14 March 2016

Response to Ofgem's consultation on the Future of Retail Market Regulation

We are grateful for the opportunity to respond to Ofgem's consultation on the Future of Retail Market Regulation (**FRR**), as well as for the chance to participate in the series of workshops that have been held to date on this important area. We look forward to engaging further with Ofgem and other stakeholders as the proposals progress.

Executive summary

- We are cautiously supportive of the aim to achieve better retail regulation through implementation of principles-based regulation (**PBR**). However, we see a number of significant risks for suppliers (and worse, for their customers) in trying to meet this aim.

- Whilst we accept that this will "place a greater onus on suppliers", we do not think this means that the compliance burden, its costs and complexities, should necessarily increase as a result of moving from prescription to principles.

- This raises an important question around what compliance, and good compliance, looks like in a PBR world. We note that penalties may still be levied for the incentive impact on others, but this seems counter-intuitive in a regime where each supplier, accepting the onus to meet the principles, takes what it considers to be reasonable steps. A penalty regime including this element risks defeating the achievement of the expressed desire to see suppliers taking their own - reasoned – view of what they believe is in customers' interests.

- We are also concerned that PBR may lead to a widening of the scope of regulation, with increased uncertainty for suppliers (and their customers) around specific aspects of regulation. Indeed, attempts by suppliers to manage the risks of this potential widening may in fact work to stifle the very innovation this approach is attempting to support.

- A PBR approach cannot work without trust: there is either a perception that licensees are ready for the challenge of PBR or a concern that they are not. The proposed "broad principles" could be taken to indicate that the necessary level of trust may not have been reached if general requirements on how things are to be done are seen as necessary. Whilst we do not support the current indicative proposals for broad principles, we do not disagree with the setting of broad principles *per se*.

- These proposed broad principles also imply that this *input*-based approach is appropriate in a more fully PBR world, which is not strongly made out. If there had been a correlation between findings of unfair treatment and lack of Board or senior

management engagement, this could contribute to evidence that such input principles were needed but this does not appear to be the case.

- We think that PBR would not work where comparability is a key component of the outcome(s) being sought, or where the same specific actions are required of all suppliers in order to ensure an output. It follows that for those areas where Ofgem is concerned about how an output is achieved, the methods will need to be specified.

- We do not think the proposal to include an obligation to comply with consumer law in supply licences is appropriate: it enables a means of enforcement not otherwise contemplated over and above that provided for EU and UK consumer protection law where Ofgem can enforce through the routes provided.

- We support Ofgem's proposed phased approach, noting however that many of the retail regulatory rules are interconnected so phasing must be carefully thought out.

- While we can understand the proposal to review SCL 25 (sales and marketing) first from a PBR perspective, we are concerned that the lessons that could be learned for PBR - given the background to face-to-face selling and the sensitivities – may not be as useful as prioritising other aspects of RMR.

- We would suggest that phasing aligns with the CMA proposals, taking the "simpler" elements of RMR as a priority. This must include in particular, those measures that have found to be confusing or misleading for consumers in practice.

Detailed views on FRR proposals

Question 1: In what circumstances do you think that prescriptive rules are likely to be most appropriate? Which specific SLCs/policy areas should remain prescriptive in nature?

In broad terms, prescriptive rules are likely to be most appropriate where:

- A common methodology or compliance with the same standard(s) is required;

- Interoperability of any system or device is needed in the customer interest;

- A specific outcome, which is the same for all customers, is needed;

- As a specific aspect of the specific outcome, a measure or function is needed to aid comparability when it is not likely that licensees will be able to develop something themselves; and

- Where Ofgem requires the same information or data from all licensees to aid comparison or otherwise.

Taking into account the factors noted above, we think that example of those SLCs (using the electricity supply licence as the basis) or policy areas should remain prescriptive in nature include the following:

- SLC 9 (Obligations under Last Resort Supply Directive) and 10 (Claims for Last Resort Payment);
- Condition 12 (Matters relating to Electricity Meters)
- Condition 12A (Matters relating to Theft of Electricity)
- Condition 14 (Customer transfer blocking); and
- Condition 14A (Customer transfer).

Question 2: Should we supplement the principle of "treating customers fairly" with any other broad principles? If yes, please outline what these should be and why.

We are not averse to "broad principle-based rules" in addition to "treating customers fairly" being included. However, we have strong reservations regarding the list provided for initial consideration as "useful additions to the existing SoC obligations". We do not see the initial principles being proposed as in the same or an equivalent category to that of "treating customers fairly". Rather, these proposals seem aimed at the *how* rather than the *what outcome* of supplier behaviour. They are qualitatively different to prescriptive rules and on that basis, would appear to be aimed at achieving something different to that of outcome-based principles.

We appreciate the comment that during the Challenge Panel process, Ofgem found varying levels of change(s) made by suppliers to their internal governance processes. Differences - in structure, approach, and development - will in our view continue to manifest, as suppliers grow and adapt their business models. Indeed, differences are part of a more PBR world. Ofgem's approach to enforcement, which incentivises specific adaptations in reaction to more active monitoring, feels like the appropriate means of working with each supplier to ensure – for that supplier – that reasonable steps are taken to meet principles, whether broad or narrow. Suppliers are, essentially, rewarded for taking a reasonable approach to risk to customers and more generally, graded in light of an appropriate assessment of that risk to customers (or otherwise where relevant), and showing how that process was undertaken.

We consider that strong evidence would be needed to support an input-based approach to supplier behaviour as implied by the indicative broad principles and we not aware of evidence of a widespread lack of Board or senior engagement or concerns around honesty or active and constructive engagement. Whilst Board and senior management level engagement was called out in the summary of the 2014 Ofgem consumer Challenge Panel outcomes, for example, it did not appear that there was routine lack of such involvement (absent such an "input" principle), or routine and/or material of levels of dishonest dealing with the regulator.[1]

We also do not consider that the comparison to the financial services sector is the most appropriate one: the specific behaviours and risks – that signally manifested sector-wide and beyond – are well known, with behavioural rules crafted accordingly to meet the challenges of that specific sector and its products, taking account of the wider impacts. This justifies specific sectoral principles that may otherwise be regarded as included or that are specifically over and above those in companies legislation, company governance best practice and general law, as well as in good professional practice.

We have noted elsewhere that should specific records be required, this should be specified in requirements addressing what is needed at the right level (i.e. templates/specific formatting, etc.).

Question 3: Where might narrow principles be more appropriate than broad principles or prescription?

It is difficult to comment on cases where narrow principles may be more appropriate than broad principles. Overall, the scheme set out at figure 3 seems reasonable, noting the need to ensure consistency across the tiers of rules (paragraph 2.19).

Question 4: What are your views on the potential merits or drawbacks of incorporating consumer protection law into licences?

Where Ofgem has been given consumer protection enforcement powers, it is of course appropriate for these specific powers to be exercised. We would be concerned by the addition of an alternative enforcement route where one has not been provided by the legislation – whether energy legislation or general consumer protection or otherwise. It follows that we do not think a licence condition requiring compliance with consumer protection law is appropriate and we have not therefore considered any potential benefits or dis-benefits.

[1] https://www.ofgem.gov.uk/sites/default/files/docs/2015/03/standards_of_conduct_-_findings_from_the_2014_challenge_panel_0.pdf

We would also note that we do not consider it appropriate for inclusion of a licence obligation mandating compliance with other legislation in licence conditions. The issue is not whether

Ofgem has been granted specific duties or enforcement powers, and is considering an alternative route to meet its statutory duties, but that the legislature did not extend to Ofgem the obligation to ensure compliance or the powers to enforce that.

Question 5: How should we use principles and prescription to most effectively protect consumers in vulnerable situations?

We consider that in this area, it is important both that outcomes are appropriately specified (which may be a combination of broad and narrow principles), and that prescription may be needed where experience has shown that a minimum level protection is needed from all suppliers. This is not to say that some flexibility is not justified, in particular as it would not be appropriate to specify requirements for all customers: suppliers should work hard to ensure that the needs of their customers can be and are being met.

We also consider that guidance - potentially through anonymised case studies and best practice – has a strong role to play to ensure that vulnerable customers are effectively protected.

Question 6: Do you agree with our proposed approach to guidance?

We agree that there is a risk that a legitimate call by suppliers for certainty could lead to the replacement of prescription by the equivalent amount of guidance, which then essentially becomes the baseline against which to show compliance. As noted above, where Ofgem requires a particular outcome, that outcome should (taking account of all relevant factors) be specified in the licence conditions. Where Ofgem contemplates different means to achieve an outcome, which may manifest differently as between suppliers, guidance may not be helpful.

This is not to say that transparency around Ofgem's developing thinking, views on emerging approaches and learning and best practice derived from e.g. Challenge Panels, should not be made available. What we want to avoid is mandated guidance, or guidance too closely derived from specific approaches or actual outcomes that it acts to prevent any innovation.

If however the aspiration of a relationship of trust, built around the active and ongoing exchange of information by suppliers with Ofgem and the increased knowledge of particular suppliers and input that Ofgem intends to gain around planned changes manifests, specific guidance may become less of a concern over time. However, we recognise that as conditions become principle-based, suppliers, including us, will want to have confirmed:

- That at the start of this process, continued adherence to the prescriptive elements of (a) licence condition(s) will be sufficient (which assumes that the prescription forms *de facto* guidance);

- During the engagement process (whether through a Challenge Panel or otherwise), it is reasonable to expect indications from Ofgem as to the areas where a supplier should be looking beyond prior prescription, potentially giving views on expectations for changes to its approach; and

- It would also be reasonable for Ofgem to expect that a supplier has its own proposals, following its review(s) of principles, for changes to its policies and processes, which could take the form of case studies (on approach to system change, for example, or around product or tariff launches).

We also think that the approach to guidance is likely to change over time as participants gain experience of the engagement process, monitoring and enforcement in the PBR context. Guidance could usefully be developed within an agreed Terms of Reference approach, which would cover matters from the practical (all guidance to be accessible and fully searchable, version controlled and with previous versions also available) to the substantive (guidance should not be binding, that is, prescription by the back door).

Question 7: How can we best engage with suppliers in the context of principles?

We have covered our initial views in other responses, including as set out above.

Question 8: What specific support may be needed for new and prospective entrants?

We note that Ofgem and DECC are working on the provision of information to independent and smaller suppliers through the Independent Suppliers Forum. Specific workshops could be developed within this context. All suppliers should of course place equivalent weight and importance upon compliance: a lack of scale or resource cannot of itself be a justification for not taking steps that objectively speaking would be considered reasonable.

Transparency and availability of information on the PBR approach, and location and accessibility, as well as the ability to search all relevant information, including guidance, of guidance and an appropriate engagement process recognising the limits of smaller suppliers (e.g. they may not have historic data, initial requests may take longer to meet) would help new entrants.

Question 9: Do you have any views on how best to approach monitoring in the context of principles? Specifically, which indicators and approaches should we use to catch potential problems early?

It is difficult to set out specific monitoring measures or approaches in general terms. Supplier activity ranges from large-scale system replacement, through to upgrades or minor changes (e.g. to website format), contractor failure (e.g. telephone lines cease to work, data run not completed), to a refresh of the customer journey and on-boarding. Most companies

will provide ongoing information around delivery, potential risks, alerts around service impacting issues and other details to relevant teams and accountable officers within the company. We would advocate an approach that works with the grain of generally accepted types of management information, as there are likely to be similarities across suppliers (e.g. around reports from contractors/suppliers, KPIs and SLAs, root cause analysis, etc.) and taking account of various composite requirements from listing, through to trading counterparties and other performance or status-related information.

More specifically, the main aim in the context of service or customer affecting issues is to correct or fix that service or customer affecting issue, followed by a review to assess root causes and to consider a longer term fix or mitigation. The information will depend on the nature of the incident, the underlying third party arrangements (where relevant) and to an extent, the understanding Ofgem has of the processes for handling such issues within each supplier. The scale of the underlying issue or its basis would also affect the monitoring, e.g. a proposed billing-system change versus an upgrade. We would also expect some similarities across internal supplier reporting, but this is not to suggest any need to mandate such information.

Self-reporting was raised at a recent workshop and would provide a useful status check for Ofgem if properly scoped. This may be one area where some guidance would be useful, although not binding.

By way of example, if a supplier experiences a short-term contractor failure, such as limited access to telephone lines, this issue is likely to be notified internally, with the contractor being approached to report on the issue, its cause and the remedy. If there is a short-time fix, such that only a small number of customers cannot contact a sales line for a short time, this type of issue may not need to be reported to Ofgem: it may be sufficient that policies exist to track and address such issues. This is not to suggest that there is no customer impact here, rather that this approach reflects a view of the nature of that impact, which is reflected in the approach to monitoring.

Clearly, the approach would alter where the contractor issues were service-affecting or system-wide. Here, self-reporting to Ofgem may be appropriate where no short-time fix was available for a one-off problem. For system changes, or upgrades, monitoring could focus

on the internal project governance. If a supplier had no such governance, this may be an area for enhanced engagement through the period of implementation.

It may be easier to start by considering an overall approach, as follows:

- For what areas does Ofgem consider comparison or consistent and ongoing data is needed in order to help them review the market;

- Are there areas on or around which Ofgem would expect to see management or other internal information and if so, is this required in a particular format or for specific purposes;

- Are there areas where Ofgem would be concerned if a supplier did not have in place processes or policies covering particular eventualities?

- Has engagement highlighted certain themes within the supplier, e.g. a lack of root cause analysis, or similar issues being experienced repeatedly.

Question 10: Do you have any views or comments on the following proposals?

- **We will expand our engagement with suppliers to enhance our understanding of their businesses and help them better understand our rules so they can get things right first time.**

We agree that Ofgem should expand its engagement with suppliers to gain a wider and deeper understanding of the different business models used in the market and the many different ways of working, as well as areas where suppliers tend to approach things in the same way.

We agree with the aims for the proposed move to PBR, being to protect consumers better, to future-proof regulation and clearly signal to suppliers that treating customers fairly is more than "a tick box approach to compliance" (paragraph 1.13, FRR). We are concerned that active engagement and a more iterative approach to enforcement may not arm suppliers fully in order to live up to the aim of "placing a greater onus on suppliers". On that basis, we would urge Ofgem to fully engage in an iterative process with suppliers and provide their views on and raise any concerns around e.g. product or tariff launches or other initiatives, as well as being prepared to discuss suppliers' approach to risk and mitigation. We do understand that it is challenging for Ofgem to commit to giving advice but it is reasonable for suppliers to take into account for their own compliance risk assessment that they raised an issue with Ofgem and included in their subsequent approach the outcome of those discussions.

We would also highlight here the need to ensure, as far as possible, consistency of approach from Ofgem. Developing a relationship of trust implies both continuity of contact and ensuring that relevant Ofgem colleagues are also briefed on suppliers and any issues discussed. In our view, the objective should be the ongoing moderation of behaviours considered unfair and inappropriate, rather than too overt a focus on penalties.

A "right first time" aspiration is very important: however, innovation involves some risk and provided that suppliers have fairness to customers front-of-mind, and manifesting throughout the organisation, it may be that with e.g. clear messaging around risks or a robust roll-back

or other mitigation plan, those risks are worth taking. On this basis, some customer harm may result but it is how suppliers address this which matters in such cases, with the expectation that launch of a new product anticipates a fair outcome for all, whilst providing for "worst case" handling of any systemic issues where this is not the case.

- **We will collaborate closely with the Citizens Advice Service and the Ombudsman Services: Energy to ensure we maximise the effectiveness and impact of the monitoring activities across our organisations.**

We agree in principle with Ofgem working closely with Citizens Advice Service and the Ombudsman Services: however, this could raise the issue of different bodies taking different views of what is fair treatment of customers or what "reasonable steps" are expected of suppliers in order to arrive at what such organisations consider to be "fair treatment". Citizens Advice are advocates for consumers: the Ombudsman is retained to deal with disputes. It is possible that given these different remits, they would arrive at different views as to fairness in a particular context, which may be different from that of the supplier, each other or Ofgem. Suppliers would not necessarily look for a mediated view between the different bodies upon which they could rely: rather, the implication of the onus being on suppliers to take a reasoned approach to what it considers fair is that only in cases where a reasonable person would consider that steps taken were *unreasonable* should more formal enforcement action be considered.

Assuming that this is the intended consequence of placed the onus upon suppliers, the logical outcome is that where a supplier can show that they acted reasonably, including around the handling of any adverse customer impact (noting the point above about right-first-time being the aspiration) this should be sufficient. Suppliers therefore have every incentive to make engagement with Ofgem work and to retain records which set out those steps taken around those steps, in light of their ongoing and continuous consideration of fairness.

Provided that input into monitoring by such bodies avoids this substantive interpretative role, Ofgem is right to consider how these highly experienced bodies can appropriately be involved in the process. In our view, it cannot be the case that differences are taken as *per se* evidence of a reckless approach by a supplier to treating customers fairly.

Question 11: Do you have any views on how best to approach compliance in the context of principles?

We have included in our previous answers an outline of a potential approach to aspects of compliance. We would need to consider this as specific changes are being proposed to aspects of the licence – which we would be happy to do on a bilateral basis with Ofgem or more generally in the context of workshops or a Challenge Panel.

Question 12: Do you have any views or comments on the following proposals?

- **We will retain our current flexible and discretionary approach to escalating issues to enforcement. We will prioritise compliance activities where possible and appropriate.**

- **We will increase the links to the level and impact of harm when deciding whether to open a case.**

- **Engaging early with Ofgem may reduce the likelihood of later enforcement. Information from engagement and monitoring activities may be shared with enforcement where appropriate.**

- **We will continue to apply our full range of enforcement tools to principles-based rules.**

- **We will make it easier for all suppliers to learn lessons from enforcement outcomes.**

- **Enforcement action will continue as usual throughout the transition to principles.**

Subject to the points made in our previous responses, and in particular to the consequences of the onus being on the supplier, these proposals seem reasonable. However, we think it is important to review these once the overall structure for the changes to PBR is more settled in order to ensure that they remain appropriate.

Question 13: How would you like to engage with us on our proposals and the broader work programme?

Ofgem should continue to engage with suppliers through workshops as proposed, as well as individually. It would also be useful to include industry representative bodies such as Energy UK, which body has developed, with members, various self-regulatory codes of practice that may provide helpful models for certain types of rules or behaviours, e.g. for areas where common standards are beneficial and not mandatory, and represent best practice.

It may also be useful for Ofgem to constitute smaller workshops focused on independent and smaller market players, and in particular, new entrants. This could be done e.g. through the DECC-Ofgem Independent Supplier Forum.

Question 14: Do you agree with our proposal to take a phased, priority-driven approach to reforming the supply licences.

We agree with the proposed phased, priority-driven approach to reforming the supply licences. This sequential approach allows lessons from previous changes to be assessed, and any relevant lessons learned for subsequent change. This raises the question of the best way to assess the efficacy of any change from prescription to principles-based regulation.

We also agree that prioritisation should take into account those areas where innovation is being stifled. To some extent, Ofgem is already looking at one area where there appears to be consensus that innovation is being hindered, e.g. in looking at what could make bills more effective, enabling, as set out in its recent open letter, trials by suppliers to assess different approaches to this key area, and other customer communications, and more generally.

However, we do think that it is important to ensure that in determining the phasing, Ofgem considers inter-connected groups of conditions – it seems sensible to start with the "simpler" aspects of RMR, reflecting the CMA's proposals, alongside the "clearer" elements, with the "fairer" elements to follow, albeit with a parallel review of the SoC as this work progresses to test how it works with any changes being proposed. We also note that the CMA has proposed an additional SoC in the context of the "simpler" elements of RMR.

Question 15: Which areas of the licence should we prioritise? In particular, please provide examples where existing prescriptive rules may be causing problems or where market developments are leading to new risks to consumers.

In addition to the (ongoing) review of effective billing and other customer communications, it would seem sensible to align any process with any proposals to be put forward by the CMA, e.g. the proposed Ofgem-led programme for engagement remedies.

The phased approach will allow Ofgem to include important elements that have been found in practice to be confusing at best and misleading at worst, such as the approach to the Personal Projection (**PP**). The aim for the PP was understandable at the time. As Ofgem described,

> "The intention of our proposed methodology for the calculation of the Personal Projection is to provide consumers with a view of the costs they would incur over the next 12 months should they take no action in the interim."[2]

Experience and customer complaints have shown that this is not at all how customers expect this measure to work (notwithstanding explanations provided prior to or after its use by suppliers and intermediaries who use it). Indeed, many feel misled by the savings indicated having made their decision. This points to a helpful framework for review of specific RMR measures (i.e. against the original overarching and specific aims and intentions for each section - "simpler", "clearer" and "fairer" - and the specific measure) in light of actual practice, taking into account the parallel consideration of fairness and Standards of Conduct overall, and those factors highlighted in our response to question 1 on where prescription may be needed and where it is in fact leading to unhelpful measures for customers.

Question 16: Can you provide any initial views on potential costs and benefits (eg avoided costs) of regulation via principles versus prescription to your organisation? Please explain which parts of our proposals (eg rulebook, operations) these costs relate to.

In principle, we consider that the costs of compliance should not increase through a phased introduction of principles and replacement with principles for prescription, although they may be distributed differently within the organisation. It does not follow that a difference in regulatory approach should of itself either increase or decrease supplier compliance costs. This takes into account that:

- Substantial costs have already been incurred by the industry in implementing e.g. RMR;
- The aims and outcomes to be achieved remain the same as the current rules; and
- The supplier is compliant to date, and has made and continues to make good progress in embedding the Standards of Conduct within its overall business.

Exploring priority areas for reform

It is not entirely clear what the basis for prioritising SLC 25 is. Whilst we agree that sales and marketing is an important aspect of consumer engagement, the example given does not detail specific substantive reasons leading to its prioritisation, for example, specific elements of prescription that have actually stifled innovation or that are not adequately protecting consumers or both. The outcome of such a review would, in our view, provide strong indicators as to whether the principles worked or needed amendment/addition, or if it was

[2] https://www.ofgem.gov.uk/sites/default/files/docs/decisions/the_retail_market_review_-_implementation_of_simpler_tariff_choices_and_clearer_information.pdf at p. 32

specific elements of prescription that were proving more complicated. We note Ofgem's comment as to the current structure of the condition, and that its current structure lends itself more readily to a split between principle and prescription than other retail conditions, as well as that there may be further changes depending on the principles to be established.

A more general concern is that sales conduct - whether face-to-face or otherwise – is highly visible and, given previous experience around face-to-face sales and indeed mis-selling in a

number of sectors, presents a material compliance risk, whichever a supplier chooses to carry out. Taking this into account, this may not be the most appropriate starting point for PBR.

Question 17: Are the existing provisions of SLCs 25.1 and 25.2 the right ones for regulating sales and marketing activities (or are any additional principles needed)?

As currently drafted, SLC 25.1 and SCL 25.2 do raise a number of interesting questions (i) as between principle and prescription and (ii) on the interaction of a subject-specific objectives, with SLC 25C (Standards of Conduct). On the first question, it may be open to challenge whether the principles alone are sufficient (paragraph 6.3 FRR) given that SLC 25.5 to 25.16 must also be complied with.

The second question is, what is the anticipated difference between these objectives and the cumulative effect of the Objective and Standards of Conduct is SLC 25C.2 and SLC 25C.4. Ofgem anticipates a further review of this SLC depending on the principles to be established and we agree that this is an important element of any move to PBR. This is not simply to limit the expectation of separate record keeping and assessment of fairness against principles which vary slightly in wording, but to ensure that there isn't any substantive overlap and potential conflict between principles.

Question 18: What, if any, prescriptive rules are needed in addition to the principles in SLC 25 to deliver good consumer outcomes?

In order to answer this question, we think that a review of the concerns around SCL 25 and any inhibiting effects it is considered to have could usefully be undertaken.

Question 19: What engagement and monitoring process might be required to best operate SLC 25?

Where a specific action is considered necessary to ensure that Ofgem's statutory duties are met, and that action is proportionate and appropriate taking that and other relevant factors into account, this should be prescribed. An example could be where Ofgem considers that a sample of sales and marketing calls should be recorded. Without such prescription, each supplier may take a different view as to how to show its compliance with stated principles, for only some of whom this may include sample call recording.