



The future of retail energy regulation -
OVO's response to Ofgem's consultation

11th March 2016

Contents

1. Introduction.....	3
2. Outcomes, not Rules – Lessons learned from recent reforms	6
Energy Supply Probe.....	6
Retail Market Review.....	7
Lessons learned	8
3. New regime, new approach – OVO’s model for reform	10
4. The Vision and The Outcomes – Protect, Engage & Innovate	12
The Vision.....	12
The Outcomes	12
Protect.....	13
Engage.....	17
Innovate	19
5. The Rules – Formulation, compliance & enforcement.....	24
Formulation, Compliance and Enforcement.....	25
Financial Conduct Authority	27
Takeover Panel	28
Information Commissioner’s Office.....	29
6. The Next Phase.....	32
Annex	34

1. Introduction

- 1.1. OVO is one of the UK's fastest growing independent suppliers, with currently over 600,000 customers and 900 staff. In January 2015 we also became the first Which? Recommended Energy Provider and we won the same accolade again this year.
- 1.2. The key to OVO's success and one of its core values is to treat its customers fairly. It's a simple principle which permeates every aspect of our business and every decision that we make – from improving day-to-day customer experience to technological innovation in our products.
- 1.3. In light of this customer-centric foundation to OVO's business, we are highly supportive of this consultation and Ofgem's intention to transition to a more principles based form of regulation. In particular we commend Ofgem for acknowledging the current limitations of prescriptive rules and the recognition that fundamental cultural change is required to enable the transition.
- 1.4. We have been amongst the most vocal parties in the retail energy market seeking reform to the regulatory framework not because we see an opportunity to de-regulate the market, but because we feel that the current regulations are not delivering the right outcomes for consumers.
- 1.5. To put it another way, we are not advocating a 'regulation lite' model. Quite the contrary – we recognise that as energy is an essential service, energy customers require a high degree of regulatory protection and monitoring. However we feel there is currently a disconnect between what the regulations say and what protections they are intended to deliver. As a result, suppliers (and Ofgem) are too focussed on complying with the former rather than delivering the latter.
- 1.6. We are optimistic that this consultation is the start of a journey to resolve that disconnect and refocus the industry on delivering better outcomes for consumers. It's an opportunity to ensure that new regulations are designed to achieve those

outcomes and that suppliers are given primary responsibility for delivering the outcomes – not just complying with the regulations that underpin them. We are encouraged to see Ofgem also highlighting throughout the consultation the onus on suppliers to take greater responsibility.

- 1.7. In reviewing the consultation there are few statements or proposals with which we strongly disagree. However, after much consideration and reflection it became apparent that it was much less the content of the consultation that required comment than the approach. At this very early stage of the reform, by focussing almost immediately on what the regulations should look like and how they should be enforced we feel that a fundamental step has been missed.
- 1.8. Instead, OVO believes it is absolutely imperative to take a 'top-down' approach and start with Ofgem's vision for what a reformed, properly functioning retail market should look like. Once the vision is clear, Ofgem needs to set out clearly the specific outcomes it wishes suppliers to achieve under three core pillars: Protect, Engage and Innovate.
- 1.9. It is only after these first two steps are completed that we can dive into shaping the regulations that will facilitate how suppliers can achieve the vision and the outcomes. Indeed, without being clear upfront about the vision and the outcomes the format of the regulations – whether prescriptive or principles based – will be almost irrelevant in determining whether or not any regulatory reform succeeds.
- 1.10. OVO is greatly concerned that taking a 'bottom-up' approach risks this consultation becoming an exercise in simply transposing existing rules into principles. After such great intentions and effort, we will have wasted a unique opportunity and will find ourselves back to square one – a regulatory framework that dictates rules to follow (albeit in a different format) rather than outcomes to achieve. This would ultimately be to the detriment of energy consumers who will continue to remain insufficiently protected and dis-engaged in a stagnant, un-innovative market.

1.11. In response to the consultation and the concerns outlined above:

- (a) First, in section 2 we set out our assessment of recent regulatory reforms and the lessons learned.
- (b) Next, in sections 3 and 4 we explain in more detail OVO's top-down, outcomes-based approach to regulatory reform.
- (c) In section 5, we discuss how outcomes can be transposed into principles, the role of enforcement and what we can learn from examples of principles-based frameworks in other sectors.
- (d) Finally, in section 6 we wrap up our thoughts and propose some next steps.
- (e) While we feel that we have answered the substance of the consultation in our response, we answer the specific consultation questions in the Annex.

1.12. Before we proceed it is important to acknowledge that we are not presenting our approach as a final, perfect model for reforming retail regulation. Quite the contrary - we acknowledge that the thinking behind our model remains a work in progress as we are attempting to radically re-shape a well established regulatory framework to an extent that has not been attempted before. And we recognise that we have used some overly-simplistic examples, which we have done deliberately in order to demonstrate the methodology behind our approach rather than as the final solution. However we are confident that our approach provides a starting point for ensuring that we avoid the mistakes of the past and maximises this opportunity for regulatory reform for the benefit and protection of all consumers.

2. Outcomes, not Rules – Lessons learned from recent reforms

2.1. In this section we review several recent regulatory interventions by Ofgem and draw from lessons learned on how they have succeeded or failed to deliver consumer benefits.

Energy Supply Probe

2.2. Since the findings of the 2008 energy supply probe (the **ESP**) Ofgem has been searching for a means of improving outcomes in the retail energy market. The ESP found that despite encouraging levels of customer switching, the market was not working for all customers, particularly vulnerable customers who were disengaged. In essence the problem was that not enough customers seemed to switch to the tariff that was best suited to them.

2.3. To address the shortcomings of the market, Ofgem introduced a suite of remedies which aimed to:

- (a) Improve the quality and accessibility of the information available to consumers so that they can make well-informed decisions about their energy supply (**A**);
and
- (b) Empower more consumers to engage effectively in the market (**B**).

2.4. We would argue that although these were worthy goals in their own right, they were not directly aimed at solving the overarching problem of the lack of customers on the best available tariffs. The theory was that by solving problems A and B you would achieve the desired outcome – i.e., customers being on the tariff that is best suited to them (let's call this **C**). However C was not clearly stipulated, and the regulations were designed only to solve problems A and B in isolation – i.e., not to directly solve problem C. As a result there was a distinct disconnect between problems A and B and the ultimate problem of C. And suppliers were made responsible only for

problems A and B, without being accountable for C. Worse still, suppliers were made responsible only for complying with the rules created to solve problems A and B, further distancing their accountability from the ultimate goal of C.

- 2.5. We are not denying that the ESP reforms succeeded to a degree in providing customers with more information and reducing incidents of customers being overcharged. But the number of customers on the best available tariffs did not increase markedly. In other words Ofgem succeeded primarily in reducing the likelihood of bad outcomes occurring but not necessarily delivering better outcomes.
- 2.6. We continue to reference "best suited" or "best available" tariffs throughout our response. By this we do not mean simply the cheapest tariff available. We mean, for an individual customer, the tariff that is most suitable and cost efficient for them based on their personal circumstances and needs – e.g., their energy usage profile, their appetite for other bundled products and other similar factors.

Retail Market Review

- 2.7. Following the ESP, Ofgem commenced another review of how the retail market was performing. This review, which became known as the retail market review (**RMR**), found that despite the success of some of the ESP based remedies, the wider problems relating to a lack of customers on the best available tariffs persisted.
- 2.8. Based on the findings of the RMR, Ofgem decided to introduce a further set of remedies. Once again we assume that Ofgem's desired outcome was to increase the number of customers on the best available tariffs, but unfortunately once again this outcome was not explicitly set out, nor were the new rules designed to directly achieve this outcome. Therefore once again a disconnect arose between the desired outcome and the rules brought in to achieve that outcome.
- 2.9. RMR centred around making the market:
 - (a) "Simpler", by capping the number of tariffs a supplier could offer to four.

- (b) “Clearer”, by requiring suppliers to provide their customers with greater amounts of information, and
 - (c) “Fairer”, by introducing the Standards of Conduct in SLC 25C.4 which required suppliers to treat customers in accordance with broad principles of fairness and transparency.
- 2.10. As with the ESP remedies, some elements of the RMR reforms were successful in improving certain aspects of the market to a degree. There is no doubt that RMR succeeded in making the market “simpler” to navigate, as suppliers were prevented from using copious numbers of tariffs to befuddle customers. Some customers may also have benefitted from receiving more detailed information more frequently. But as with the ESP reforms, the fact that suppliers could comply with the rules without having to deliver the ultimate intended outcome made it unlikely that RMR would succeed in materially improving the market for consumers.

Lessons learned

- 2.11. In short, one of the most important lessons learned from ESP and RMR, we think, is that in whatever way rules are written, they cannot be written until the desired outcomes are clear, and only then can they be written to directly achieve those outcomes. To put it another way, rules simply facilitate achieving outcomes – they are simply the vehicle for getting to the right destination, but they are not the destination in their own right.
- 2.12. It is fair to ask at this point, if we could do RMR again using this top-down outcomes-based approach, what would be the right outcomes? In our opinion, outcomes (and therefore the rules underpinning them) should be designed in direct response to problems in the market – i.e., what would be the outcome if a problem were solved? And in order to measure the effectiveness of the rules underpinning the stated outcomes, they should be formulated in such a way to be deliverable and measurable (in contrast to the vision which can be aspirational).

- 2.13. So, applying an outcomes-based approach in the case of RMR, one outcome is likely to have been 'increasing the number of customers on the best available tariffs' because it responds directly to a problem that RMR was trying to solve and is deliverable and measurable.
- 2.14. However, because the approach in RMR was to focus on writing the rules rather than formulating the outcomes, the problem Ofgem was trying to solve (customers not being on the best available tariffs) was not directly linked to the means by which Ofgem sought to solve it (making the market simpler, clearer and fairer). This in turn meant that the outcome Ofgem desired was not explicitly linked to what the rules directed suppliers to achieve. Suppliers were therefore responsible only for complying with rules, not for delivering market outcomes.
- 2.16. In the next section we discuss OVO's alternative outcomes-based based approach to designing the regulatory regime.

3. New regime, new approach – OVO’s model for reform

3.1. Figure 1 shows a diagram illustrating OVO's approach to creating an outcomes-based regulatory regime.

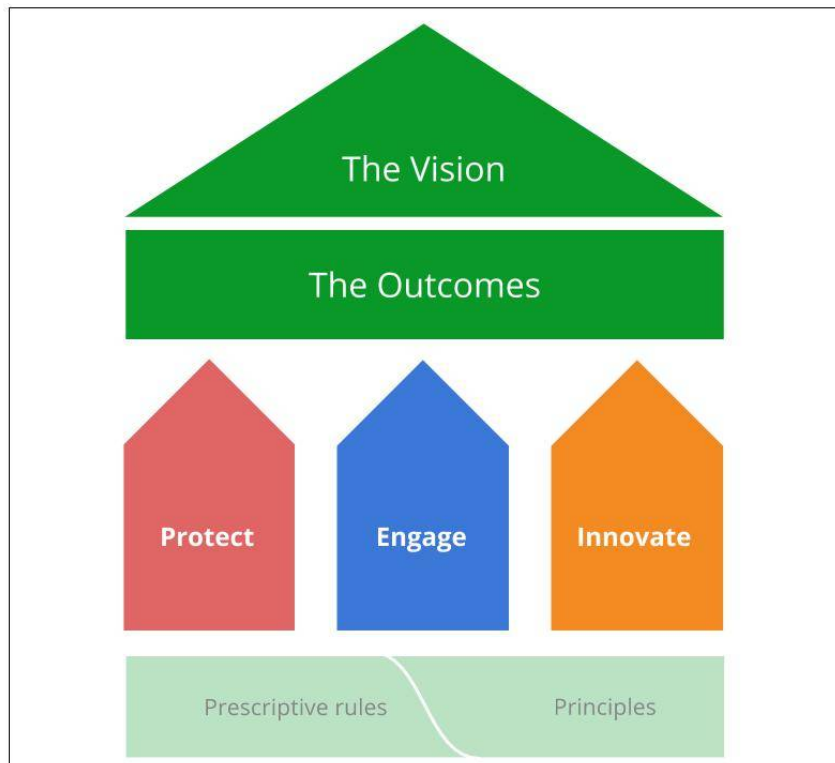


Figure 1 - Framework for an outcomes-based regulatory regime

3.2. Taking each element in turn, using the analogy of building a house:

- (a) **The Vision.** At the top is everyone’s vision of what a well-functioning market should look like. This is the apex to the roof of the house.
- (b) **The Outcomes.** Next comes high level, clearly stated, deliverable outcomes – i.e., direct solutions to problems in the market. This is the roof of the house.
- (c) **Protect, Engage, Innovate.** These are **The Pillars** – the walls and foundation of the house – within which sit more detailed sub-outcomes designed to facilitate achieving The Outcomes. The Pillars are crucial because they ensure

that, whatever The Vision, The Outcomes or The Rules, the regulatory framework is operating to Protect consumers, to Engage consumers, and to enable suppliers to Innovate.

- (d) **The Rules.** These are the mechanics – whether prescriptive rules or principles – to facilitate achieving The Outcomes and The Pillars in the market. We see The Rules as the wires and the pipes of the house – vital components but they exist only to deliver The Outcomes and The Pillars. As such they should work seamlessly and almost invisibly behind the 'roof' and 'walls' of The Outcomes and The Pillars.
- 3.3. We will now take each element in turn and explore how they might be formulated, drawing on specific examples of recent regulatory changes and consultations.

4. The Vision and The Outcomes – Protect, Engage & Innovate

The Vision

- 4.1. This is what all market participants – whether it be Ofgem, suppliers or consumers themselves - should be aspiring towards in the long run. The Vision therefore is aspirational and is not intended to be the basis for measuring performance of outcomes or rules, but simply a focal point for the end goal.
- 4.2. Applying this in practice, The Vision could be as simple as "To deliver a fair, transparent and competitive market".

The Outcomes

- 4.3. We acknowledge that Ofgem has outlined outcomes in the consultation at a high level, namely lower bills, reduced environmental damage, improved reliability and safety, improved quality of service, and benefits to society as a whole.¹ These outcomes are commendable at a high level but they are not measurable and directly attainable by suppliers. Therefore, taking OVO's approach Ofgem needs to clearly stipulate achievable, measurable outcomes that directly tackle problems in the market and will contribute towards achieving The Vision.
- 4.4. The Outcomes are not specific to any one Pillar. Instead they should be formulated to mirror stated problems that span the market. For example, Ofgem might identify one market problem as being "The lack of customers on their suppliers' best available tariffs". In this case The Outcome would be a positive statement of the solution to

¹ Ofgem (2015) The future of retail market regulation, paragraph 1.4

that problem – i.e., "For each supplier the majority of their customers are on the best available tariffs."

4.5. Well designed outcomes should be clear, deliverable and measurable - for both suppliers and the regulator. This will enable suppliers to take responsibility for delivering The Outcomes and their success in doing so can be measured.

4.6. Using examples of The Vision and The Outcome outlined so far we can now start to map out the 'roof' of the house (Figure 2):

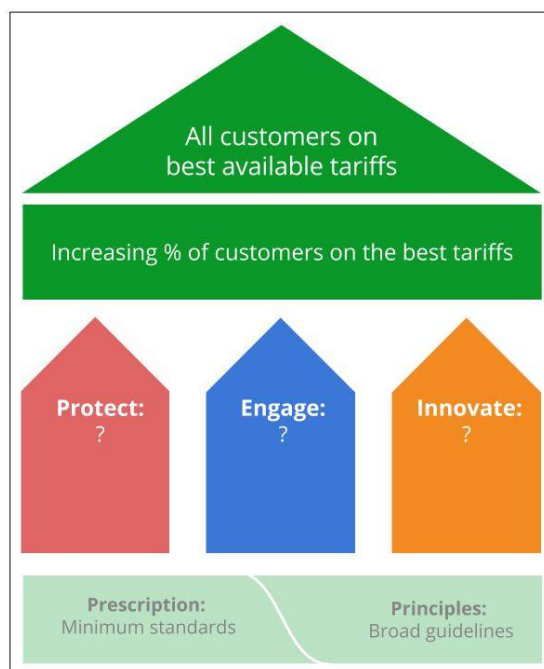


Figure 2 – The Vision and The Outcome

4.7. In the following paragraphs we explain using this example how The Pillars – Protect, Engage and Innovate – can guide us in creating more specific sub-outcomes.

Protect

4.8. All stakeholders would agree that protecting consumers is one of Ofgem's core *raison d'être*. But what does that mean in terms of practical, achievable sub-outcomes? In our opinion, the specific sub-outcomes required in order to protect consumers are to retain and enhance certain existing protections, and to develop

new ones, specifically for vulnerable customers. Achieving these specific sub-outcomes should, in turn, contribute to achieving The Outcomes.

- 4.9. Using the example in Figure 2, certain protections can affect vulnerable customers' affordability of energy and therefore contribute towards whether or not customers are on the best tariffs. In the following paragraphs we look at two specific examples of how this might work – the warm home discount scheme and warrant charges.

Warm home discount scheme (WHD Scheme)

- 4.10. In our experience the WHD Scheme is unnecessarily complex, restrictive and ultimately ineffective in maximising coverage of those customers who are in genuine need of it.
- 4.11. The WHD Scheme currently works by dictating to each supplier their set quota of eligible customers to find. However this quota is calculated purely based on market share without any reflection of the supplier's customer demographics or profile of vulnerable customers. As a result, some suppliers struggle to meet their quota because they have a lower proportion of vulnerable customers in their base, while other suppliers have surplus demand.
- 4.12. This can make it both difficult and needlessly expensive for some suppliers to operate the scheme as they expend time and resource trying to meet their artificial quota. There is also a risk of some suppliers 'over-selecting' customers in order to simply meet their quota, while customers with other suppliers who are in genuine need miss out on the scheme. As a result, funds are being directed away from those customers in the market who need it most.
- 4.13. The inconsistency in the criteria applied between different suppliers exacerbates the problem and may result in customers having to 'shop around' for suppliers who are most likely to give them the WHD and have remaining quota to do so.

4.14. Drawing these issues back to The Outcome, if the WHD Scheme can be simplified and more vulnerable customers are able to access the scheme across the market, then we believe that vulnerable customers are more likely to engage in the market. This in turn creates better opportunities for vulnerable customers to be exposed to the best available tariffs.

Warrant charges

4.15. In response to Ofgem's recent prepayment consultation published on 17th December 2015 we were disappointed to see a lack of reference or connection to a principles-based approach. Nevertheless we considered each of the three options and presented our comments.

4.16. OVO is equally sensitive to the support vulnerable customers require and the specific problems encountered by those customers in the warrant process - namely that they are more susceptible to debt and therefore warrant charges, and inconsistent charging practices between different suppliers (e.g., range of charges and how they are calculated). We are also very open to circumstances where prescriptive rules might be warranted in order to protect vulnerable customers (as indicated in our model in Figure 1).

4.17. However we fear that by simply introducing more rules – i.e., caps on charges or similar mechanisms - rather than outcomes-driven principles, we revert to a world where suppliers will simply follow the rules without taking responsibility for solving the actual problems relating to warrant charges. Put simply, reducing and/or prohibiting warrant charges will not solve the problems at source.

4.18. Therefore we have proposed in our response to the prepayment consultation several principles-based solutions to tackle the specific problems directly. Applying OVO's outcomes-based approach the solutions can be evolved into specific sub-outcomes, namely:

- (a) "Suppliers prioritise installing smart meters for customers in debt" in order to minimise having to use the warrant process – and therefore incurring warrant costs – in the first place.
 - (b) "Suppliers' warrant charges are cost reflective" – i.e., their charges must genuinely reflect the costs that they incur from third parties and internal resources.
- 4.19. Instead of stipulating rules around warrant charge amounts, OVO's proposal incentivises suppliers to minimise warrant charges upfront. This in turn should minimise suppliers having to recover warrant costs by increases to their tariffs.
- 4.20. Turning back to The Outcome and our example in Figure 2, sub-outcomes such as those set out in paragraph 4.18 contribute to achieving The Outcome because keeping tariffs down should, broadly speaking, present more opportunities for customers to take advantage of the best available tariffs in the market.
- 4.21. We can now complete the Protect pillar of our diagram by summarising the spirit of the WHD Scheme simplification and the intended sub-outcomes for warrant charges as follows in Figure 3.

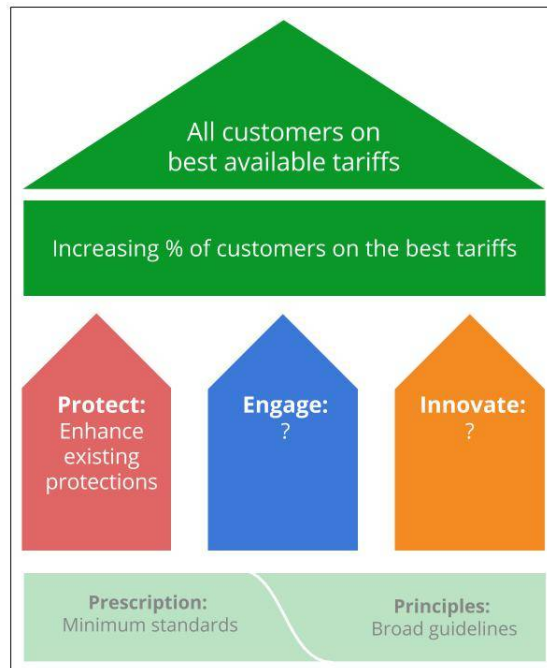


Figure 3 – Protect

4.22. In the following paragraphs we set out our thoughts on creating sub-outcomes under the Engage Pillar.

Engage

4.23. Engagement is a critical pillar for delivering The Outcome of increasing the number of customers on the best available tariffs because, put simply, we cannot expect customers to take advantage of the best available tariffs if they are not sufficiently engaged by their suppliers.

4.24. The most compelling example for creating the specific Engagement sub-outcomes is customer information – specifically bills.

4.25. We know that Ofgem is only too acutely aware of the current issues with customer information and the RMR rules brought in to regulate them. In short, the current rules are disproportionately prescriptive (SLCs 31-32 now total almost 70 pages) and have succeeded only in creating more customer confusion and increasing operating

costs for suppliers. It is safe to conclude that despite the best intentions the rules have not succeeded in achieving the "simpler" and "clearer" objectives of RMR.

4.26. Again applying OVO's outcomes-based approach using the example from Figure 2, we start by tackling the problems at source which are preventing both suppliers and customers from achieving The Outcome, namely:

- (a) The complexity and sheer volume of details required to compare tariffs between different suppliers.
- (b) Customer confusion resulting from that complexity and quantity of information.
- (c) How information is presented and delivered to customers to minimise that confusion.

4.27. In an outcomes-based world we would turn each of these problems into specific sub-outcomes, for example:

- (a) "All information is presented clearly, accurately, and succinctly."
- (b) "Customers understand the information on their bills."
- (c) "At least X% of customers have taken action to switch tariffs based on the information on their bills."

4.28. Delivering these sub-outcomes should be relatively straightforward for suppliers and there are a host of metrics that could be used to measure how suppliers are performing against them, namely:

- (a) Monitoring switching rates not only between suppliers but internally within suppliers – to demonstrate whether or not customers who are satisfied with their supplier's service are taking advantage of the best tariffs;
- (b) Monitoring switching rates specifically of those customers with incumbent suppliers who have never switched or who have not switched for a considerable length of time (e.g., more than 10 years);

- (c) Holding regular customer focus groups to assess levels of customer engagement around information and bills (among other areas);
- (d) Applying the Net Promoter Score metric to suppliers – a tool which is widely used in retail markets to measure broad customer satisfaction and brand loyalty; and
- (e) Continuing to collect complaints data to demonstrate customer satisfaction and the extent to which suppliers are resolving issues efficiently and effectively.

4.29. We can summarise the spirit of the intended sub-outcomes set out in paragraph 4.27 and complete the Engage pillar of our diagram as follows in Figure 4.

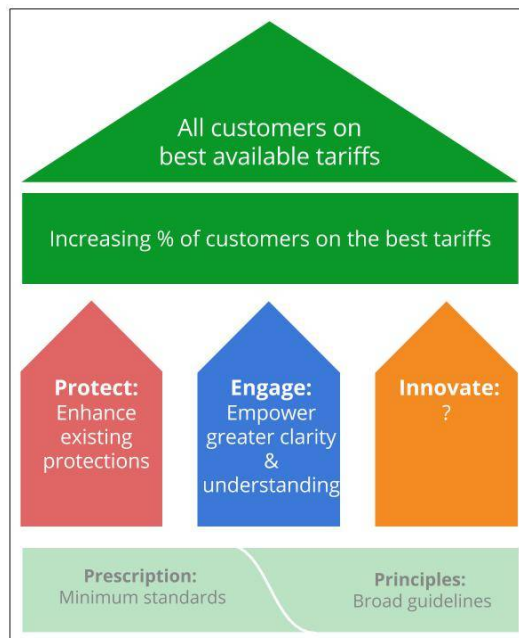


Figure 4 – Engage

4.30. We now turn to the third and final Pillar - Innovate.

Innovate

4.31. In the following paragraphs we outline how an outcomes-based approach can remove current restrictions and deliver greater opportunities for suppliers to

innovate, but in a way that maintains sufficient transparency and protection for customers.

- 4.32. Returning to the example of RMR, the prescriptive rules capping the number of tariffs, prohibiting discounts and restricting bundling has resulted in suppliers being enormously restricted in how they can structure their tariffs and propositions.
- 4.33. We are mindful that the CMA's findings issued on 10th March 2016 already address these areas. Nevertheless, for illustration purposes we will use the current discount and bundling licence conditions in the paragraphs below to demonstrate how OVO's approach can deliver the right sub-outcomes for enabling innovation and contributing towards The Outcome, whilst protecting against the pre-RMR practices that led to the restrictions in the first place.
- 4.34. The illustration below also serves as an urgent call to Ofgem to implement immediately the CMA's findings in relation to the removal of RMR rules. And it tells a tale of caution against repeating the same mistakes in the future of having overly-prescriptive rules that are designed 'bottom-up' with little thought of the impact on customer engagement and supplier innovation.
- 4.35. From our experience of attempting to structure our pricing and propositions, one of the main hurdles we have faced is navigating the detailed, complicated rules governing discounts and bundling. Similar to customer information, the discount and bundling rules are disproportionately complicated and prescriptive. In our view, while the rules may have prevented some pre-RMR practices of confusing pricing structures, they have resulted mostly in fostering a culture among suppliers of finding loopholes. And the rules seem to have had no meaningful impact on improving customer engagement or understanding of the market.
- 4.36. Specifically, for example:

- (a) The definition of "Discounts" is so broad as to encompass almost any and every mechanism used in standard retail markets for adjusting pricing.
- (b) The blanket prohibition on Discounts with only exceptions for dual fuel and online account management discounts are unclear and (in our view) unnecessarily restrictive.
- (c) The rules in relation to bundling of products are largely impenetrable and extremely difficult to navigate – again, unnecessarily so.

4.37. None of this complexity and prescription benefits the customer. In fact, we would argue that the overall effect of these rules has been to actively harm consumers because:

- (a) The rules have stifled suppliers who wish to innovate in a genuine, fair and transparent way;
- (b) They have limited the choices available in the market and the differentiation between different suppliers' tariffs, which has arguably made it more difficult for consumers to engage and make informed switching choices; and
- (c) They have created a 'loopholes' culture where those suppliers who succeed in finding exceptions to the rules are rewarded, while those who genuinely wish to create innovative products in the best interests of their customers are silenced.

4.38. However by applying OVO's outcomes-based approach we are confident that the protection against pre-RMR practices and mis-selling practices can be preserved without limiting the scope for suppliers to innovate. Returning to our example in Figure 2, as with the Protect and Engage Pillars we start by identifying the problems which prevent customers from taking advantage of the best available tariffs:

- (a) Suppliers' historic practices in structuring pricing and bundles lacked transparency.
- (b) These practices lead to customers being confused – and potentially misled - by multiple, undifferentiated tariffs in the market.

- (c) These practices also lead to customers being unable to assess the value of bundles or packages that combine energy and non-energy products.
- (d) Customers therefore were unable to reliably compare different tariffs / bundles and make well informed choices.
- (e) This resulted in customers either selecting tariffs / bundles that were not best suited to them, or disengaging from the market altogether.

4.39. We now turn the problems into positive outcomes-based statements:

- (a) "Suppliers market their pricing and bundles in a clear, transparent way."
- (b) "Customers can distinguish between suppliers' different tariffs / bundles and make informed switching choices."

4.40. The metrics for measuring success in achieving these sub-outcomes can be the same as those used to measure Engagement – see paragraph 4.28 above. In addition, Ofgem could work with the Advertising Standards Authority in monitoring misleading claims and customer complaints arising from poor marketing practices, as energy suppliers should be subject to the same level of scrutiny as any other retail operator in marketing their products and services.

4.41. And now we can complete the final pillar – Innovate – by summarising the spirit of the intended sub-outcomes set out in paragraph 4.39 as follows in Figure 5.

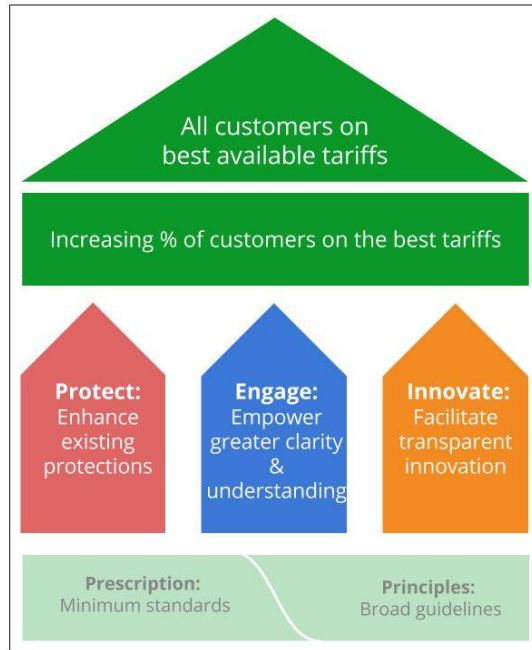


Figure 5 - Innovate

5. The Rules – Formulation, compliance & enforcement

- 5.1. Now that we have built the 'house' – setting out The Vision, The Outcome, and the sub-outcomes under each of The Pillars – we can install the 'pipes' and the 'wires' by translating the sub-outcomes into rules.
- 5.2. In the battle between prescription and principles, we believe in most cases that principles will prove more effective in facilitating the delivery of The Pillars and ultimately The Outcome.
- 5.3. We recognise for some outcomes it might be necessary to retain elements of prescriptive rules, particularly where de minimis standards are required to protect vulnerable customers. We also recognise the role for guidance but, like Ofgem, are wary of guidance bringing in prescription through the back door.²
- 5.4. In the context of warrant charges for example, there could be guidance or prescriptive rules to ensure suppliers publish charges on their website or clearly identify which charges are not straight pass-through third party costs.
- 5.5. The current standards of conduct in SLC 25.4 are a good starting point as they clearly state principles that should cover most if not all outcomes that Ofgem may wish to achieve. Also we note that Ofgem has successfully set up the Challenge Panel to monitor compliance with SLC 25.4 – again this is a good starting point for governing compliance with additional principles-based rules.
- 5.6. Furthermore, using the example from Figure 2, many of the sub-outcomes we have proposed in section 4 will translate readily into principles.

² Ofgem (2015) The future of retail market regulation, Operating the new framework p2.

- 5.7. We can continue theorising endlessly about the benefits of principles over prescription or narrow vs broad principles, but little progress can be made until The Outcomes and The Pillars are clearly articulated. And ultimately no reform will succeed in doing anything other than reinventing the wheel unless there is a genuine and deliberate culture shift amongst all market participants, and Ofgem gains better in-depth understanding of supplier businesses.
- 5.8. Therefore in the following paragraphs we discuss the importance of culture shift and upskilling in the context of formulating, complying with and enforcing The Rules, and we look at what we might learn from examples of principles-based regimes in other sectors.

Formulation, Compliance and Enforcement

- 5.9. First, we would recommend redefining compliance – rather than compliance with rules we should be thinking about achievement of outcomes.
- 5.10. Supplier success in achieving outcomes should be measured by a combination of metrics – as outlined in paragraphs 4.28 and 4.40 - underpinned by a substantive approach which looks at supplier behaviour and culture.
- 5.11. Supplier behaviour and culture can be assessed by looking not only at the end result – i.e., whether or not an Outcome has been achieved or a Rule has been followed – but also by focussing on a supplier’s decision making process and whether there has been genuine intention and effort to fulfil the underlying spirit and intentions of The Outcomes and The Rules, even if the end result was unsuccessful. We are confident that this constructive approach is the polar opposite to the current tick-box approach to compliance, and is therefore more likely to encourage – or ultimately force - long-term change in supplier behaviour and culture.
- 5.12. A radical shift in culture – amongst all market participants - is particularly critical in the context of enforcement. We are extremely mindful that the high degree of

flexibility offered by principles represents a large 'carrot' for suppliers, so there is the ever greater need to guard against abuse of that flexibility by having an equally large 'stick'. However having a large 'stick' comprises of not necessarily higher fines or other prescriptive remedies, but Ofgem having greater scope to exercise subjective judgement in how they assess and address infractions. And that judgement can be effective only if Ofgem takes the substantive, constructive approach we outline in the paragraphs above.

5.13. In parallel with radical culture change, we feel Ofgem would benefit from acquiring more practical, hands-on expertise in relation to the technical, operational and commercial aspects of suppliers' businesses. Without understanding in sufficient depth how everything from billing systems to call centres work, new regulations in whatever form are at risk of being crafted in a vacuum too far removed from the practical realities of how a supplier operates.

5.14. Therefore the success of formulating and implementing genuine regulatory reform is dependent on two key practical factors:

- (a) Ofgem formulating the right metrics for measuring suppliers' success in fulfilling The Outcome and the sub-outcomes in each Pillar (as outlined in section 4), and
- (b) Ofgem having the sufficient skills and culture to exercise measured and consistent judgement in monitoring supplier behaviour and activities, looking holistically and substantively at all circumstances at hand to determine whether or not the principles – and their intended spirit - have been met.

5.15. The following paragraphs look at examples of principles-based regimes in non-energy retail sectors to illustrate how outcomes can be transposed into principles-based regulations, and how compliance and enforcement operate under those regulations.

Financial Conduct Authority

- 5.16. The retail banking sector is quite similar to the retail energy sector in a number of ways. There are a large number of complex products that could potentially bewilder many customers and cause them harm. The complexity of the market also creates information asymmetry between suppliers and customers that suppliers could exploit by selling products that are aligned to a supplier's – not the customer's - best interests.
- 5.17. In order to achieve fair market outcomes, the FCA stipulates six retail outcomes as part of its Treating Customers Fairly (TCF) initiative and places the onus on suppliers to act in the best interests of their customers. These outcomes also remain central to consumer protection, policy, general guidance and the principles by which the FCA makes rules.³
- 5.18. The specific outcomes most relevant in the context of this consultation are as follows:
- "Outcome 2:** Products and services marketed and sold in the retail market are designed to meet the needs of identified consumer groups and are targeted accordingly."
- "Outcome 3:** Consumers are provided with clear information and are kept appropriately informed before, during and after the point of sale."
- "Outcome 4:** Where consumers receive advice, the advice is suitable and takes account of their circumstances."
- 5.19. Critically, these outcomes recognise and respond directly to potential problems in the market – i.e., information asymmetry. The outcomes are also clear with regard to what the FCA wishes to achieve - customers are sold products appropriate to them.

³ FCA (2013) The FCA's approach to advancing its objectives, July.

Finally and most importantly, the outcomes are written such that they are easily deliverable and relatively straightforward to measure progress against. Broadly speaking, the regulator need only review the content of any correspondence between the supplier and customer to establish whether all three outcomes were satisfactorily delivered.

- 5.20. The FCA's model therefore illustrates how an outcomes-based regulatory framework can work in a highly analogous sector.

Takeover Panel

- 5.21. Next we look at the Takeover Panel and their regulations under the Takeover Code. We feel this is relevant to the retail energy sector because the Takeover Panel governs complex transactions that have wide-ranging consequences and which often involve highly technical matters.
- 5.22. The Takeover Code is based upon six 'General Principles' which are statements of standards of commercial behaviour. Those General Principles are then supplemented by rules contained within the code, which are framed in narrower terms than the General Principles but not in overly- prescriptive terms because the Takeover Panel expects to interpret them by judging whether their underlying purpose has been achieved – i.e., "their spirit must be observed as well as their letter".⁴
- 5.23. By way of example, the Takeover Code rules do stipulate specific matters such as the threshold of ownership at which a shareholder of a public company must make an offer to acquire all other shareholders' shares, or the timing for making certain announcements during a takeover process.

⁴ <http://www.thetakeoverpanel.org.uk/the-code/download-code>.

- 5.24. However, those specific rules are heavily underpinned by core principles of ensuring that shareholders are treated fairly. Furthermore, the Takeover Panel's approach to compliance and enforcement "focus[es] on the specific consequences of breaches of the Code with the aim of providing appropriate remedial or compensatory action in a timely manner".⁵
- 5.25. In terms of internal resource and skills, we're aware that the Takeover Panel runs an active programme to second-in personnel from firms and organisations in relevant businesses. This provides enormous benefit for both parties – the Takeover Panel gains invaluable business knowledge while firms gain insight into how the regulator operates.
- 5.26. The Takeover Code is therefore a good example of how a regulatory framework for similarly complicated activities can be based on principles and supplemented by specific rules. It also shows how a regulator exercises judgement in enforcing the rules – by looking not at formal compliance with the rules but at the consequences of a person's conduct, and taking all matters into account, whether or not they have complied with the spirit of the intended purpose underlying the rules.

Information Commissioner's Office

- 5.27. The Data Protection Principles governed by the Information Commissioner's Office (the **ICO**) provides another useful example of principles-based regulation as it is designed largely to protect retail consumer interests in a similar way to the energy sector.
- 5.28. The Data Protection Principles comprise eight broad principles governing how organisations should capture, process, use and store a person's data. For example:

⁵ <http://www.thetakeoverpanel.org.uk/the-code/compliance>.

"**Principle 1** requires personal data to be processed "fairly and lawfully"."

"**Principle 7** requires organisations to have "appropriate technical and organisational measures" in place to safeguard personal data."

5.29. Similar to the Takeover Code, there is legislation in the form of the Data Protection Act which sits behind the Data Protection Principles, but the principles form the cornerstone of the ICO's regulatory framework.

5.30. The ICO uses a number of tools to ensure compliance by organisations. Importantly however, their approach to enforcement is very much focussed on:

- "taking action to change the *behaviour* of organisations"⁶ (emphasis added);
- "helping and encouraging organisations to understand and meet their information rights obligations more easily"⁷; and
- in providing guidance on how organisations can self-report breaches, "[T]he potential detriment to individuals is the overriding consideration"⁸ of the ICO.

5.31. This shows a focus on behaviour, outcomes, and similar to the Takeover Panel, the underlying spirit of the rules. We are also encouraged to see a sense of partnership in the relationship between the ICO and organisations. The ICO has access to heavy 'sticks' in the form of financial penalties, but it recognises that penalties only punish behaviour in the short term and therefore they would prefer to change how an organisation operates and behaves in the long term – which ultimately benefits all consumers.

5.32. We believe there is much to learn in this approach for retail energy regulation, where supplier behaviour and the actual consequences of their behaviour – as opposed

⁶ <https://ico.org.uk/about-the-ico/what-we-do/taking-action-data-protection/>.

⁷ <https://ico.org.uk/media/about-the-ico/policies-and-procedures/1853/data-protection-regulatory-action-policy.pdf>.

⁸ https://ico.org.uk/media/for-organisations/documents/1536/breach_reporting.pdf.

ticking the rule boxes – are the focal point of scrutiny. Adopting this approach is also consistent with our proposal of placing direct responsibility on suppliers for meeting the outcomes and the need for enormous culture shifts in the industry in order for regulation to succeed.

6. The Next Phase

- 6.1. As we said in our Introduction, we very much recognise that this consultation represents the start of the journey towards radical reform of energy retail regulation. And as a consumer champion OVO is well placed to be at the forefront of the debate around how we implement such reform.
- 6.2. As we have outlined in our response, the key to successful reform is to take a top-down, outcomes-based approach. Without doing so risks wasting the rare opportunity this consultation presents to redesign regulation for the genuine benefit of all energy consumers.
- 6.3. In order to progress the reform we strongly recommend that Ofgem resists the urge to dive into the detail of The Rules, and instead start formulating The Vision, The Outcomes and The Pillars.
- 6.4. Next, we recognise that top-down reform requires a top-down culture shift, so we would recommend that Ofgem engages with senior management representatives of suppliers to start debating at a high level The Vision, The Outcomes and The Pillars. Until we have this debate we cannot move forward with formulating The Rules – in whatever shape or form.
- 6.5. Finally, we would recommend prioritising the specific areas of the rulebook we have used as examples in section 4, namely:
 - (a) **Protect:** Prepayment customer warrant charges and the WHD Scheme;
 - (b) **Engage:** Customer information, particularly bills; and
 - (c) **Innovate:** Discount and bundling.

We are greatly encouraged to see that the CMA's findings on 10th March 2016 fully support our proposals in respect of (b) and (c), and would therefore strongly urge

Ofgem to introduce the CMA's findings in respect of RMR rules without any further delay.

- 6.6. We recognise that any regulatory reform of this scope will take time and that 'business-as-usual' will need to continue under current regulations in the meantime. However we urge Ofgem to ensure that any changes proposed to current regulations are kept to the absolute minimum, and all changes are considered in the context of upcoming reform. We have flagged the absence of this context in the recent prepayment and PSR consultations, and shortly before the submission of this response we note yet another prescriptive change in respect of the rounding of decimal places in tariff information labels.
- 6.7. This latter most recent example is a worrying translation of the standards of conduct principles into a highly prescriptive rule. Furthermore in terms of priority and cost/benefit analysis (i.e., the resource required to implement the change vs the benefit to customers), the resource required to implement the change is wholly disproportionate to the likely benefit and is therefore by no means essential.
- 6.8. This recent example highlights a wider issue of commitment and resource at both Ofgem and suppliers being distracted away from future regulatory reform work. It is crucial that Ofgem and all stakeholders dedicate sufficient resource and priority to this work.
- 6.9. We remain hopeful that this reform will bring genuine positive change to the retail energy market and will continue to engage with Ofgem to facilitate the reform.

Annex

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?

As outlined in our response, we are open to maintaining a level of prescription but only where absolutely necessary to protect consumers, particularly vulnerable customers.

In any event we feel that we cannot have a sensible debate about what prescriptive rules might be appropriate until The Outcomes are clearly formulated.

In broad terms, we could see a role for prescription in specifying de minimis standards or thresholds in a similar way to the Takeover Code – e.g., maintaining certain requirements for large suppliers with more than 250,000 customers.

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.

Yes, we would recommend supplementing the principle of “treating customers fairly” and other standards of conduct in SLC 25C.4 in order to make them outcomes-focussed and emphasise the responsibility of suppliers to deliver the outcome.

For example, in the context of SLC 25C.4(b) suppliers could be required to present information (whether in writing or orally) in a manner that empowers customers to make informed decisions. This goes one step further than the existing standards in that SLC by stipulating not just how to communicate but what outcome should be achieved by a communication.

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

Please see section 5 of our response which explains why we have deliberately avoided debating narrow vs broad principles at this stage.

However in broad terms we could see a role for narrow principles in a similar way to prescriptive rules – as a way of setting de minimis standards or thresholds, particularly in the Protect Pillar where certain protections needs to be retained for vulnerable customers.

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

We do not understand this question entirely. As a general observation we would encourage regulators of all retail markets to co-ordinate with each other, but we would not recommend 'mixing' one regulatory framework with another.

<p>Taking marketing or doorstep selling as examples, where consumer protection law sufficiently protects energy (and other) customers we do not feel that Ofgem should add further regulation unless necessary in order to cover energy-specific matters – e.g., how energy price quotes are calculated.</p>
<p>Question 5: How should we use principles and prescription to most effectively protect consumers in vulnerable situations?</p>
<p>Please see paragraphs 4.8 to 4.21 for our comments on protections for vulnerable customers, and responses to questions 1 and 3 above in relation to how to use principles vs prescriptive regulation to achieve such protections.</p>
<p>Question 6: Do you agree with our proposed approach to guidance?</p>
<p>Broadly, yes. Guidance should be sparingly used, only in response to areas of confusion or concern across the market (i.e., not where only one or two suppliers are affected). They should be easily accessible and clearly linked to The Rules.</p>
<p>Question 7: How can we best engage with suppliers in the context of principles?</p>
<p>We believe the best way is to start engagement on the basis of The Vision, The Outcomes and The Pillars. Otherwise any engagement at a lower level will result only in creating a new rulebook, not in reforming the framework within which the rulebook operates.</p>
<p>Question 8: What specific support may be needed for new and prospective entrants?</p>
<p>In a principles-based world there will be a greater role for Ofgem in providing support in the form of behaviour and culture training, and perhaps greater monitoring during a new supplier’s initial period of operation. We would encourage Ofgem to take guidance from the ICO as to how they partner with organisations to effect the right behaviours and culture.</p>
<p>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?</p>
<p>Please see paragraphs 4.28 and 4.40 of our response where we outline possible metrics for measuring success in achieving outcomes, and paragraphs 5.9 and 5.14 for our thoughts on enforcement.</p>
<p>Question 10: Do you have any views or comments on the following proposals?</p>
<ul style="list-style-type: none"> • <i>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.</i>

We would greatly support this proposal. Please see paragraphs 5.30 and 5.31 of our response where we look at the ICO's partnership approach to its relationship with organisations.

- *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 do not understand how this proposal differs from Ofgem's current relationships with Citizens Advice and the Ombudsman Service. In any event we would support Ofgem co-ordinating with these organisations to monitor supplier behaviour and activity.

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

Please see paragraphs 5.9 to 5.15 of our response where we outline our proposed approach to compliance and enforcement.

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.*

Yes we would broadly support this approach. The approach to compliance and enforcement outlined in paragraphs 5.9 to 5.15 would require retaining flexibility and discretion.

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

Yes we would support this proposal. It is very much consistent with our proposal for ensuring outcomes and principles have measurable metrics.

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

Yes we would support this proposal. It is consistent with our suggestion of having a partnership-type relationship between Ofgem and suppliers.

We would stress however that early engagement requires suppliers to trust that Ofgem will act proportionately and exercise judgement consistently.

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

Yes we would support this proposal, provided that the framework for compliance and enforcement is changed (as outlined in paragraphs 5.9 to 5.15).

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

Yes we would support this proposal.

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

Yes we would support this proposal, provided that the framework for compliance and enforcement is changed (as outlined in paragraphs 5.9 to 5.15).

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

We think that workshops and roundtables will continue to be useful, but we would encourage higher-level conversations through senior management representatives of suppliers.

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

Yes we agree with this proposal. The priorities should be driven by The Outcomes and The Pillars that Ofgem wants to achieve.

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.

Please see paragraph 6.5 of our response.

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 (e.g. rulebook, operations) these costs relate to.

Yes we can provide initial views in relation to SLCs 31 and 32 in respect of Domestic Customer information. We have estimated that every change of text in a bill requires – at a minimum - the following internal resource in terms of man hours:

- Legal & compliance assessment of regulation requiring change, advising relevant stakeholders and teams, and managing and co-ordinating the change: three to five hours.
- Copyrighting change: one hour.
- Technology resource to implement the change in our technical and operational systems (e.g., billing): six hours.
- Customer service resource to update training materials and cascade changes to call centre staff in case it generates customer queries: two hours.

In total it can take up to 15 man hours to change one word or line of text in a bill.

By moving from prescription to principles, we can not only avoid this highly disproportionate operational cost and complexity, but we can direct the resource towards innovation and other projects that we believe will have more meaningful impact for customers. We can achieve a much better cost:benefit balance and ultimately deliver better value for our customers.

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)?

Broadly speaking, yes, provided that they are outcomes-focussed and are supplemented by the right metrics for Ofgem to monitor achievement by suppliers.

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

Please see response to question 1.

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

Please see previous responses.