

Holders of Gas and Electricity Supply Licences, DECC, Consumer Focus, consumers and their representatives and other interested parties

Our Reference: 107/13
Email: rmr@ofgem.gov.uk
28 June 2013

Dear Colleagues,

Implementation of the domestic Standards of Conduct –decision to make licence modifications

This letter notifies stakeholders of the Gas and Electricity Markets Authority's (the Authority¹) decision to proceed with licence modifications to the gas and electricity supply licences by amending Standard Licence Condition (SLC) 1 and inserting the new SLC 25C which introduces new mandatory Standards of Conduct (SOC). We are proposing to introduce the SOC as a binding licence condition because voluntary interventions through the existing SOC² have not, in our view, resulted in improved interactions between consumers and suppliers. The effective date for these modifications is on and from 00:00 on Monday 26 August 2013.

On 17 May 2013, the Authority issued a statutory consultation (the 'May consultation') on these proposed licence modifications. The full detail and rationale for these policies can be found in 'The Retail Market Review – Proposed licence modification of SLC 1 and insertion of new SLC 25C of the gas and electricity domestic supply licences' (80/13, 17 May 2013) consultation³ and 'The Retail Market Review – Final domestic proposals' (40/13, 27 March 2013) consultation.⁴ The deadline for representations on the modifications set out in the May consultation was 18 June 2013.

Policy overview of the Standards of Conduct

In the May consultation, we proposed new rules requiring all energy suppliers (and their representatives) to treat consumers fairly. Treating consumers fairly is a key part of our Retail Market Review (RMR) package of reforms, which also include proposals to provide clearer information to consumers and to simplify tariff choices within the retail energy market. The SOC are designed to improve the interactions and experiences consumers have with energy suppliers in order to increase levels of consumer trust in the industry and

¹ <http://www.ofgem.gov.uk/About%20us/Pages/AboutUsPage.aspx>

² Ofgem (2009) Energy Supply Probe – Proposed Retail Market Remedies

³ <http://www.ofgem.gov.uk/Markets/RetMkts/rmr/Documents1/RMR%20Domestic%20Statutory%20Consultation%20SOC%20online.pdf>

⁴ <http://www.ofgem.gov.uk/Markets/RetMkts/rmr/Documents1/The%20Retail%20Market%20Review%20-%20Final%20domestic%20proposals.pdf>

the energy market.⁵ This, in turn, is intended to improve consumer engagement and increase competitive pressures within the market.

Ofgem has proposed a bespoke approach to enforcement in relation to the SOC, which would include an assessment of the seriousness of a potential breach. When assessing a potential breach of the SOC, we would consider whether a reasonable person, intent on complying with the SOC, would have acted in the way a supplier did in its interactions with consumers.

As part of the March 2013 consultation⁶, we also produced draft guidance on terminology used within the SOC licence condition. The content of the guidance is based on existing legal terminology. A final version of this guidance is included in Appendix 1 of this decision letter.

Summary of statutory responses and Ofgem's views

We received eight responses to the statutory consultation. Respondents included suppliers, a trade association and a consumer group.

Responses were broadly supportive of the intent behind the SOC, with respondents welcoming their introduction. Many suppliers noted that the intent behind the SOC is consistent with the way they currently operate, or that they are making changes to bring practices in line with the SOC. Some suppliers illustrated this point by outlining initiatives they are currently undertaking to rebuild their relationship with their consumers. Respondents were also largely supportive of our policy approach, including the bespoke approach to enforcement and the emphasis on the relationship between the supplier and consumer as opposed to the relationship between the regulator and supplier.

Some respondents raised points of clarification and requested further information about certain elements of our policy approach. The section below notes these points and, where relevant, provides Ofgem's views.

Definition of fairness in the Customer Objective

Following both the October 2012 'Retail Market Review - Updated domestic proposals' (135/12)⁷ and March 2013 RMR consultations, some suppliers raised concerns regarding how the Customer Objective would work in practice. The Customer Objective stipulates that all licensees and their representatives must treat consumers fairly. The licence condition defines when a licensee (or their representative) would not be treating a customer fairly as:

"25C.3 For the purposes of this condition, the licensee or any representative would not be regarded as treating a Domestic Customer fairly if their actions or omissions:

(a) significantly favour the interests of the licensee; and

(b) give rise to a likelihood of detriment to the Domestic Customer."

Some suppliers expressed concern that the above drafting, in their view, would not allow them to exercise a right to undertake particular actions. For example disconnecting a consumer could be seen as detrimental to consumer welfare and the supplier could be seen to benefit by reducing bad debt. Three suppliers suggested inserting the word 'undue' would resolve this problem and help mitigate regulatory risk.

⁵ In this letter we use the term 'market' as shorthand for referring to the energy sector. For the avoidance of doubt this term is not intended to describe or otherwise suggest the approach that may be taken by Ofgem for the purposes of market definition in competition law investigations.

⁶ <http://www.ofgem.gov.uk/Markets/RetMkts/rmr/Documents1/The%20Retail%20Market%20Review%20-%20Final%20domestic%20proposals.pdf>

⁷ <http://www.ofgem.gov.uk/Markets/RetMkts/rmr/Documents1/The%20Retail%20Market%20Review%20-%20Updated%20domestic%20proposals.pdf>

In the May consultation, we clarified that where a supplier has a right to undertake an action, the effect of 'significantly favour' means that the SOC would not necessarily, in itself, prevent the supplier from ultimately exercising that right. We did note the SOC will capture whether the process for exercising the right and the manner in which it is exercised is fair and that a supplier should employ its discretion before exercising a legal right.

Following the statutory consultation, we again received feedback on this issue:

- Two suppliers were comfortable with our clarification including how the fairness test will work in practice.
- One supplier agreed that the insertion of undue was not needed in the licence condition but that the clarification on suppliers' rights should form part of the guidance.
- Two respondents welcomed clarification about exercising rights, but still felt that the insertion of 'undue' was needed in the licence.
- One supplier firmly believed that the clarification must form part of the licence and stated that our justification for excluding 'undue' was flawed and proposed amended text for the fairness test.

Having considered the range of views expressed, Ofgem has decided against changing the proposals. The fairness test is based on the Unfair Terms in Consumer Contracts Regulations (UTCCRs) 1999. The SOC licence condition is consistent with the UTCCRs and the insertion of the term 'undue' would impact on this consistency. As noted in the May consultation, the insertion of the word 'undue' may mitigate supplier responsibility to treat consumers fairly. We believe our explanation regarding suppliers' ability to exercise their rights provides clarity to stakeholders on how the fairness test will work in practice. Moreover, our drafting will help ensure suppliers take responsibility for their actions and exercise their rights in a fair way.

Although most respondents welcomed the clarification about suppliers being allowed to exercise statutory rights, some respondents suggested that this should be part of the licence condition or included in the illustrative guidance. We have decided against including this clarification in the licence condition as we do not consider it necessary and wish to avoid reference to specific scenarios in what is principles-based regulation. The addition of detail into the licence condition (such as the clarification of suppliers exercising their rights in situations such as disconnecting a customer) is a move away from this approach.

We also received requests for clarification of the interaction between the fairness test and suppliers ability to exercise their rights to be published in our illustrative guidance. This guidance is intended to clarify key terminology contained in the licence. However, at this time, we consider the guidance should be limited to key terms, which clarifies technical points of definition. It should also be noted that the May consultation has already clarified Ofgem's position on suppliers exercising their rights.

One respondent proposed alternative drafting for the fairness test. The formulation of the fairness test in the licence condition (SLC 25C.3) is based on the definition from the UTCCRs. Proposed alternative drafting also appears to be based on the UTCCRs drafting. However, we do not consider it is necessary to modify drafting proposed in the statutory consultation. We are content that the drafting in SLC 25C.3 explains the policy intent and the alternative drafting provides no greater level of clarity.

Approach to Enforcement

We have previously proposed that our assessment of the seriousness of a potential breach will include consideration of whether a reasonable person, intent on complying with the SOC, would have acted in the way the supplier did in its interactions with consumers. To this end we will have regard to the supplier's actions and considerations (including at a senior level) in (i) the development of new policies or processes and amendments to

existing policies and processes; (ii) the monitoring of its implementation of new initiatives and operation of existing policies and processes; and (iii) the taking of remedial action where any adverse consequences for customers came to light. This means that we will usually ask suppliers for contemporaneous documents so we can make this assessment before opening investigations.

Most respondents acknowledged and supported the work Ofgem has undertaken to develop a bespoke approach to enforcement for the SOC. However, there were again calls for a formal two-stage approach to enforcement. This approach would involve a dialogue between Ofgem and a supplier where a potential breach is identified, with the supplier being given an opportunity to correct a problem ahead of any enforcement action (except in very serious circumstances). As we have previously stated, we are not in favour of this approach and believe it may reduce incentives on suppliers to take a proactive approach to compliance. Ultimately suppliers would have a lower incentive to comply with the SOC and this may reduce the quality of interactions with their customers. As interactions with suppliers may be infrequent for some consumers, it heightens the importance of each interaction in establishing trust.

In previous consultations, we stated how we will enforce the SOC, including the use of the 'reasonable person test'⁸ we describe above. Some respondents have requested Ofgem formally publish this approach to enforcement. As noted in previous consultations, the enforcement approach we are adopting for the SOC⁹ is bespoke. Our approach is clearly outlined and we have provided details on how this will work in practice. We believe this is consistent with the principles of Better Regulation by being transparent, consistent and accountable.

Some respondents suggested we should not launch enforcement action until we have a final published policy on our approach to enforcement or until the review of our enforcement policies and procedures ('the Enforcement Review') has concluded. Our previous research and policy rationale indicates that the SOC need to be an enforceable licence condition to bring improvements in supplier behaviour.¹⁰ We have also engaged in an industry workshop, providing further clarity over how enforcement will work in practice. For these reasons, we do not believe we should delay implementing the SOC until the conclusion of the Enforcement Review. When revised Enforcement Guidelines are published as part of the Enforcement Review, they will include our approach to enforcing the SOC. Further details on the criteria for opening an investigation and our investigation and decision making process can be found in Chapters 3 and 4 of our published Enforcement Guidelines.¹¹

We received feedback that some suppliers believe the SOC will take time to become fully operational across all aspects of supplier and consumer interactions. In order to comply with the SOC, suppliers should be taking account of consumers' needs and ensuring they are treated fairly. This includes looking at interactions that fail to comply with the SOC and finding short and longer term solutions to address these problems. Supplier actions in relation to the SOC should evolve over time depending on a range of factors including consumer needs, changes in the market, technology and suppliers' opportunity to consider and implement relevant change within their organisation.¹² We will be proportionate in our approach to enforcement, in line with our enforcement guidelines.

⁸ <http://www.ofgem.gov.uk/Markets/RetMkts/rmr/Documents1/The%20Retail%20Market%20Review%20-%20Final%20domestic%20proposals.pdf>

⁹ [http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=41&refer=About us/enforcement](http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=41&refer=About%20us/enforcement)

¹⁰ Insight Exchange (2012) Consumer research and collaborative engagement on the proposed SOC – Domestic Customers

¹¹ <http://www.ofgem.gov.uk/About%20us/enforcement/Documents1/Enforcement%20guidelines%202012.pdf>

¹² <http://www.ofgem.gov.uk/Markets/RetMkts/rmr/Documents1/The%20Retail%20Market%20Review%20-%20Final%20domestic%20proposals.pdf>

One supplier suggested alternative drafting of our 'reasonable person' test. The response suggested that the word 'would' should be substituted with the word 'could' in the following text: "...whether a reasonable person, intent on complying with the SOC, would have acted in the way the supplier did in its interactions with consumers". The respondent suggested that there may be a number of courses of action open to a supplier and any may have been chosen by a reasonable person. We acknowledge that as this is a principles-based regulation, there may be more than one way to achieve relevant outcomes for consumers. We are not proposing to change the wording and we believe the current drafting is the right assessment for evaluating the activities of suppliers in relation to the SOC. We believe the alternative drafting would mean a supplier is not held accountable for their actual actions.

A similar response outlined two alternative tests for assessing the reasonable person test. The response suggested we should assess:

"Whether a reasonable person would judge a supplier to have been intent on complying with the SOC"; or

"Whether the supplier took reasonable steps".

We do not agree with this suggested drafting as it shifts the focus away from suppliers actually delivering the best outcomes for consumers and towards merely being seen to attempt to comply with the SOC. Therefore, we do not feel it is appropriate to change the reasonable person test.

Individual versus systemic breaches of the licence

In the May consultation, we said that a breach of the SOC may occur in relation to systemic issues as well as issues arising from the unfair treatment of individual consumers. One respondent was concerned by the suggestion that they could be in breach of the SOC for individual as opposed to systemic issues. As we outlined in October 2012:

"As set out in chapter 2 of our Enforcement Guidelines, we would not necessarily take enforcement action in light of individual or isolated consumer complaints. Our focus is more likely to centre on systemic weaknesses in suppliers' actions. As Ofgem has limited functions in dealing with individual disputes between consumers and licensed suppliers, we therefore see a role for the Ombudsman Services: Energy (Ombudsman) in applying the SOC when dealing with individual cases referred to it".¹³

We will take a proportionate approach to enforcement. This has remained our intention throughout the policy development of the SOC. As stated above we are more likely to focus our resources on systemic weaknesses, although this does not rule out the possibility of investigating instances of particular detriment affecting small groups or individual consumers.

Guidance

The majority of respondents welcomed our decision to amend the 'honest and transparent' section of the illustrative guidance. Respondents agreed with our revised wording, that a supplier should not "deliberately, recklessly or negligently" take advantage of a customer's position. Respondents also agreed that this drafting accurately reflects our policy position.

We received a suggested drafting amendment for the illustrative guidance with regard to our information requirements. A supplier suggested the insertion of the word 'normally' (underlined) may improve the guidance as it may not always be best to provide information. Therefore, the guidance would read: "...acting in a transparent manner would normally include (but is not limited to) proactively providing consumers with appropriate

¹³ <http://www.ofgem.gov.uk/Markets/RetMkts/rmr/Documents1/The%20Retail%20Market%20Review%20-%20Updated%20domestic%20proposals.pdf>

and/or relevant information...". However, we believe the "appropriate and or relevant information" wording in the same sentence would cover this situation. A supplier who is complying with the SOC will assess the information that is relevant to a consumer in a given scenario. Sometimes they may assess that it is not appropriate to provide all information.

One respondent asked for more guidance to be published on the SOC. The SOC are a principles-based form of regulation. We consider the illustrative guidance strikes the right balance between allowing licensees flexibility to interpret the licence condition and providing clarity over Ofgem's interpretation of the SOC. Providing guidance with further details about our expectations in relation to the SOC may lead to a departure from a principles-based approach to one that outlines the precise actions we expect suppliers to take, rather than the outcomes for consumers. This is a stance we may review if needed, but we do not believe more guidance is warranted at this stage.

Coverage of the SOC

One supplier noted that we have removed the words "Discounts, Bundled products" from exceptions to the coverage of the SOC. We confirm the SOC will not cover the level of any charge, except in the case of a Deemed Contract. However, the SOC would apply to a determination of whether it was fair to charge for a given product or service, including the circumstances in which a charge is levied. Moreover, under consumer protection rules Ofgem currently has powers to consider the fairness of ancillary charges, and are able to draw on these powers where appropriate.

We also received a question regarding whether the SOC would cover the fairness of terms in a contract itself. The respondent noted that including contract terms within the scope of the SOC might replicate existing legislation (UTCCRs 1999). We confirm that the SOC cover the fairness of contractual terms. We agree that this provision would be similar to matters covered by the UTCCRs. The policy intent with the SOC has always been that all interactions with consumers would be covered and by definition this overlaps with existing provisions in a broad range of consumer protection legislation. Given the rationale for the introduction of the SOC, Ofgem is firmly of the view that it is necessary to have provisions in place which are ultimately enforceable by financial penalties imposed by Ofgem.

The role of the Ombudsman

A number of respondents noted it would be useful to maintain a dialogue with the Ombudsman about the SOC. We are already working with the Ombudsman and will continue this dialogue in the coming months with the aim of confirming a shared understanding of the SOC. One respondent thought it would be helpful for the Ombudsman to discuss its decision making process with all interested stakeholders, including suppliers and consumer groups.

Treating customers fairly statement

The 'Treating Customers Fairly Statement' is a requirement that licensees inform their customers annually of the main actions that have been taken to comply with the Customer Objective and the service and treatment a consumer can expect from a supplier. We received one request that Ofgem provide early feedback on suppliers' 'Treating Customers Fairly' statements. The respondent felt this would be helpful in establishing a dialogue over suppliers' application of the SOC. Ofgem intends to continue to interact with suppliers on implementation of the SOC.

The Authority's Decision

Having carefully considered the responses to the May consultation, the Authority has decided to proceed with the modifications to the gas and electricity supply licences by

amending SLC 1 and inserting SLC 25C. The effective date for these modifications is on and from 00:00 on Monday 26 August 2013.

Statutory directions modifying the standard conditions of all electricity and gas supply licences have today been issued to all relevant licensees. The statutory directions have also been published on the Ofgem website.

Next Steps

Licence holders, trade bodies representing licence holders and Consumer Futures will have 20 working days to decide (from the first working day after this letter is published) if they want to appeal to the Competition Commission against the licence modifications. Barring any appeal the licence modifications will have effect from the relevant dates set out above.

We are committed to continue our monitoring of the performance of the market, and in particular the impact of our new rules. We will review the impact of the RMR remedies no later than 2017 – and may examine specific issues as new information and evidence emerges.

If you have any queries regarding the content of this letter please contact David Hunt, Head of Retail, Retail Market Functioning (020 7901 7000) or email rmr@ofgem.gov.uk.

Yours faithfully,

Maxine Frerk
Partner, Retail Markets and Research

Appendix 1: Final Guidance for the Standards of Conduct key terms

The content below represents final guidance relating to the new standard licence condition 25C "Customer Objective and Standards of Conduct for supply activities". We consider this guidance will help provide further clarity regarding how some of the terminology used in this licence condition should be interpreted. This guidance is being issued pursuant to paragraph 25C.10 of standard condition 25C and therefore suppliers will need to have regard to the guidance in their interpretation and application of standard condition 25C.

Illustrative guidance on concepts used in Standards of Conduct

<i>Expression</i>	<i>Illustrative guidance</i>
'honest' and 'transparent'	<p>The requirements to be honest and transparent encapsulate the following:</p> <p>Honesty requires that the actions and omissions of a supplier are truthful, free of any form of deceit, and sincere.</p> <p>Transparency requires that information about a product (including the terms and conditions) is expressed fully, and in a manner which is clear and easy to understand and which avoids concealed pitfalls or traps.</p> <p>When communicating directly with consumers, acting in a transparent manner would include (but not be limited to) proactively providing consumers with appropriate and/or relevant information (orally or in writing) to make them aware of their rights and the supplier's obligations. It would also encapsulate actively responding to any questions.</p> <p>Transparency and honesty would require appropriate and prominent signalling to be given to aspects of a product or contractual rights which might operate to the disadvantage of the customer. It also requires that a supplier does not, whether deliberately, recklessly or negligently, take advantage of the customer's necessity or desperation, lack of experience or knowledge, unfamiliarity with the subject matter of the product, or weak bargaining position.</p> <p>An example of transparency and honesty would be for the supplier to disclose all relevant information the supplier has in response to a consumer's query via telephone even if this information does not favour the supplier. This query may relate to the price of the product or the quality of service provided by the supplier.</p>
'appropriate'	Encapsulates adapting behaviour to take into account particular circumstances

	<p>arising in a given situation, including but not limited to: cultural or other sensitivities, the position of vulnerability, disabilities, or intellectual and technical (including IT skills and access to the internet) capabilities of consumers.</p> <p>Examples of when a supplier may be insensitive to a consumer's circumstances when they are in a vulnerable position may include scenarios where a consumer is in financial difficulty, are suffering from stress and/or are in debt.</p> <p>An example of inappropriate behaviour in this scenario would involve the supplier's customer service representative adopting an aggressive/rude tone when speaking to a consumer on the phone.</p>
`professional manner`	<p>Encapsulates acting with reasonable care and skill, having good knowledge of the product and relevant aspects of the energy sector, dealing with consumers in a courteous manner and having relevant knowledge of the rights of consumers' and suppliers' obligations.</p> <p>It also covers matters of taste and decency. The behaviour should not put the industry in disrepute.</p> <p>Aggressive, intimidating, rude or condescending behaviour would be examples of acting contrary to this requirement.</p>
`plain and intelligible language`	<p>As per the SLC 7A guidance, we would look to the interpretation the courts and the Office of Fair Trading (OFT) have taken in the context of the Unfair Terms in Consumer Contracts Regulations 1999.</p> <p>For example, plain and intelligible language requires:</p> <p><i>"...not only that the actual wording of individual clauses or conditions be comprehensible to consumers, but that the typical consumer can understand how the term affects the rights and obligations that he and the seller or supplier have under the contract...I would consider it proper when assessing whether terms are in plain intelligible language to take into account clear and accessible presentation with, for example, useful headings and appropriate use of bold print, which can contribute to</i></p>

the intelligibility to the typical consumer of the language.”

*(Smith J, OFT v. Abbey National [2008]
EWHC 875 (Comm))*