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OFFICE OF RAIL REGULATION

To railway operators, funders and other respondents to our 'role of the regulator' consultation

14 May 2012

Changing our penalties statement

In our 'role of the regulator' consultation with DfT in December 2011 we asked for your views about whether we should change our enforcement policy[1]. In particular, we asked if we should consider accepting commitments to make improvements for passengers as an alternative to levying a penalty ("reparations"), where we find a penalty to be appropriate.

Virtually everyone who expressed a view thought we should be prepared to do this as it would bring a much more immediate and tangible benefit to passengers and other customers than a financial penalty and could benefit the railway in the long-term. Passenger Focus, London TravelWatch and Transport Scotland were strongly supportive and the independent consumer organisation Which? noted arrangements for redress were important alongside prompt, transparent action to remedy a failing. One train company pointed out the DfT already sometimes accepted such commitments and it would be a retrograde step to lose that flexibility for any activity where oversight transferred from DfT to ORR. Several pointed out it would be important to be clear what alternative commitments were accepted and to make sure they were delivered.

Given this broad consensus and our commitment to a sharper focus on customers, we agree we should change our policy. I attach an annex with more detail and a mark up of how we could do this. If you have any comments about this detailed wording, please send them to Sukhninder Mahi at sukhninder.mahi@orr.gsi.gov.uk by Monday 11 June 2012.

Subject to considering your views, we plan to make these changes later in June.

Yours sincerely

John Larkinson

[1] See page 17 of http://www.rail-reg.gov.uk/server/show/ConWebDoc.10746.

INVESTOR IN PEOPLE

Detailed proposals

Our enforcement policy already allows us to take account of reparations made when setting a penalty but only if the reparations are made unconditionally (so, for example, without knowing how we will treat them). We have also said we would be unlikely to reduce a penalty "£ for £" to reflect reparations made after we had proposed a penalty. Taken together these conditions have meant there has been little incentive to make reparations and in practice none have been made.

We therefore propose to make two main changes to our policy statement. Firstly, we will remove the requirement that reparations must be offered unconditionally. Secondly, we are prepared in principle to reduce a penalty '£ for £' to reflect reparations offered where appropriate. The annex shows how these changes would be reflected in the section of our enforcement policy that deals with penalties.

These changes will give us more flexibility to accept reparations in lieu of a financial penalty than we have now. We also expect they will make it more likely an operator will offer to make good the harm brought about by a breach of its licence obligations as an alternative to paying a financial penalty. They should incentivise compliance and change future behaviour no less than a penalty without reparations would, but with the added advantage that operators will be actively encouraged to think directly about the impact they have had on their customers and their customers' needs. The change would be consistent with the approach set out in the Macrory report[2] 'Regulatory Justice: Making Sanctions Effective', and in particular with the principle that penalties should aim to restore the harm done by non-compliance.

We are not proposing to change any other aspect of our penalties policy. We will still need to be satisfied that reparations offered are genuinely 'extra', which could mean they are wholly new benefits or the bringing forward of benefits originally planned for later. We will also need to ensure they are enforceable. How we do this will depend on the particular situation. For example, we may be able to treat the commitments made as a "reasonable requirement" under the terms of a licence condition, or we may look to reflect the reparations offered explicitly in a penalty notice.

[2] See http://www.berr.gov.uk/files/file44593.pdf.

These changes would also bring us more into line with the approach adopted by other regulators. For instance, on 9 March 2012 Ofgem accepted an energy company's offer to invest £4.5m to help vulnerable customers and consequently reduced a penalty for breach of marketing rules to £1.[3]

Similarly, the OFT recently consulted[4] on changing its penalties guidance including the way it handled certain aggravating and mitigating factors. Among other things, it sought views on whether it would be appropriate to include as an illustrative mitigating factor a situation where an undertaking has paid, or agreed to pay, compensation to those who have suffered loss due to the infringement of competition law. The OFT has not concluded its review yet, but we note its consultation recognises that such an approach may encourage those it is taking enforcement action against to commit to providing redress (although, in the event, the OFT consultation proposed whether to treat compensation as a mitigating factor would be decided on a case by case basis rather than being an illustrative mitigating factor in its guidance).

We welcome comments on our proposals. Please send your comments to Sukhninder Mahi at sukhninder.mahi@orr.gsi.gov.uk by 11 June 2012. We would prefer you to send your comments by email. However you can also post comments to:

Sukhninder Mahi
Licensing and Network Regulation Team
Office of Rail Regulation
One Kemble Street
London
WC2B 4AN

If you would like your comments, or any part of them, to be kept confidential please say so clearly. Otherwise we will publish the responses on our website in full.

ORR
14 May 2012

[3] Details of Ofgem's decision are available at: http://www.ofgem.gov.uk/Media/PressRel/Documents1/EDF%20press%20notice%20March%209%202012.pdf

[4] Full details about the OFT's October 2011 consultation are available at - http://www.oft.gov.uk/OFTwork/consultations/penalties-guidance/

Penalties statement

1. Section 57B of the Railways Act 1993 (the Act) (introduced by section 225 of the Transport Act 2000) requires ORR to "prepare and publish a statement of policy with respect to the imposition of penalties and the determination of their amount". Related turnover regulations made by the Secretary of State under the Transport Act 2000 [1] became law on 3 August 2005.

2. Under section 57B of the Act ORR must undertake appropriate consultation in preparing the statement of policy. We consulted on this policy in November 2005, October 2007, ~~and~~ October 2008 and May 2012.

3. This penalties statement relates to licence enforcement under the Act and covers both the levying of a penalty (under section 57A(1)) and the inclusion of a reasonable sum (under section 55(7A)) in an individual enforcement order. References to a penalty should be understood to apply equally to a reasonable sum, where the context permits. Penalties under the Competition Act 1998 are governed by statutory guidance on penalties, issued by the Office of Fair Trading,[2] and associated turnover regulations.[3]

4. We must have regard to the statement in deciding whether to impose penalties and in determining their amount. Any penalties in relation to licence breaches are paid to the Secretary of State for Transport.

5. ORR can impose a penalty if it is satisfied that a licence holder has contravened or is contravening a relevant condition or requirement or a final or provisional order. This means that we can impose a penalty for a past or current breach, irrespective of whether we have made an enforcement order or not. The maximum penalty we may impose is 10% of turnover, as defined in the turnover regulations.

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1 The Railways Act 1993 (Determination of Turnover) Order 2005, SI 2005/2185.

2 OFT 423, Guidance as to the appropriate amount of a penalty, 21 December 2004.

3 The Competition Act 1998 (Determination of Turnover for Penalties) Order 2000 (SI 2000/309) (as amended by the Competition Act 1998 (Determination of Turnover for Penalties) (Amendment) Order 2004 (SI 2004/1259)).

Is a penalty appropriate?

6. In deciding whether a penalty is appropriate we shall take full account of the particular facts and circumstances of the contravention, including any representations and objections made to us, and shall act in a manner best calculated to fulfil the duties placed upon us by section 4 of the Act. We shall take account of the six penalty principles set out in the Macrory report[4] 'Regulatory Justice: Making Sanctions Effective' and the related five principles of good regulation: proportionality, targeting, consistency, transparency, and accountability.

7. Our primary objective in setting a penalty is to change the future behaviour of an offender so as to deter non-compliance with its obligations (both specifically and in general). We also aim to incentivise others subject to similar obligations to comply with them.

8. The legal status of the licence holder (for example, whether it is a publicly listed company, an unlisted company or a company limited by guarantee) and any dependency on public funds of itself will not influence a decision whether to impose a financial penalty.

Calculating the amount of a penalty

9. When assessing the amount of a penalty ORR is likely to consider a number of factors falling into three categories:

   (a) proportionality;

   (b) adjustments for mitigating and aggravating factors; and

   (c) financing duty.

Proportionality

10. A penalty should be proportionate to the seriousness of the breach. In some cases, this may lead to no penalty being required. In other cases the potential penalty may be substantial.

[4] Available at http://www.berr.gov.uk/files/file44593.pdf

11. We will take into account that levying a financial penalty has both a financial effect and a reputational effect, and that both of these are capable of being powerful.

12. In setting a penalty, our starting point will normally be the seriousness of the offence. In considering seriousness, we will look at:

- The actual and potential harm caused to third parties including passengers and other railway users, and to the public interest purpose of the obligation (including to the effectiveness of the regulatory regime); and
- The culpability of the offender, including whether the licence holder has acted negligently, recklessly, knowingly or intentionally.

13. We distinguish five levels of seriousness of breaches of licence. These are: technical or de minimis, less serious, moderately serious, serious and very serious. We have developed a corresponding financial range for each level of seriousness in respect of breaches by Network Rail. The aim of this is to help us determine, in the case of a breach by Network Rail, the starting amount for a penalty to which the other factors in this statement might then lead us to make adjustments.

14. If a penalty is to be proposed the likely levels and corresponding financial ranges for a breach by Network Rail are given below. As we consider the particular facts and circumstances of each individual case we may consider it appropriate to deviate from this. The numbers in brackets in column two show the range as a percentage of Network Rail's annual turnover. Column three gives examples of the sorts of breaches that might fall into each level.

15. The highest range given of £25m + is limited only by the legal maximum of 10% of turnover (around £500m in the case of Network Rail).

16. In relation to a smaller licence holder, the starting penalty would normally be lower than the figures given above for Network Rail, though not necessarily reduced pro-rata to turnover. Our aim would be to reflect the particular circumstances of the licence holder, and to achieve the same impact and degree of incentivisation that would apply in Network Rail's case for breaches of a similar level of seriousness.

Seriousness of breach	**£m (% of turnover)**	**Example**
Technical or de minimis	Usually no penalty	A breach falling into this category would probably involve no, or very little, culpability on Network Rail's part, or cause no harm or potential harm to third parties. An example of a case that would have been likely to fit under this category, if it had existed at the time, is Network Rail's unauthorised disposal of land at East Grinstead, which occurred in 2006. This breach did not cause any significant harm and involved very limited culpability on Network Rail's behalf.
Less serious	Up to £2m (up to 0.04%)	Network Rail's failure to publish accurate information about network capability, for which ORR imposed a penalty on Network Rail in April 2006. This breach was less serious because it related to a relatively small number of routes and to the difference between published and actual capability, rather than a failure to maintain capability. It was not technical or de minimis because it had more serious implications for the industry, including potentially impacting on freight customers' ability to plan their businesses.
Moderately serious	£2 – 10m (0.04% – 0.2%)	The breach arising from Network Rail's planning and execution of the Portsmouth resignalling project in 2007. This led to real disruption for some train operators and passengers for several months and, if repeated, the breach could have had a greater impact on third parties and Network Rail's wider signalling programme. We did not consider it 'serious' because the problem was localised and a service (albeit reduced) was running.
Serious	£10 – 25m (0.2% – 0.5%)	Network Rail's continuing failure to properly plan and execute engineering projects that require possessions, for which ORR imposed a penalty on Network Rail in May 2008. This breach was serious because the problem was a systemic one and Network Rail had prior warning of the implications of not addressing it. The breach had manifested itself by causing a large impact on third parties over New Year 2008 and there was potential for further similar harm to be repeated if the problems were not addressed.
Very serious	£25m + (0.5% +)	A breach falling into this category might involve significant harm, or the risk of significant harm, being caused to a wide range of third parties and/or greater culpability on the part of the Network Rail, for example, where it was deliberately misleading.

17. We will take account of the principle that the starting penalty should be not less than any benefit for the licence holder from the breach.

Adjustments for mitigating or aggravating factors

18. We will adjust the starting penalty up or down to take account of relevant mitigating and aggravating factors, according to the particular facts and circumstances of each case. The appropriate adjustment will be a matter of judgement, taking previous cases into account for consistency. We will apply an overall adjustment reflecting the net effect of all the relevant mitigating and aggravating factors.

19. ORR may consider the following factors as mitigating or aggravating factors as appropriate:

(a) any steps which have been taken to rectify the breach, including whether these were initiated proactively by the licence holder or in response to ORR's actions;

(b) any steps which have been taken to minimise the risk of the breach recurring or the absence of internal procedures intended to prevent infringements occurring and the extent to which organisational weakness may result in repeated infringements of the same type by the same licence holder;

(c) any actions which have been or will be taken to make worthwhile restoration to those who suffered the consequences of the breach, where ~~the actions indicate a sincere admission of guilt or remorse, are taken unconditionally and~~ any committed expenditure is verifiably additional;

(d) the extent of involvement of directors or senior management in the action or inaction which caused the breach or their lack of appropriate involvement in action to remedy the breach;

(e) repeated or continuing infringement of this or other obligations, particularly if subsequent breaches occur after the licence holder becomes aware of, or is made aware of, the initial infringement; and

(f) co-operation with ORR's investigation or evidence that the licence holder attempted to conceal the infringement from ORR.

20. ~~We will consider mitigating actions falling into category (c) taken after a penalty has been proposed, but we are likely to give them less weight than~~

~~those taken before we propose to impose a penalty. In considering by how much a penalty could be reduced in recognition of such actions, we will be mindful of our primary objective to change the future behaviour of an offender. It is unlikely that any potential penalty would be reduced to zero on a "£ for £" basis for such actions as this would not be likely to achieve such an outcome. In addition, it should be noted that our statutory framework does not allow us to consider imposing alternatives to a financial penalty payable to the Secretary of State.~~

21. Other mitigating or aggravating factors may arise depending on the particular facts and circumstances of a specific case.

22. The net effect of all mitigating and aggravating factors may be significant. Potentially, taken together these adjustments could reduce a penalty to zero, or increase it several fold, in appropriate cases. A penalty on a licence holder may therefore be adjusted to be outside the range which determined our starting point.

Financing duty

23. When setting a penalty we will consider all our duties under section 4 of the Act.

24. In the cases we have had to date one relevant duty has been our duty to act in a manner that does not make it unduly difficult for a network licence holder to finance those activities relevant to our functions. However, we consider that this duty does not require us to protect a firm from its own inefficiency. In the event that ORR concludes, having regard to the particular facts and circumstances, that it would be appropriate to impose a penalty sufficient to change future behaviour or incentivise compliance, we consider it would be inappropriate not to do so just because this would make it difficult for an inefficient operator to finance its functions.

Reaching a conclusion

25. Having considered, to the extent appropriate, the factors listed above, ORR will determine an appropriate amount for a penalty. In doing so, we shall ensure that the amount determined does not exceed 10% of the turnover of the licence holder (as calculated in accordance with the turnover regulations) and that it is consistent with our statutory duties in section 4 of the Act. The imposition of a penalty is also subject to the procedural requirements set out in Annex B of this document. These require us to consult on a proposed penalty

and to take into account any representations that are made. Such representations may include offers of reparation.

Revision of the statement of policy

26. ORR may, from time to time, revise this statement, in accordance with section 57B(4) and (5) of the Act. This is the ~~first~~ second revision of the penalties statement published in April 2006.