

Principles-Based Regulation

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Contents

1. Executive Summary	3
2. What is the purpose of this paper?.....	5
3. What does Principles-Based Regulation mean to SSE?	5
Key elements needed for PBR to work	6
4. Which supply licence conditions would be suitable for PBR?	7
What should PBR look like in practice	9
5. Implementation of PBR	11
6. Enforcement	11
The FCA's approach	12
Self Reporting	13
7. Conclusion	14

1. Executive Summary

- 1.1 This discussion paper provides Ofgem with SSE's views on the proposed shift towards principles-based regulation (PBR) and some of the important issues that will need to be addressed as a priority. In particular, we provide some examples of those licence conditions we consider ideally suited for PBR. We consider that those licence conditions that govern a supplier's relationship with consumers would be most suited for PBR. This would allow suppliers to determine what approach is most effective for serving their customers in a way that is designed to both fairly meet the customer's needs but also makes most commercial sense for the supplier. In this way, PBR would ultimately deliver competitive diversity which is currently stifled by prescriptive rules, which we think will offer benefits for consumers.
- 1.2 The 'Simpler, Clearer, Fairer' objectives, which were at the heart of the RMR reforms, are still relevant in the context of Future Retail Regulation. These objectives should also underpin Ofgem's approach towards PBR. But, instead of prescriptive rules, these objectives should be translated to principles which are designed to put the customer at the heart of supply regulation. SSE is supportive of a customer-centric approach, which ties in with our wider ethos of seeking to treat customers like family. We therefore see the proposed introduction of PBR as a positive step by Ofgem, which has the potential to deliver improvements for customers by focusing more on outcomes, innovation and competition rather than meeting prescribed formats.
- 1.3 SSE is particularly concerned with the aspects of the domestic energy supply licence that require an overly complex volume of information to be delivered to consumers. We consider that PBR provides significant scope for innovation around customer engagement. By enabling suppliers to develop optimum approaches to customer communication, PBR offers the potential to deliver improvements for customers.
- 1.4 Ofgem's approach to enforcement under a principles-based regime will ultimately determine whether or not it is a success for industry and, more importantly, consumers. SSE does not agree that a dissuasive enforcement regime is necessarily appropriate for a PBR regulatory framework. Instead a compliance-based enforcement model would appear to be more suitable when dealing with principles. We consider that positive consumer outcomes can be achieved through collaborative and transparent engagement between industry and Ofgem, which could be undermined through fear of a heavy-handed enforcement approach.
- 1.5 Effective PBR demands that there be close engagement between the regulator and licensee based on mutual trust. In order for a licensee to effectively go beyond the requirements laid out in licence, the regulatory expectations, outcomes and goals must be clearly communicated by Ofgem. In order for suppliers to confidently deliver positive outcomes, any trust gained must not be abused by either party. SSE is advocating a 'two staged' enforcement regime that involves structured dialogue between regulator and regulated, enabling a "without prejudice" exchange of views on what behaviours constitute compliance. Whilst we appreciate that Ofgem already regularly deals with non-compliances of a more minor nature through a compliance approach, there is currently a lack of transparency of when this approach would be employed in practice and whether, assuming issues can be successfully

dealt with through informal compliance dialogue, this might still result in formal enforcement measures.

1.6 SSE has concluded the following is necessary to successfully implement and see lasting benefits from the introduction of PBR:

- A fair and appropriate enforcement process with opportunities for dialogue with the Ofgem.
- Providing suppliers with the flexibility to determine the best approach to meeting a principle or outcome, coupled with an open dialogue with the regulator.
- Those licence conditions that govern a supplier's relationship with consumers would be most suited for PBR.
- PBR does not mean the end for prescriptive rules and Ofgem/industry needs to carefully consider where appropriate prescription should remain.
- Ofgem should adopt the phased approach towards implementation as suggested within the Future of Retail Market Regulation consultation document.

1.7 SSE would like to work with Ofgem to develop an effective framework and would like the opportunity to have further discussions on PBR once we have further developed our thinking. SSE is continuing to undertake further analysis and evaluation of different enforcement models across a variety of different industries. SSE would welcome further discussion with Ofgem in order to develop and implement a model that best protects consumers' interests, whilst providing suppliers with an open and transparent approach to enforcement.

2. What is the purpose of this paper?

- 2.1 In July 2015, Ofgem proposed a shift in regulatory approach¹, moving from a prescriptive regulatory framework towards PBR.
- 2.2 During the event, Ofgem noted it was in the early stages of a “journey” towards PBR. SSE is supportive in principle of Ofgem’s move to PBR and would like to work with Ofgem to ensure a successful implementation of the PBR into Electricity and Gas Supply Licence Conditions. With this in mind SSE is taking the opportunity to explore and communicate its thoughts on the transition to a principles-based regulatory framework.
- 2.3 Whilst SSE will also be responding to Ofgem’s ‘The future of retail market regulation’ (FRR) consultation² we also wish to have direct dialogue with Ofgem to ensure that the framework is one that works for all those impacted, including Ofgem, consumers and suppliers. We hope that the issues highlighted within this discussion paper will be useful to Ofgem’s FRR team when re-developing the regulatory framework over the course of the next couple of years.

3. What does Principles-Based Regulation mean to SSE?

- 3.1 PBR is outcome focused and it will empower suppliers to decide how best to align their business objectives and processes with specified regulatory outcomes, rather than providing a prescribed format for compliance. SSE agrees with Ofgem that prescription will not always deliver the best outcomes for customers. In SSE’s opinion the prescriptive conditions introduced by RMR did not take account of whether the prescribed formats were a good fit for individual suppliers’ internal processes, approach and culture.
- 3.2 By allowing suppliers flexibility in delivering Ofgem’s policy outcomes, suppliers can deliver increased innovation in the industry. This is because it will give suppliers room to develop different approaches, tailored to customers’ needs, and capable of being adapted with the benefit of experience. This contrasts with prescriptive regulation approach, which is extremely ‘straight-jacketed’ in nature and does not enable suppliers to evolve their processes in response to customer feedback.
- 3.3 When looking to modify the licence and introduce PBR conditions, SSE believes that Ofgem should focus on the areas of the supply licence that will most benefit from a PBR approach, by forming relevant outcomes and developing principles-based rules that are suitable for those licence areas. This paper provides our views as to which areas would be most suitable for early reform, and the approach to embedding PBR that we think would be most effective when working to revise these areas.

¹ Ofgem PBR Workshop - 7 July 2015 - <https://www.ofgem.gov.uk/publications-and-updates/future-retail-regulation-stakeholder-workshop-7-july-2015>

² <https://www.ofgem.gov.uk/publications-and-updates/future-retail-market-regulation>

Key elements needed for PBR to work

- 3.4 Effective PBR demands that there be close engagement between the regulator and licensee based on mutual trust. In order for a licensee to effectively deliver on the regulatory principles laid out in licence, the regulatory expectations, outcomes and goals must be clearly communicated by Ofgem.
- 3.5 PBR will demand a different relationship between Ofgem and suppliers, whether that is in the context of day-to-day contact, formal information requests or the use of its enforcement powers. PBR will place different requirements on suppliers to ensure a more proactive approach towards complying with principles-based rules. These changes will require the relationship between Ofgem and Suppliers to evolve and we would expect there will be increased engagement to deliver the required outcomes.
- 3.6 There are a number of key elements needed for PBR to work effectively. These are summarised below:

Communication

- 3.7 An open and trusted relationship between Ofgem and those it regulates is required for PBR to be successful. During the development of a particular principle (whether broad or narrow) the policy intent must be thoroughly understood by all to ensure the consumer outcomes are achieved. Whilst a licensee might choose to deliver compliance in a different manner to that of a competitor, there should be no ambiguity over the consumer outcome the principle is attempting to achieve.
- 3.8 Clearly, suppliers will be expected to engage with Ofgem throughout the development of a particular policy or legislative change. We also note that Ofgem has referred to the need for an enhanced engagement and monitoring programme to help aid understanding of the delivery of positive consumer outcomes in its consultation paper.

Trust

- 3.9 Instead of taking actions to secure compliance with prescriptive requirements, PBR involves the development of trust and cooperation to identify means of meeting the goals enshrined in principles.
- 3.10 To encourage the dialogue required to build this trust, there needs to be a fair and appropriate enforcement process with opportunities for informal 'without prejudice' dialogue with the regulator. In SSE's opinion, the current enforcement regime is not designed with PBR in mind and should be subject to further review in parallel with the FRR work stream. This is elaborated on within Section Six of the paper entitled 'Enforcement'.

Flexibility

- 3.11 Ofgem's desired outcome of a transition to PBR should be to facilitate greater innovation and competition. To achieve this outcome, compliance and enforcement must be flexible and allow for different suppliers to use different options to comply with the principles in different ways. A supplier should be expected to be able to evidence to Ofgem that due process was followed in making the business decision, the reasoning behind the decision and how the decision adheres to the relevant principle.

Clarity and consistency

- 3.12 Ofgem should work with suppliers to ensure all suppliers understand their responsibilities under a principles-based approach to regulation. In order for a licensee to effectively go beyond the requirements laid out in licence, the regulatory expectations, outcomes and goals must be clearly communicated by Ofgem.
- 3.13 Ofgem should monitor the market to ensure suppliers have a common and equal incentive to ensure compliance. There should not be retrospective changes to Ofgem's understanding of principles. Any policy changes should follow due process (i.e. consultation and impact assessment).
- 3.14 Ofgem should be consistent in its approach to enforcement, and be able to evidence this consistency.

Collaboration

- 3.15 Ofgem must consider the role of and approach other stakeholders (including the Ombudsman Services: Energy and Citizens Advice) and bring them with them on the journey to PBR. SSE notes Ofgem's intention to collaborate with Citizens Advice³ and the Ombudsman within the future of retail market regulation consultation⁴.
- 3.16 SSE would recommend that, where possible, consumer groups should be encouraged to approach a supplier directly to resolve and answer issues, concerns or questions, rather than going straight to Ofgem. We believe this collaborative approach will be in the best interests of consumers. If a supplier deems that an issue is of at odds with any of the principles, it can self report to Ofgem. This will, ultimately, allow Ofgem to focus on those areas it considers as a priority but the success (or not) of suppliers' self reporting issues will hinge on Ofgem's approach towards compliance and enforcement (see chapter entitled 'Enforcement').

4. Which supply licence conditions would be suitable for PBR?

- 4.1 PBR does not necessarily mean the end of detailed rules: it is SSE's view that not all of the supply licence conditions can be adequately covered by PBR and the licence should be a mix of PBR and prescriptive rules. There are strong arguments for saying that a tiered approach to rule design should be adopted. Principles need an underpinning of more detailed rules in some areas and detailed rules in turn need the support and coverage of principles to thwart strategies which seek to exploit gaps and inconsistencies in these detailed provisions⁵.

³ SSE notes the CMA's Provisional Finding for Citizens Advice to become a recognised provider of information and support to domestic electricity customers on restricted meters.

⁴ <https://www.ofgem.gov.uk/publications-and-updates/future-retail-market-regulation>

⁵ J Black Rules and Regulators (Oxford : Oxford University Press 1997) 'Using Rules Effectively'

4.2 SSE has reviewed the Gas and Electricity Supply Licences with a view to assessing which licence conditions could be replaced with a more principled approach and those where more prescriptive rules would be either advantageous or necessary.

4.3 The outcome from SSE's review can be seen below. The licence conditions have been split into two categories: SLCs suitable for PBR and SLCs not suitable for PBR.

SLCs suitable for PBR

4.4 PBR is most appropriate for areas of the licence where there is a distinct relationship between supplier and the customer. This allows suppliers to determine what is most valid for serving their customers and what makes most commercial sense, keeping in mind reputational risk. From SSE's perspective, we believe that the prescriptive RMR communication requirements (and any related recommendations arising from the ongoing CMA investigation⁶) would be ideal for PBR.

- The areas potentially covered by PBR would also give suppliers some competitive diversity.
- Flexibility will allow for more innovation leading to more effective communication.

SLCs not suitable for PBR

4.5 Detailed rules would still be best to explain the relationship between Licensees and the Regulator.

- This gives detail to the arena that suppliers work in but draws the line between what they are required to do within that environment.
- There are mechanisms Ofgem are responsible for such as 'supplier of last resort' which could be quite technical in how they are executed so it makes sense to have details of this would be done.
- Ofgem need to be able to request information from suppliers and this is best given in specific terms.

Supply licence conditions that <u>may be suitable</u> for PBR	Supply licence conditions that <u>are not suitable</u> for PBR
SLC 7 - Terms of Contracts and Deemed Contracts	General arrangements: SLC 1-6
SLC 7A - Supply to Micro Business Consumers	SLC 8 Obligations under Last Resort Supply Direction
SLC 7B - Customer Objective and Standards of Conduct for non-domestic supply activities	SLC 9 - Claims for Last Resort Supply Payment
SLC 7C - Restriction on supplying Green Deal Premises	SLC 10 - Restriction or revocation of licence
Information for all Customers: 20-21C	Industry and activities and procedures: 11-19B
Standard Conditions for Domestic Suppliers: SLC22-24	SLC 25D - Power to direct payment of rebates to Domestic Customers

⁶ SSE notes the CMA's Provisional Finding contains a recommendation to remove certain elements of SLC 22A and SLC 22B.

Domestic Customer Protection: SLC-25-28 (except SLC 25D and SLC 26)	SLC 32 - Reporting on performance
Domestic Customer Information: SLC 31 - SLC 31E	Standard Conditions for All Suppliers: SLC 33 - 49 (except SLC 41, SLC 42 and SLC 45)
SLC 41 - Smart Metering Installation and Installation Code of Practice – Domestic Customers	
SLC 42 - Smart Metering Installation and Installation Code of Practice – Micro Business Consumers	
SLC 45 - Smart Metering Consumer Engagement	
SLC 26 - Services for specific Domestic Customer groups ⁷	

What should PBR look like in practice

- 4.6 To illustrate what SSE thinks would be a good example of a PBR licence condition, we have drafted an alternative to SLC 22C, which we have found to be one of the most unnecessarily prescriptive licence conditions introduced under RMR.
- 4.7 We consider that a good regulatory approach to licence conditions incorporates the following elements:
- (i) Licence conditions should be as clear and simple as possible.
 - (ii) Ofgem's expected customer outcomes should be clearly specified.
 - (iii) Certain aspects of "baseline" customer service and information provision should be either prescribed in the licence or contained in regulatory guidance. This is necessary for two reasons: first for the purposes of consumer protection; and, second, for the purposes of regulatory certainty for the supplier.
 - (iv) Licence conditions should only prescribe elements that are necessary to meet the objectives referred to in (ii) above. All other aspects should be left to the supplier to tailor their approach in accordance with overarching principles, and meeting any overarching outcomes.

The following condition has been drafted under two possible approaches:

- (i) A "broad-principles" only PBR approach would only include SLC 22C.1

⁷ SSE notes that Ofgem has taken into account a move towards principles (with some prescription required) as part of the 'Priority Services Register – Final Proposals' review (https://www.ofgem.gov.uk/sites/default/files/docs/psr_final_proposals_final_0.pdf)

- (ii) A narrow PBR approach, which allows for prescriptive elements would include both SLC 22C.1 and SLC 22C.2.

4.8 The benefit of SLC 22C.2 would be to provide a baseline of expectations of how a supplier ought to meet the outcomes, but avoids the complexity of the existing licence condition, which we think creates an “over-information” effect that is confusing for customers. As an alternative, the contents of SLC 22C.2 could potentially sit in regulatory guidance.

4.9 We are inclined to consider that the requirements in SLC 22C.2 below are useful to ensure a baseline level of consumer protection and that they are not overly prescriptive. However, we are agnostic as to whether this should sit in the licence itself or in regulatory guidance.

Condition 22C: Fixed Term Supply Contracts

Customer Outcomes

22C.1 The following Customer Outcomes apply:

- (i) Domestic Customers should have all the necessary information to make an informed choice at the expiry of a Fixed Term contract.
- (ii) Domestic Customers should be provided with all necessary information to be informed of the arrangements that will be put in place in the event they do not expressly enter a new Domestic Supply Contract.
- (iii) Domestic Customers should not be rolled onto a further Fixed Term Contract or extend the term of their existing Fixed Term Contract without their express agreement.

Requirements at the end of a Fixed Term

22C.2 Within a reasonable period before a Fixed Term Supply Contract is due to end, the supplier must send the Domestic Customer a Notice, which must include the following information:

- (i) the date the Fixed Term Supply Contract is due to end;
- (ii) a statement explaining that if the Domestic Customer does not change supplier or does not expressly enter into a new Domestic Supply Contract, then the Domestic Customer will become subject to the Relevant Cheapest Evergreen Tariff;
- (iii) the Tariff Information Label of the Relevant Cheapest Evergreen Tariff;
- (iv) details of any Principal Term not already incorporated into the Tariff Information Label (if applicable);
- (v) the Domestic Customer’s Estimated Annual Costs in the event that the Domestic Customer will become subject to the Relevant Cheapest Evergreen Tariff;

- (vi) the difference between the Domestic Customer's Estimated Annual Costs as would apply under their current Fixed Term Supply Contract and the Estimated Annual Costs under the Relevant Cheapest Evergreen Tariffs;
- (vii) where the Domestic Customer can find further information on alternative Domestic Supply Contracts available from the supplier;
- (viii) where the Domestic Customer may obtain impartial advice and information about changing their Electricity Supplier;
- (ix) that the Domestic Customer may switch terminate their Fixed Term Supply Contract without being charged a Termination Fee.

5. Implementation of PBR

- 5.1 SSE believes that a phased approach to implementation PBR is the best course of action. A phased approach allows Ofgem to begin the move to PBR sooner tackling priority areas first to ensure that good customer outcomes can be achieved for these areas in a relatively short timeframe. The phased approach has the additional benefit of allowing Ofgem and suppliers to adapt to the new regulatory regime gradually. It has the additional benefit of allowing the change in relationship that is required to develop at a manageable pace.
- 5.2 The 'big bang' approach could bring a whole host of additional risk. PBR is a significant change for the industry and should be managed in phased and controlled manner. We also agree with Ofgem's view within the future of market retail regulation consultation that a gradual approach will potentially delay progress and risk losing momentum.
- 5.3 During the implementation of PBR, SSE would like to be as transparent and open as possible in order to ensure effective engagement that delivers the best possible regulatory regime to the benefit of consumers. Clearly, a change of this nature will require much debate and discussion. Whilst responding to consultations is appropriate and provides an opportunity for stakeholders to air their views on a particular subject, SSE believes that bilateral meetings and industry workshops will be important in ensuring the best outcome for consumers, Ofgem and industry.

6. Enforcement

- 6.1 PBR will allow suppliers flexibility in ensuring they deliver on outcomes, this flexibility will mean that suppliers have to take responsibility and ownership of the outcomes and demonstrate how they have considered the outcomes within their business decisions. Ofgem should aim to allow suppliers to take that responsibility with confidence, adopting an "educative and advisory" approach to supervision and enforcement.

- 6.2 Ofgem note that one of the main benefits of PBR could allow suppliers the flexibility to develop innovative solutions, which meet the regulatory objectives at low cost to the business, and bring new benefits to consumers. In this sense, and as experienced through the Standards of Conduct (or SLC25C), there is no 'right' way. In as much as suppliers are expected to, Ofgem should be prepared to learn, adapt and accept that different suppliers will apply different solutions.
- 6.3 The dilemma for PBR is that for it to work, suppliers will need guidance but not too much prescription. This, according to Black⁸, is the key question: 'how to provide both certainty and predictability whilst giving firms the flexibility and space to innovate that Principles can create'. Instead of taking actions to secure compliance with prescriptive requirements, PBR involves the development of trust and cooperation to identify means of meeting the goals enshrined in principles.
- 6.4 Suppliers will increasingly respond to the threat of compliance issues or enforcement by seeking guidance from Ofgem, and there is a risk that Ofgem will seek to offer prescriptive guidance in order to overcome this.
- 6.5 It is SSE's view that a 'two-stage enforcement' process should apply in relation to the proposed PBR framework. A "two-stage regime" would involve an initial stage of informal dialogue between both parties that enables a "without prejudice" exchange of views on what behaviours constitute compliance. Should Ofgem maintain that the behaviour is unacceptable subsequent to discussions; A reasonable timeframe should be with agreed with the supplier to remedy what the Ofgem considers to be a breach before they become liable for formal enforcement.
- 6.6 However, it is recognised that a deterrence approach is necessary and appropriate where the licensee's account of its behaviour is plainly inconsistent with the principles and/or there is evidence of serious consumer detriment.
- 6.7 However, in cases where it is clear that a supplier has not deliberately or negligently flouted the principles, a two-stage approach offers benefits to the PBR regulatory regime. These benefits include giving suppliers confidence to come up with new ways of meeting consumers' needs without the fear of immediate enforcement if they get it wrong. There are other important advantages. It could help prevent continuation of a detrimental policy - open and constructive dialogue is less likely to result in parties becoming entrenched in their positions, which is at risk of happening in an enforcement context, due to a potential fear that changing approach might be seen as evidence of a breach.

The FCA's approach

- 6.8 It is worth considering the FCA's Enforcement Guide⁹ ('the Guide') when considering our transition towards PBR. The FCA notes that enforcement is 'only one of a number of tools available to the FCA'. The FCA is a risk-based regulator with finite resources, similar to that of Ofgem. It is focused on prioritising enforcement activity on those issues which pose the biggest threat to its statutory objectives. We note that Ofgem's 'Enforcement Guidelines' set out a number of alternatives to

⁸ J Black Rules and Regulators (Oxford : Oxford University Press 1997) 'Using Rules Effectively'

⁹The Enforcement Guide' - https://www.handbook.fca.org.uk/handbook/document/EG_Full_20160101.pdf

enforcement action¹⁰ that Ofgem might take, however the guidelines contain no detail on Ofgem's view in relation to the risk-based approach (such as those offered by the FCA – see paragraph 6.10).

6.9 SSE believes that, should Ofgem decide to approach enforcement through our proposed 'two stage' suggestion, this will also allow Ofgem to focus its enforcement resource on those suppliers that are actively causing consumer detriment. Whilst we appreciate that it is unlikely that every company will 'get things right first time, certain suppliers may seek to take inappropriate advantage of the flexibility that PBR will offer.

6.10 The FCA's risk-based approach to enforcement focusses on areas of priority through its 'thematic work'. The FCA will make a conscious effort to better understand a particular issue or set of circumstances across a sample of different firms. The purpose of such work is to enable the FCA to better understand those areas that might pose a risk to its statutory objectives (without the presumption that it may lead to enforcement). Through a combination of priorities/themes and certain types of misconduct, the risk-based approach provides an indication of which cases are likely to be subject to enforcement action. SSE would suggest that a similar approach is introduced by Ofgem as this will allow it to use its resources effectively and efficiently in order to ensure it is an effective regulator. Assuming Ofgem is transparent about those areas it considers a priority, it will further encourage suppliers to engage with Ofgem and be as open and transparent as possible in order to avoid potential enforcement.

6.11 The Guide also highlights that enforcement is less likely if a firm has built a strong record of taking seriously its responsibilities up to and including board-level. This, along with a combination of open communication and a firm's response to specific issue, will determine whether enforcement is required. If a firm has self reported an issue and taken the appropriate remedial action (including addressing systems, controls and compensating those affected) then the likelihood of enforcement is reduced but additional monitoring could be implemented for a short period.

6.12 SSE would also recommend that Ofgem adopt the FCA's approach in this area. However, whilst we appreciate that a decision on whether enforcement is required or not will be based on each individual case, a supplier's past record should be influential to the decision.

6.13 Suppliers that adopt the open and transparent approach with Ofgem should be given the necessary leniency to put an issue right before enforcement action is considered. This ensures that suppliers have the confidence to raise issues to Ofgem's attention and for open discussion to take place. This approach would be beneficial both for the regulatory framework and also for customers.

Self Reporting

6.14 Ofgem's current Enforcement Guidelines note that an investigation case may start because of self-reporting by a company. The company in question has potentially realised that it may have breached a particular licence condition, code or other relevant legislation and decided to report this incident to Ofgem. In the current prescriptive framework (in relation to the supply licence), it is reasonably

¹⁰ Such as warnings, a period of reporting, independent audit, voluntary action or non-statutory undertakings.

https://www.ofgem.gov.uk/sites/default/files/docs/2014/09/enforcement_guidelines_12_september_2014_published_version_1.pdf

straightforward for a supplier to determine whether a particular process or action is non-compliant as the licence is less ambiguous.

- 6.15 However, under PBR, taking a view on whether a particular action is non-compliant will inevitably become more subjective. SSE would therefore welcome further guidance from Ofgem through its PBR enforcement regime as to the type of non-compliance it would expect a supplier to report and at what stage this should be reported. If a supplier has implemented effective assurance and monitoring controls, it will (if working correctly) identify potential non-compliant actions. In certain circumstances, the monitoring will be able to prevent non-compliance from taking place or having any impact on consumers. Would Ofgem expect a supplier to report this instance? Or, does Ofgem only expect suppliers to report instances where the suspected breach has impacted on the consumer?
- 6.16 In the absence of guidance, suppliers might identify a potential opportunity to abuse a self-reporting mechanism. For example, a supplier might decide to inundate Ofgem with what it considers to be a selection of minor non-compliance issues that may not warrant enforcement action in an attempt to detract from those larger issues causing consumer detriment.
- 6.17 The introduction of a risk-based approach towards enforcement combined with self-reporting guidance will give suppliers a clear indication of the type of information and issues that Ofgem would expect to be reported. This would allow Ofgem to focus resource, time and effort on the material issues causing consumer detriment. SSE believes this is the most effective approach to managing enforcement within a PBR regime.

7. Conclusion

- 7.1 It is important for Ofgem and suppliers to ensure that PBR achieves outcomes that will produce significant benefits both from more efficient markets and firms better attuned to customer needs. In order to achieve this, suppliers will require an approach to regulating the market that reflects the overall flexibility that PBR could ultimately provide. Firms will have increased flexibility to decide what business process and controls they should operate resulting in greater alignment of business and regulatory objectives. This will lead to a more competitive and innovative marketplace.
- 7.2 Ofgem has the potential to unlock a vast amount of positive innovation that delivers positive consumer outcomes. In addition, the introduction of PBR will allow Ofgem to keep up with the pace of change without the pressing requirement to introduce a specific licence condition to encourage certain behaviours. Those suppliers that truly adopt PBR, through investment in culture change and placing consumers at the heart of their business, will benefit most from a PBR regime.
- 7.3 However, as noted within this discussion paper, Ofgem needs to adopt an enforcement framework that reflects the nature of the market it seeks to regulate. Each supplier will adopt a different approach for delivering against a specific principle or outcome and Ofgem will also need to accept a degree of flexibility in the approach towards compliance and enforcement.
- 7.4 SSE is advocating the introduction of a 'two-stage' enforcement regime allowing suppliers to have open and transparent discussions with Ofgem aimed at achieving the best possible consumer outcomes. Those suppliers that adopt the transparency approach and are able to rectify and respond

to Ofgem will ultimately face less regulatory burden. This approach retains Ofgem's right to take enforcement action where necessary, but allows it to focus on areas of specific interest.

7.5 In summary, SSE believes the following is necessary to successfully implement and see lasting benefits from the introduction of PBR:

- A fair and appropriate enforcement process with opportunities for dialogue with the regulator.
- Providing suppliers with the flexibility to determine the best approach to meeting a principle or outcome, coupled with an open dialogue with the regulator.
- Those licence conditions that govern a supplier's relationship with consumers would be most suited for PBR.
- PBR does not mean the end for prescriptive rules and industry needs to carefully consider where prescription should remain.
- Ofgem should adopt the phased approach towards implementation as suggested within the Future of Retail Market Regulation consultation document.