The key issue in this context is the government ownership of Consignia, and the expectation from government of a particular financial dividend. The CWU is concerned that a financial penalty could not be imposed by Postcomm on Consignia without placing at risk Consignia's ability to pay the dividend to the Treasury.
- 2.49 The DMA support an approach which makes no exception for the treatment of price controlled and government owned companies. They suggest that if a financial penalty was imposed on Consignia and the Treasury sought to protect its dividends, this would be open to challenge from users and other member states. The DMA's view is that any protections or ring fencing would distort the market and competition. The FEI also saw no reason to treat price controlled companies any differently from others.
- 2.50 Consignia expressed concern about the apparent interdependency between the price control regime and the levying of a financial penalty. They saw the consultation document as alluding to a situation where the licensee will be faced with an approach to the price control which moves away from that adopted elsewhere by regulators and that Consignia will be unable to outperform the price control that is set. Postwatch saw any request by Consignia for a price increase to recover a fine as wholly unacceptable.
- 2.51 As indicated in the consultation paper, Postcomm consider it inappropriate to relieve the main provider of postal services from the enforcement powers in the Act. Consignia's ability to pay the expected dividend to the Treasury is not a matter for Postcomm and should not influence the consideration on whether to impose a financial penalty.
- 2.52 The reference in the consultation paper to financial penalties being followed by a request for a price increase was not intended to suggest a

regime where Consignia will be unable to outperform its price control. It merely reflected the facts that Postcomm has finance and universal service duties, that financial penalties are a cost and that there may be circumstances in which Consignia's financial position is such that it is able to apply for a price increase under the terms of its licence. Whether an application would be successful would be for consideration in the light of circumstances when it is made.

2.53 Postcomm recognises Postwatch's view and thinks that when a financial penalty has to be imposed it should be felt, in the first instance, by the licence holder in reduced profits. The penalty then might impact on shareholder in reduced dividends. The expectation must be that a penalty should not be passed on to customers (some or all of whom may have suffered from the licence breach that gave rise to the penalty) in higher prices. Whilst having this expectation in mind, Postcomm nevertheless must be guided, in each case, by its statutory duties.

2.54 On balance, after considering the comments that have been made, Postcomm but sees no need to change its proposed statement of policy in response to them.

The amount of a penalty – statutory and background factors

2.55 Consignia accepts that the use of turnover to determine the level of any penalty seems reasonable, but contend that it is important to recognise the small profits in the postal services. Consignia has requested Postcomm to stipulate comprehensively the proposed relationship between the size of any contravention and turnover percentage. Consignia also suggests that if there is a contravention in one geographical area, region or product area, then any penalty should take into account the turnover in that area/region or product area rather than the UK as a whole or the whole product range.

2.56 Consignia was concerned that any penalty should not be equated with the legal issue of economic loss, as this is a separate issue and not relevant to the financial penalty regime. Consignia outlined the difficulty in estimating

the amount of burdens imposed on others as a result of a breach of a licence condition.

- 2.57 Postcomm recognises the level of profitability in postal services but otherwise does not accept these points. In particular Postwatch thinks that it is impracticable to seek to determine “the size of any contravention”. For reasons explained below, Postcomm’s approach is to use turnover as a check on penalties, with the starting point being an assessment of the financial benefit obtained by the licence holder and the burden imposed on others as a result of the contravention of the licence condition. Postcomm does not see insuperable practical difficulties in assessing the extent of the burden imposed on others.
- 2.58 Postwatch noted Postcomm’s view that the imposition of financial penalties must further Postcomm’s statutory duties and that these duties include furthering the interests of users wherever appropriate by promoting effective competition between postal operators. It argued that penalties are pro-competitive as they can be used to ensure that one licensee does not gain any financial advantage over other licensees through non-compliance with its licence. The logic of this approach implies that it is appropriate for Postcomm to take as its starting point for deciding the amount of a penalty both the benefit received by the licence holder in breach and the burden imposed on other operators, as Postcomm proposed.
- 2.59 The FEI agreed that the approach should be to start from a point of benefit gained plus burden imposed on others. They suggest that where parties have suffered as a result of anti-competitive behaviour, a portion of the penalty should be paid over as compensation.
- 2.60 Consignia argued, by contrast, that penalties must be “proportional”, a term which it defined as “a level that is just sufficient, and no more, to incentivise a licensee to comply”. It suggested that Postcomm consider a sliding scale of penalties set out in advance that provides the proper economic signals to comply, which would incentivise the licensee and improve service. Consignia’s response suggests that this means that the

penalty should be related mainly to the benefit to the offending licensee. If this logic were followed, a breach that imposed severe costs on competitors, without conferring any direct financial advantage on the licence holder in breach, would attract no penalty. This seems inappropriate. If Postcomm does not consider both benefits and burdens, it will create a perverse incentive to behaviour that benefits a licence holder in breach of his licence by making life difficult for others, rather than by making immediate profit for himself.

- 2.61 In the light of these responses, Postcomm has amended paragraph 14 of the draft statement to make it clear that its starting point for penalties will be a general consideration of the financial benefit obtained by the licensee and the burden imposed on others as a result of a licence contravention, rather than the sum of these estimates. The reason for this change is that very significant benefit may be obtained quite indirectly from a licence contravention, for example if its effect is to put a competitor out of business. This benefit may continue to accrue after the breach of the condition has ceased. To emphasise this point, two bullet points have been added which make clear the reasons for a consideration of the financial benefit obtained by the licence holder and of the burden imposed on others being Postcomm's starting point for assessing penalties.
- 2.62 Postcomm found Consignia's reference to proportionality to be interesting and helpful. The concept of proportionality originates in EU law, but it now has general acceptance in the UK. For that reason it is something to which Postcomm must have regard and which it is appropriate to mention in the statement of policy. If proportionality is ignored, there is a clear reason to appeal a penalty decision by Postcomm.
- 2.63 The concept of proportionality has not been an obvious restraint on the European Commission in the imposition of financial penalties on persons found to be in breach of EU competition law. This may be because the principle is not exactly as Consignia has expressed it. In Postcomm's view it is better expressed as a requirement that the measure in question must

not be excessive by reference to the purpose for which it is adopted. Given the competition element of Postcomm's duties, Postcomm thinks that consideration of burdens imposed on others as well as the benefit gained by the licence holder in breach is consistent with the principle of proportionality.

- 2.64 A reference to proportionality therefore has been included in the statement, in the section setting out the final checks to be made before a decision on a penalty is taken (paragraph 17, first bullet).
- 2.65 Postwatch recognised that Postcomm needs to ensure that activities authorised or required by licences can be financed, but are concerned about the interpretation of the "ability to finance". Postwatch's view was that medium term cash flow, rather than profitability, should be the key test, so avoiding any impact of a short term loss.
- 2.66 Postcomm agrees that short term lack of profitability and the need to maintain dividends should not be significant factors in determining penalties in relation to a company with adequate medium term cash flow. However Postcomm has to work within the restrictions of its universal service and finance duties and it cannot, as a matter of policy, disregard lack of profit and factors that affect a company's ability to raise capital.

Aggravating circumstances

- 2.67 Taking into account aggravating factors in arriving at the level of a penalty was generally accepted by all respondents. The DMA suggested that a number of additional aggravating factors should be taken into account, including –
- where the breach had been highlighted and actioned by another licensee and was common knowledge,
 - where the damage to other parties is substantial and the licensee had been advised of such, and

- obstructive behaviour/delaying/stalling tactics during the investigation.
- 2.68 Postcomm thinks that the existing wording of the proposed statement of policy is broad enough to cover these issues.

Mitigating circumstances

- 2.69 Consignia suggests that it is important to include influences that are outside the licensee's control, such as force majeure, and circumstances that are outside or beyond management control. Postwatch recognised the possibility of exceptional circumstances provided that they did not encompass matters which management might claim were outside their control such as strikes or lack of knowledge at senior management level.
- 2.70 Postcomm thinks that two issues need to be distinguished –
- matters that are totally outside a licence holder's control, for example an earthquake or flood, and
 - matters which are substantially outside its control, but where, through contingency planning, it has an element of control over the consequences, for example a disruption to rail services.
- 2.71 Postcomm sees the former as a reason for not imposing a penalty at all and the latter as a mitigating factor. The statement of policy has been amended to reflect this view. Postcomm regards industrial action among Consignia's workforce as within its control.
- 2.72 The DMA suggest three additional factors –
- where the breach was a matter of interpretation,
 - where Postcomm's previous advice to the licensee had affected his actions, and
 - where the licence holder was acting in the best interests of customers and clients.
- 2.73 Postcomm thinks that the first of these points substantially is covered by two changes it is introducing to the statement. The first of these is the introduction of an appropriateness criterion for the decision to impose a

penalty. The second change is the introduction of clear lack of intent as a mitigating factor in relation to the amount of a penalty, when it has been decided that a penalty will be imposed. DMA's proposal of an additional mitigating factor where advice from Postcomm had affected the licensee's actions is accepted. It has been incorporated into the statement of policy as a provision referring to advice from any authority having a role in postal regulation: the Office of Fair Trading and the European competition authorities have a role as well as Postcomm.

- 2.74 Postcomm has difficulty with a reference to "acting in the best interests of customers and clients": predatory pricing may be in the interests of some customers or clients for a time, but it cannot be condoned in a policy that applies to a dominant operator as well as to its competitors.
- 2.75 Postwatch criticised the inclusion of lack of knowledge at a senior level as a mitigating factor, taking the view that good management would mean that any substantive non-compliance would be known at senior levels. Postcomm thinks that this approach is correct. Indeed management that does not know what is going on in relation to issues that are the subject of licence conditions has to be seen as poor management. As proposed, Postcomm's policy statement could be seen as a factor that encourages abrogation of good management practice. Postcomm therefore has modified its statement of policy by the removal of a lack of knowledge as a mitigating factor. Postcomm also has reinforced knowledge of a breach of licence as an aggravating factor: it will look at the organisation as a whole, rather than considering only lack of knowledge at a senior level.
- 2.76 Consignia submitted that due account must be taken of any compensation that may have been paid or will be paid to postal users. Postcomm agrees that this is a mitigating factor and has adjusted the statement of policy to refer to it.

Payment of penalties by instalments

- 2.77 The DMA agreed that the instalment proposals are sensible, but said that they should not be used as a means of off-setting the full impact of the penalty. Postwatch believes that such an option should be considered on a case by case basis.
- 2.78 Postcomm accepts these views but does not think that the statement needs amendment in response to them.

A final check

- 2.79 Consignia referred to the section of the consultation paper which says that Postcomm “is of the view that it should not be sympathetic to the plight of an individual licence holder in cases where the contravention in question is damaging to the ability of licence holders as a whole to finance the efficient performance of the activities authorised or required by their licences”. Consignia makes the assumption that this statement refers to its access condition and expresses surprise at it, in view of the principles and agreements that will apply.
- 2.80 Postcomm did not specifically have Consignia’s access condition in mind when framing this section of the consultation paper. Postcomm was seeking to make the general point that no individual licence holder should expect to be able to seek protection from penalties by virtue of section 5(4) of the Act if they themselves have imposed on others costs which prejudice their ability to finance their businesses.

Other points

- 2.81 Consignia stated that the imposition of financial penalties is likely to be a relatively rare occurrence and that for this to be the case requires Postcomm to adopt an approach that is sensible, takes into account the costs involved (especially of any investigation) and properly incentivises the licensee, taking due account of mitigating factors.

2.82 Postcomm hopes that the imposition of financial penalties will indeed be a rare occurrence. Whether it is or not depends, in the first instance, on licence holders such as Consignia recognising the importance of the conditions in their licences and complying with them. It is through assiduous compliance, rather than action by Postcomm, that penalties will be rare.

3. Statement of policy

- 3.1 Postcomm's statement of policy in relation to financial penalties is set out in the following pages.
- 3.2 Changes from the draft policy set out in the consultation paper issued in July 2001 are indicated in bold typeface or by footnotes.
- 3.3 A copy of the policy without the indications referred to above is available on Postcomm's website or on request from Postcomm at the address shown in Chapter 1.

POSTCOMM

The Postal Services Commission

Statement of Policy in relation to Financial Penalties

Introduction

1. The Postal Services Act 2000 (the Act) provides that the Postal Services Commission (Postcomm) may impose financial penalties on holders of licences granted under the Act who contravene the conditions of their licences¹.
2. The Act stipulates that the amount of such penalties must be reasonable and that it must not exceed 10% of the turnover of the licence holder, determined in accordance with an order made by the Secretary of State².
3. The Act requires Postcomm to prepare and publish a statement of policy in relation to the imposition of penalties and the determination of their amount and to consult the **Consumer Council for Postal Services** (Postwatch) and such other persons as Postcomm considers appropriate when preparing or revising its statement of policy³.
4. Postcomm must have regard to its most recently published statement of policy in deciding whether to impose a penalty and in determining the amount of any penalty.⁴
5. This statement is the statement of Postcomm prepared in accordance with, and for the purposes of, the provisions of the Act on financial penalties.

¹ Section 30(1).

² Section 30(2) and the Postal Services Act 2000 (Determination of Turnover for Penalties) Order 2001.

³ Sections 31(1) and (5).

⁴ Section 31(2).

Code of Practice on the discharge of Postcomm's functions

6. **In exercising its functions in relation to financial penalties, Postcomm will act in accordance with any code of practice, or reasonable proposal for a code of practice, it has published or adopted from time to time for the discharge of its functions⁵, insofar as adherence to that code or proposal is consistent with this statement of policy.**
7. **A code of practice for the discharge of Postcomm's functions may require Postcomm, among other things, to follow best regulatory practice.**

Receipt of complaint, investigation and procedure

8. Postcomm will endeavour to ensure that any decisions it takes in relation to financial penalties are –
 - o soundly based in fact, and
 - o reached in a manner that is procedurally fair.
9. To achieve this aim, Postcomm will –
 - o **satisfy itself that it has good reason to conduct enquiries or to commence any other action that may lead to a proposal to impose a financial penalty,**
 - o seek always properly to investigate allegations or suggestions before deciding whether it is appropriate to consider the imposition of financial penalties and in due course to impose them, and
 - o follow and apply the procedural requirements of the Act in relation to the proposing and making of penalties⁶.
10. In addition **to the procedural requirements in the Act**, Postcomm will seek, **in each case**, to –

⁵ A code of practice for the discharge of Postcomm's functions is required to be established and updated under section 50 of the Act.

⁶ Sections 32, 33(1) to (3) and 34.

- give the licence holder in question a sufficient indication of the nature of the matter complained of, in order to be able effectively to respond to it,
- **announce that is conducting enquiries into that matter, unless, in the circumstances of the case, it appears inappropriate to do so,**
- give the licence holder an indication of –
 - the facts that Postcomm is minded to rely on, and
 - the conclusion Postcomm is minded to reach as to the occurrence of a licence contravention, ⁽⁷⁾
- give the licence holder the opportunity for a hearing of these issues before a ⁽⁸⁾ decision is taken **to propose a penalty,**
- **consider whether, in the circumstances of the case, it is appropriate for any such hearing to be conducted in public,** and
- when notifying the licence holder of a penalty remind him of the provisions of the Act as regards –
 - the specification of different dates for payment⁹,
 - variation of penalties¹⁰, and
 - appeals¹¹.

Postcomm's duties

11. The imposition of financial penalties is a function that Postcomm is required to exercise in accordance with its statutory duties. These duties may be summarised as: to exercise its functions –

- in the manner which it considers is best calculated –

⁷ Deletion of “and the decision Postcomm is minded to take as to the imposition of a penalty and its amount”.

⁸ Deletion of the word “final”.

⁹ Section 32(5).

¹⁰ Section 33.

¹¹ Section 36.

- to ensure the provision of a universal postal service¹²,
- subject to that to further the interests of users of postal services wherever appropriate by promoting competition¹³ and having regard to the interests of specified vulnerable customer groups¹⁴, and
- subject to the above to promote efficiency and economy on the part of postal operators¹⁵, and
- with regard to the need to ensure that licence holders are able to finance the activities authorised or required by their licences¹⁶.

The imposition of a penalty

12. In order to decide whether it should impose a penalty Postcomm first will satisfy itself either –
- that there has been a contravention of a licence condition, or
 - that there is a contravention of a licence condition¹⁷.
13. Postcomm then will consider whether it is appropriate to make a penalty, having regard to –
- whether **or not** the contravention is **or was** serious¹⁸,
 - whether the imposition of a penalty will further Postcomm’s statutory duties, (¹⁹)

¹² Section 3.

¹³ Section 5(1).

¹⁴ Section 5(2).

¹⁵ Section 5(3).

¹⁶ Section 5(4).

¹⁷ Section 30(1).

¹⁸ Reference to a breach being “trivial” removed because of concerns as to its definition. But Postcomm would expect, for example, not to seek to impose financial penalties in relation to issues such as the delivery out of time by a day of a routine report.

¹⁹ Deletion of “whether other action that has been taken suggests that a penalty is not necessary to further Postcomm’s statutory duties”.

- **whether the nature of the contravention is such that it is particularly appropriate to impose a penalty, including that the contravention was intentional or negligent, and**
- **whether the nature of the contravention or the circumstances of its occurrence are such that it is not appropriate to impose a penalty, for example where the contravention arose from circumstances entirely beyond the control of the licence holder.**²⁰

The amount of a penalty

14. In deciding the amount of a financial penalty, Postcomm will first consider the financial benefit obtained by the licence holder and the burden imposed on others as a result of the contravention of the licence condition. **A consideration of** these estimates will be Postcomm’s starting point for deciding the amount of any penalty **with a view to ensuring that –**
- **infringement of licence conditions confers no benefit on the infringing licence holder in terms either of profits made by it or of costs imposed on competitors, and**
 - **the incentive to continuing compliance provided by the possibility of a financial penalty is realistic, reasonable and proportional in relation to the gains that may arise, directly or indirectly, from non-compliance.**
15. Postcomm will increase its starting figure for aggravating factors such as –
- clear knowledge (²¹) within the licence holder of the fact or likelihood of contravention of the licence,
 - failure to heed any warnings received by the licence holder that it was contravening its licence,
 - failure to co-operate with Postcomm’s investigation,

²⁰ It is likely that Postcomm would regard industrial action within a licence holder’s workforce as within the licence holder’s control.

²¹ Deletion of “at a senior level”.

- persistence with the contravention even after the start of Postcomm’s investigation,
 - similar contraventions having occurred previously.
16. Postcomm would decrease the starting figure for mitigating factors such as – ⁽²²⁾
- **the contravention being clearly unintentional,**
 - **the contravention occurring for reasons substantially beyond the control of the licence holder²³,**
 - a speedy positive response to warnings of possible contravention,
 - co-operation with Postcomm’s investigation,
 - any genuine lack of clarity as to whether a contravention was occurring or likely to occur,
 - **reliance by the licence holder on advice given by an authority having a role in the regulation of postal services,**
 - **the licence holder having taken steps to compensate persons affected by the contravention.**
17. **Postcomm may have regard to the need to deter similar breaches of licence by other postal operators.**
18. Postcomm then will –
- review the resulting figure generally with a view to considering whether it is reasonable²⁴ **and proportional in the circumstances of the case,**
 - ensure that the penalty is within the 10% of turnover limit²⁵,
 - consider whether the penalty should be paid by instalments, and

²² Deletion of “a lack of knowledge at a senior level within the licence holder of the fact or likelihood of contravention”.

²³ It is likely that Postcomm would regard industrial action within a licence holder’s workforce as within the licence holder’s control.

²⁴ Section 30(1).

²⁵ Section 30(2).

- reconsider whether its decision overall as to the imposition of a penalty and its amount and the manner of its payment will further its statutory duties.

Revision of policy statement

19. Postcomm will consider revising this statement of policy in the manner provided in the Act²⁶ in the light of experience in its application and on receipt of a request that it be reviewed from Postwatch or any other person having an interest in it.

²⁶ Section 31(5).