

The future of retail market regulation

Consultation

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Overview:

Ofgem's Corporate Strategy commits us to explore how best to rely more on principles in the way we regulate the retail energy market. For now, we are focused on the domestic retail supply market, where there is lots of prescription and the biggest scope for change.

We think that relying more on principles will better protect consumers, help future-proof our regulation and place a greater onus on suppliers to understand and deliver what is right and fair for consumers. We are committed to striking the right balance between principles and prescriptive rules and welcome views on how best to do this.

We are also committed to ensuring we can support this transition through effective engagement, monitoring, compliance and enforcement. We will think hard about how to manage these practical challenges within our own organisation. We recognise the challenges in making this change successful. This consultation is to seek views on how best to do so.

This document is intended for all stakeholders in the domestic retail market. We welcome views on our proposals and invite you to participate in workshops planned during the consultation period. This will help us finalise our next steps. This consultation closes on 11 March 2016.

Foreword

The way electricity and gas are supplied to Britain's homes is changing significantly. Consumers stand to benefit from innovation, particularly as smart meters are rolled out and any remedies from the Competition and Markets Authority's investigation take effect. This presents major opportunities but also challenges both to the industry and Ofgem as regulator.

To manage these changes effectively, we need to adapt our approach to regulating the retail market. Relying more on principles will enable us to continue protecting consumers while encouraging innovation. We want a marketplace where innovation and discovery can happen and it is easier for new entrants to join. In short, we want a competitive retail market that delivers positive outcomes for consumers and can be disrupted by powerful innovation.

Regulating more through principles and removing unnecessary prescriptive rules represents better regulation. It does not mean light-touch regulation. Indeed, those retail energy suppliers that do not put consumers' interests at the heart of their businesses will continue to face tough action.

While the onus is ultimately on suppliers to understand and meet the needs of consumers, as regulator we need to embrace change too. Central to this is a much richer, ongoing dialogue with industry with swift intervention to protect consumers when necessary, including those in vulnerable situations.

This approach builds on the progress we've already made through our innovation, incentives and outputs-focused regulation of energy networks and our Standards of Conduct, which require energy retailers to treat consumers fairly. We are committed to making further significant progress in using principles during 2016.

This first formal consultation document on the future of retail market regulation has drawn on extensive, and very constructive, engagement with stakeholders over the past six months. I invite all of you in the industry, consumer groups and government to continue engaging with us on this important project.

Dermot Nolan
Chief Executive

Context

In our Forward Work Programme for 2015-16 we indicated that we would seek to further expand the use of principles with a view to reducing our reliance on prescriptive rules. We are publishing this first consultation as the culmination of an extensive programme of stakeholder engagement. It is intended to generate further discussion to inform subsequent policy development.

Associated documents

- [Standard conditions of gas supply licence](#) (Consolidated to 1 October 2015)
- [Standard conditions of electricity supply licence](#) (Consolidated to 1 October 2015)
- [Future retail regulation stakeholder workshop](#) (July 2015)
- [Treating Customers Fairly, Findings from the 2014 Challenge Panel](#) (March 2015)
- [Forward Work Programme 2015-16](#) (March 2015)
- [Corporate Strategy](#) (January 2015)
- [Statement of policy with respect to financial penalties and consumer redress under the Gas Act 1986 and the Electricity Act 1989](#) (November 2014)
- [Enforcement Guidelines](#) (September 2014)
- [Open letter on regulatory compliance](#) (March 2014)

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Executive Summary

The retail energy market is undergoing a period of far-reaching and exciting change, driven by new technologies, new business models and new ways of running the energy system. In the face of this change, our role is to maintain a regulatory framework which delivers positive outcomes for consumers by protecting them from poor supplier behaviour, while allowing them to enjoy the benefits from innovation.

We need a regulatory framework for the retail market which is flexible enough to enable this change. Regulation needs to stay ahead of market developments and in a way that does not distort them – enabling suppliers to take diverse approaches, while offering effective protection to all consumers.

To this end, we have committed over time to rely more on general principles rather than detailed rules about how companies should run their businesses. We consider that this will better protect consumers' interests by:

- focusing our efforts as a regulator on good consumer outcomes and more effective and comprehensive consumer protection
- creating room for innovation, so suppliers can be more flexible in how they meet the needs of customers, including those in vulnerable situations
- putting much greater onus on suppliers, especially senior management, to treat consumers fairly.

This approach builds on substantial progress already made through the introduction of the Standards of Conduct in 2013 as part of our Retail Market Review reforms. These have forced suppliers to think more deeply about treating consumers fairly and enabled us to launch major investigations into poor levels of customer service.

We recognise the practical challenges in taking this agenda forward, particularly how to bring about a culture change in the industry and make a shift in the way we work in Ofgem. Our thinking is still developing on how best to operate this new framework. We are keen to draw on the experience of other regulators and we welcome views from stakeholders on how to meet this challenge.

Reforming the rulebook

In the domestic retail market, we have tended to regulate predominantly through detailed rules. This default approach is unsustainable. Over time, it will lead to an increasingly complex set of rules for suppliers to navigate, but where loopholes in consumer protection remain. Furthermore, some of these rules may well become out of date as the market evolves and they could stifle innovation – a risk highlighted recently by the ongoing Competition and Markets Authority investigation.

We would like to see supply licences that are much shorter, more accessible and clearer about what is expected of suppliers. We see a role for both principles and, in limited circumstances, prescriptive rules. We are consulting on the nature and volume of principles in the licence. We see a strong continued role for the principle of treating customers fairly and will consider whether further principles are necessary. We are also consulting on where we can remove unnecessary prescription, especially where this may limit the ability of businesses to explore, discover and innovate.

Operating the new framework

Under this proposed new regulatory approach, there will be a much greater onus on suppliers, right up to board level, to work out what's right and fair for consumers rather than following a list of prescriptions from Ofgem. This requires a significant culture change where suppliers place consumers at the heart of their business, watch carefully for any areas where they may not be getting things right for consumers and, if this happens, put things right quickly. Suppliers who do this will face fewer burdens and have flexibility and space to innovate. Those suppliers who do not take this seriously will have a much more difficult time.

As regulator, we must also shift our mind-set. Only where there is a single way to provide the right outcome for consumers should we be prescribing the detailed things suppliers should and shouldn't do. We see a role for publishing guidance, but in limited circumstances and not in large quantities, so that we don't re-introduce rules "by the back door". Central to our new approach will be increased ongoing engagement between Ofgem and suppliers. Relying more on principles does not equate to stepping back and only intervening when things go wrong. Rather, it will require effective monitoring, including through early warning indicators. Where our ongoing engagement and monitoring identifies issues with compliance, we may work together with the supplier to solve the issue and, if appropriate, take enforcement action. We will think hard about how to manage these practical challenges within our own organisation. We recognise the challenges in making this change successfully and welcome stakeholder views on how best to approach these operational issues.

Managing the transition effectively

We are committed to changing the way we regulate. We propose to take a phased approach to setting the framework of principles and removing unnecessary prescription. This will enable us to prioritise areas of most potential benefit and move at pace to enable market development. It will also help build confidence in the new systems, processes and behaviours that are key to the success of this new approach.

To help accelerate our thinking, we aim to explore as a priority reform of standard licence condition 25 which governs sales and marketing activities. This licence condition is already underpinned by a set of principles, which have proven themselves capable of protecting consumers. We consider that these principles, in combination with the Standards of Conduct and consumer protection legislation, are sufficient and that we may be able to remove most if not all of the detailed rules that sit alongside them. In doing so, we aim to enable suppliers and third party intermediaries to innovate in marketing and selling to consumers in a good quality, responsible way. Following this consultation, we will only move ahead in this area when we are assured that we have the right tools in place to allow us to continue to protect consumers effectively.

Next steps

We want to make tangible progress on this agenda in 2016. To help us do so, we would like to hear your views on any of the issues in this document, particularly on the questions we ask at the start of each chapter. Please send your responses to futureretailregulation@ofgem.gov.uk by 11 March 2016. We will continue to engage actively with stakeholders during this consultation period and are always happy to discuss your views over the phone or in person.

1. Introduction

1.1. This is an exciting time for the energy market.¹ Rapid technological change, including the rollout of smart meters across Britain, should increasingly enable retail energy suppliers to provide new products, services and pricing options to consumers. At the same time, we expect new business models to challenge the established way of doing things. For example, third party intermediaries (TPIs) and community energy schemes could help change the way consumers manage their energy consumption and interact with the market. Coupled with the ongoing revolution in online and mobile technology, the consumer experience of the energy market is undergoing remarkable change.

1.2. The market is changing fast, and it is important that our regulatory framework protects consumers and also enables them to benefit from new opportunities. Energy is an essential service and with this comes the need for certain protections, including effective support for consumers in vulnerable situations. Regulation should enable and encourage suppliers to compete and innovate in ways that serve the interests of their customers. And it should empower consumers to take control of their energy bills with access to a growing range of products and services.

1.3. Our regulation must be as future-proof as possible, and capable of delivering positive consumer outcomes both today and tomorrow. We will also need to scan the horizon for developments across the retail market.

Delivering positive consumer outcomes

1.4. Ofgem's principal objective to protect the interests of existing and future consumers means that we should be open to changes in the market that can benefit consumers. We aim to deliver better consumer outcomes through lower bills, reduced environmental damage, improved reliability and safety, improved quality of service, and benefits to society as a whole.²

1.5. In the retail market, we consider that these outcomes are best achieved through competition and a more efficient, innovative market, comprised of empowered and engaged consumers.³ We think that central to such a market is a higher degree of consumer trust in suppliers.

1.6. We also recognise that energy consumers have a diverse range of needs, demands and capabilities. Some will thrive in an increasingly sophisticated market

¹ In this consultation document we use the terms "market" and "markets" as shorthand to refer to different segments of the energy sector. For the avoidance of doubt these terms are not intended to describe or otherwise suggest the approach that may be taken by Ofgem for the purposes of market definition in competition law investigations.

² Ofgem (2015) [Corporate Strategy](#), p.10.

³ See our [Smarter Markets vision](#).

with a range of offerings and should be allowed to do so. But there is a risk that those who already see the energy market as complex and hard to navigate will be left behind. We therefore need an approach to regulation which works for all consumers and includes sufficient protection for consumers in vulnerable situations.

1.7. We are committed to improving the way we regulate to help deliver the market we want to see. We do not consider it primarily a question of more or less regulation, but rather finding the most effective possible form of that regulation. We are also mindful of our “better regulation” duties in the Gas Act 1986 and Electricity Act 1989.⁴

1.8. Aiming to enable innovation is also not revolutionary. Indeed, this project sits alongside many other initiatives which share this goal. Innovation is one of the cornerstones of our regulation of networks.⁵ For example, our Network Innovation Competition fund encourages network companies to innovate to reduce costs for consumers while helping deliver a low carbon future.⁶ And we are currently undertaking work on non-traditional business models (NTBMs), looking beyond the traditional models of market participation.⁷ We will showcase what we have done to support innovation in our Innovation Plan in spring 2016.⁸

Prescriptive rules – what is the issue?

1.9. Great Britain’s gas and electricity regulatory framework is made up of a variety of legal instruments, including European Union (EU) law, domestic legislation, licence conditions and industry codes.⁹ This consultation is focused on the standard conditions of gas and electricity supply licences,¹⁰ which contain a mixture of prescriptive rules and principles-based rules.¹¹ In general, however, **they are characterised by a prescriptive approach.**

1.10. The volume of prescription in the licences has grown over time, in response to market developments, new policy initiatives and observed supplier behaviour. Prescription has generally been the default approach: it gives us a lot of control over

⁴ Section 3A(5A) of the Electricity Act 1989 and section 4AA(5A) of the Gas Act 1986. See also the [Principles of Good Regulation](#) which are part of our statutory duties.

⁵ Our [RIIO factsheet](#) has more information.

⁶ This year alone £62.8 million was rewarded to network companies by us to undertake such innovative projects. Our [press release](#) has more details.

⁷ Ofgem (2015) [Non-traditional business models: Supporting transformative change in the energy market](#).

⁸ In the [Productivity Plan](#) published in July 2015, government committed departments to work with regulators to publish Innovation Plans by Budget 2016. These will set out how legislation and regulation could adapt to emerging technologies and disruptive business models.

⁹ In some cases, domestic legislation and licence conditions transpose the requirements of EU law.

¹⁰ We refer to the “supply licences” as shorthand for this throughout.

¹¹ In this document we use “principles” to refer to broad rules (which could be outcome-based) and “prescription” to refer to detailed rules. The subtleties of this distinction are explored in greater detail in Chapter 2.

specific inputs and outputs, and gives licensees greater certainty over what they need to do to comply with the rules.

1.11. The cumulative outcome of this approach is that the supply licences are now long and complex. They each contain a large number of discrete conditions (over 40), many of which carry sub-conditions. For example, the standard conditions of electricity supply licences have expanded from 64 pages in 2007 to 465 pages today (new rules include those derived from EU and government initiatives, such as smart metering). The current supply licences focus on retail market issues such as billing, information, metering and a range of other services that suppliers deliver.

1.12. Prescriptive rules (particularly in high volumes) come with a number of potential drawbacks. Stakeholders have echoed this in our discussions with them. And the Competition and Markets Authority (CMA) has recently highlighted how prescription can get in the way of competition and innovation, in the specific context of some of the Retail Market Review (RMR) “simpler choices” rules. Specifically, we consider that, in the context of future market developments, prescriptive rules could lead to the following problems:

- Prescriptive rules can lead to gaps in consumer protection, which may be exploited through undesirable supplier behaviour. With a changing market, new risks and issues emerge, and there is continual pressure to create prescription to deal with new situations. This is a resource-intensive exercise, for all parties, and adds to an ever-growing rule book.
- Designed with imperfect foresight, detailed rules can unintentionally act as a barrier to competition and innovation that would be in consumers’ interests. This is particularly relevant during the period of significant change that we anticipate in the coming years.
- The requirement to comply with detailed prescriptive rules can lead companies to focus on compliance with the letter of the rules rather than their spirit. This could amount to exploiting regulatory “loopholes”.

Our proposal: relying more on principles

1.13. We propose to address these issues by relying more on principles in the way we regulate the retail market. Our intention to move in this direction is set out in our Corporate Strategy. We think this approach could:

- **Protect consumers better.** Higher-level rules can help to prevent poor consumer outcomes that might fall through the gaps of prescriptive rules, and avoid the continual need to create new rules.
- **Future-proof regulation.** Whereas existing prescription might need modifying to respond to problems or enable innovations, principles can apply to new circumstances as markets develop. They can thus enable suppliers to innovate and use a range of approaches tailored to meet the needs of consumers, including those in vulnerable situations.

- **Place a greater onus on suppliers.** Principles can ensure suppliers must understand and deliver what is right and fair for consumers. This will encourage higher standards and a consumer-centred culture, ensuring that all parts of the business, especially senior management, are focused on achieving the right consumer outcomes and avoiding a tick-box approach to compliance.

1.14. A greater reliance on principles will allow us to remove prescriptive rules in places where positive consumer outcomes can be achieved with principles. Removing unnecessary prescription is integral to our objective: we do not wish simply to add additional requirements on top of the existing obligations. At the same time, we consider there are various situations in which prescription is and will remain the best way to regulate. We are committed to striking the right balance between principles and prescriptive rules. Engaging stakeholders throughout the process will be key to getting this right.

Starting the journey: the Standards of Conduct

1.15. In the retail market, the Standards of Conduct (SoC) are a major step on the road to relying more on enforceable principles.¹² They were introduced in 2013, following the RMR, and are intended to ensure that suppliers treat consumers fairly.¹³ The SoC are broad in application and apply to all areas of a supplier's interactions with domestic consumers.¹⁴

1.16. Through our monitoring activities, including our first SoC Challenge Panel, we have seen suppliers make progress in embedding in their businesses the fairness principle at the heart of the SoC.¹⁵ Some suppliers have told us that their experience of embedding the SoC has prepared them well for the further use of principles.

1.17. Nevertheless, the SoC Challenge Panel also highlighted that suppliers had to take more action to consistently deliver positive consumer outcomes on an ongoing basis. Highlighted actions included:

- Aligning strategic objectives with customer values.
- Ensuring board engagement and effective corporate governance and accountability.
- Aligning incentives throughout the organisation.
- Empowering employees to make decisions.
- Embedding appropriate processes and continuous feedback loops.

¹² It is worth noting that our reforms in 2009 to SLC 25 introduced a set of overarching principles relating to sales and marketing.

¹³ Ofgem (2013) [Implementation of the domestic Standards of Conduct](#), p.1.

¹⁴ Ofgem [Standard conditions of electricity supply licence](#), Condition 25C.1.

¹⁵ Ofgem (2015) [Treating Customers Fairly, Findings from the 2014 Challenge Panel](#), pp.3-4.

- Using consumer views to inform decision-making.

Further expanding the role of principles

1.18. Earlier this year, we launched a project to expand the use of principles in areas where we think this can deliver the benefits outlined above. The scope of this work (including this consultation) is initially focused on the domestic retail supply market, where concerns around supplier behaviour and the volume of prescription are particularly acute and the SoC provide a good foundation.

1.19. As our primary policy lever in the domestic retail market, we are focusing on the relevant parts of the supply licences. We are not examining industry codes as part of this consultation. Neither are we considering the definition of supply. Alongside this project, we recognise that managing these issues will be fundamental to a successful regulatory future. We will consider at a later time the applicability of this approach to other parts of the retail market (for example, non-domestic suppliers, TPIs and NTBMs that challenge the definition of supply). However we welcome early views from stakeholders on this potentially wider scope.

1.20. We are already focusing more on consumer outcomes in our wider policy work in the retail market (some examples are set out in Chapter 2). We are also actively committed to removing unnecessary prescription, where this is appropriate. Our recent workshop on effective billing, where we discussed more flexible approaches to presentation of information, is one example of this. This is also an example of how we will prioritise key areas within the supply licence, where stakeholders have told us that our prescriptive rules are getting in the way of delivering positive consumer outcomes.

Our approach

1.21. An increased reliance on principles will involve far-reaching changes to our regulation and the way suppliers interact with it. We recognise the need to approach such changes in a fully coherent manner. So far, we have been developing our approach through three workstreams. This will help us lay the groundwork for the significant amount of work required in later phases of the project. We will consider these different aspects as part of a holistic reform package, particularly at this early stage. This will help capture any interactions and dependencies between them.

Reforming the rulebook

1.22. In the context of our regulation, the “rulebook” refers to the standard conditions of gas and electricity supply licences. Relying more on principles will be most apparent within the supply licences, which will need to undergo significant reform. We are also considering the role of guidance, including examples of good practice, as a possible way to increase clarity of the rulebook. We are currently focusing on rules relating to the domestic supply market.

Operating the framework

1.23. Operations are the regulatory activities of Ofgem, which put the rulebook into practice. This includes engagement, monitoring, compliance and enforcement. Many stakeholders have emphasised that how we apply this approach in practice is the greatest part of the challenge in achieving a successful transition to more principles.

Managing the transition effectively

1.24. An important consideration is how and when we should move to the future rulebook and operations that we want to see. The timing and phasing of the delivery of reforms will be important. It needs to balance our and stakeholders' desires to deliver timely results with an understanding of the complexity of the task. Getting the planning right at the start is crucial so we can give all parties clarity on next steps and key milestones. Another key element of the transition is how ongoing changes in the short-term should be managed – it is important that these should be aligned to our longer-term move towards principles in the retail market.

Links and interactions with other work to improve regulation

1.25. This transition to an increased reliance on principles in the retail market has links with a number of other concurrent initiatives to improve our regulation, and we will ensure these are coordinated. We are already placing an increased focus on outcomes in our policy development across the retail market. We are working to ensure that live policy areas are approached consistently, and are aligned with the forward approach set out in this document.

1.26. There are several areas of live policy development which are considering issues addressed by this project, such as the Priority Services Register (PSR) Review¹⁶ and follow-up to the prepayment meter (PPM) review¹⁷. We are also mindful of future areas of work that depend on a clear approach to principles in the retail market (including flexibility, NTBMs and TPIS).

1.27. Outside of Ofgem's work, provisional findings from the CMA's investigation of the energy market have highlighted the importance of regulation that enables innovation.¹⁸ Our work is aligned with the CMA's desire to enable an innovative and dynamic market. This project also interacts with government initiatives to reduce the burden of regulation on industry, including the Cutting Red Tape review and Business Impact Target.¹⁹ An increasing reliance on principles and our continuing risk-based approach to enforcement would give suppliers the space to explore and innovate,

¹⁶ Ofgem (2015) [Priority Services Register Review - Final Proposals](#).

¹⁷ Ofgem (2015) [Proposals to improve outcomes for prepayment customers](#).

¹⁸ CMA (2015) [Summary of provisional findings](#), pp.32-33.

¹⁹ The Cutting Red Tape review aims to reduce bureaucratic barriers to growth and productivity. The Business Impact Target is a target for Government to make £10bn of regulatory savings during the current Parliament.

and should lighten the burden on those suppliers which effectively embed the principles within their business.

Engagement to date and this consultation

1.28. Earlier this year we began an extensive programme of research and stakeholder engagement to inform our policy development. We have talked to a wide range of stakeholders including academics, other regulators (at home and abroad), government departments, both well-established and newer energy suppliers, consumer organisations and other market participants.

1.29. This has included over 80 in-depth interviews, as well as a workshop in July with around 50 external stakeholders.²⁰ We have learned valuable lessons from our experiences with outcomes-focused network regulation and using the SoC. We also gathered stakeholder views at our annual enforcement conference in June and last month held a well-attended workshop on “effective billing”, which focused in part on the role principles could play in providing information to consumers.

1.30. We would like to thank all stakeholders who have taken the time to participate in this dialogue, and in particular those who have engaged with some of the more challenging policy issues discussed in this document. Appendix 2 sets out the main things we have learned from other regulators.

1.31. We now wish to gather stakeholders’ views on the contents of this consultation. Continuing to work together with our stakeholders will be crucial in developing and implementing our forward approach.

Structure of the document

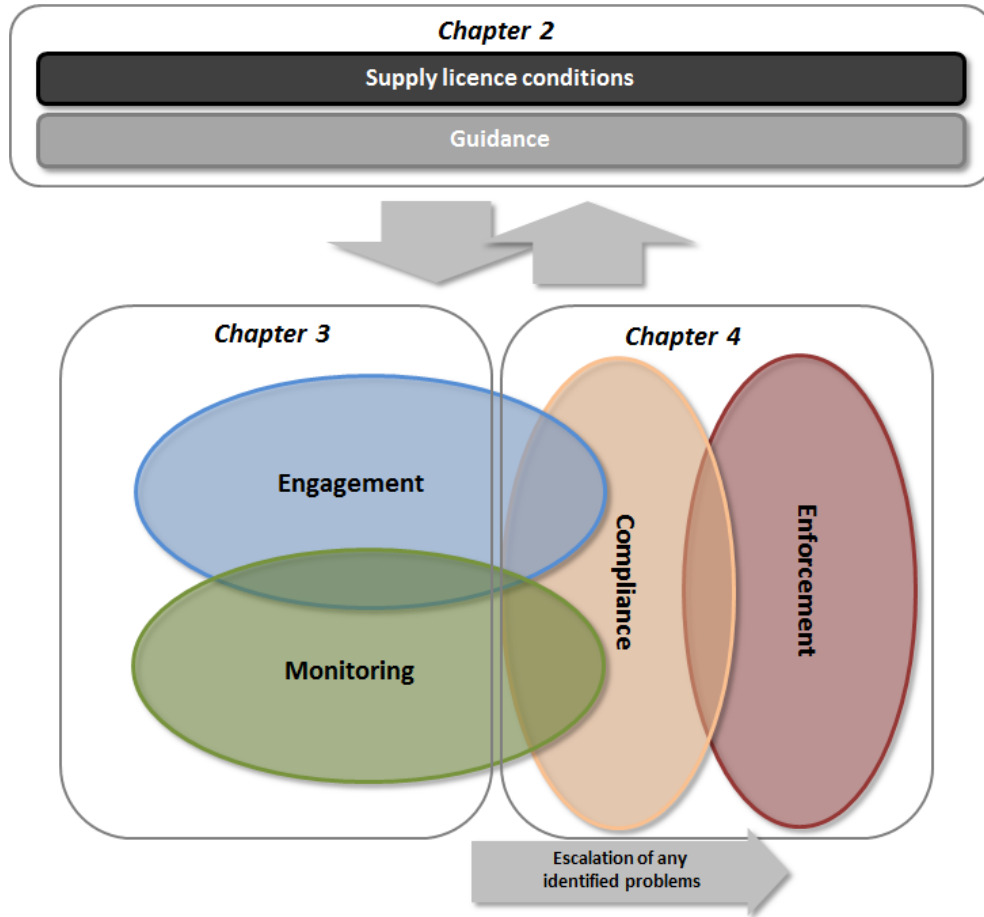
1.32. Building on what we have learned to date, this document sets out our thinking on how the various elements of regulation may need to be adapted to facilitate a greater reliance on principles.

1.33. In Chapter 2 we discuss questions relating to reform of the rulebook, including the role of guidance. In Chapter 3 we consider how we can best engage suppliers and monitor their activities. In Chapter 4 we move on to consider our approach to compliance and enforcement activity. In Chapter 5 we turn our attention to how and when to make this transition. In Chapter 6 we look in detail at one area of regulation where we propose to prioritise reform. In Chapter 7 we look ahead to our next steps, including further stakeholder engagement.

²⁰ Ofgem (2015) [Future retail regulation stakeholder workshop](#).



Figure 1: Components of regulation and structure of document



1.34. In practice, both engagement and monitoring interact with compliance and enforcement. Engagement partly overlaps with compliance, as initial conversations may be sufficient to resolve potential issues without the need for further escalation. Monitoring also partly overlaps with compliance because new issues may be identified in the compliance space.

2. Reforming the rulebook

Chapter summary

We want a shorter rulebook which will protect consumers and encourage innovation and drive positive outcomes. This chapter includes options for the nature and level of principles in the licence. We envisage a mixed approach that has a role for both principles and prescription and seek views on where the latter may be appropriate. We also welcome views on priority areas where we can reduce unnecessary prescription, particularly where these may limit the ability of businesses to explore, discover and innovate in the way they deliver positive outcomes to consumers.


Questions for this chapter

- 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?
- 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.
- Question 3:** Where might narrow principles be more appropriate than broad principles or prescription?
- Question 4:** What are your views on the potential merits or drawbacks of incorporating consumer protection law into licences?
- Question 5:** How should we use principles and prescription to most effectively protect consumers in vulnerable situations?
- Question 6:** Do you agree with our proposed approach to guidance?

2.1. We are focusing on the standard licence conditions of electricity and gas supply licences (our “rulebook”) as these are our primary means of regulating the interactions between suppliers and consumers and underpin other forms of regulation, including through industry codes.²¹ Supply licence conditions serve a wide range of policy objectives, including:

- Consumer protections, both minimum standards and outright prohibition of certain practices. For example, we set a minimum standard for how long a supplier may take to issue a final bill; and we prohibit disconnections in winter for certain categories of customers in vulnerable situations.
- Competition remedies (for example, to address market failures). For example, we set obligations relating to meter interoperability in the case of customer transfers with smart meters.

²¹ It is worth noting that the CMA, as part of their energy market investigation, is examining whether the code governance arrangements are fit for purpose.



The future of retail market regulation

- Government initiatives, such as rules around the Feed-in Tariffs scheme.

2.2. Our aim is to recast the SLCs in the form of clearly-drafted principles, where possible. We also aim to reduce the volume of prescription in the licences, where this is possible and appropriate. There are a number of different ways this could be achieved and we need to consider which ones are best before modifying the SLCs.

2.3. We recognise that the future rulebook is also likely to be influenced by the findings of the CMA's energy market investigation. For example, as a result of the investigation it may be that the RMR "simpler choices" rules are removed. The CMA is planning to publish its provisional decision on remedies in early 2016 and has until the end of June 2016 to publish its final decision.

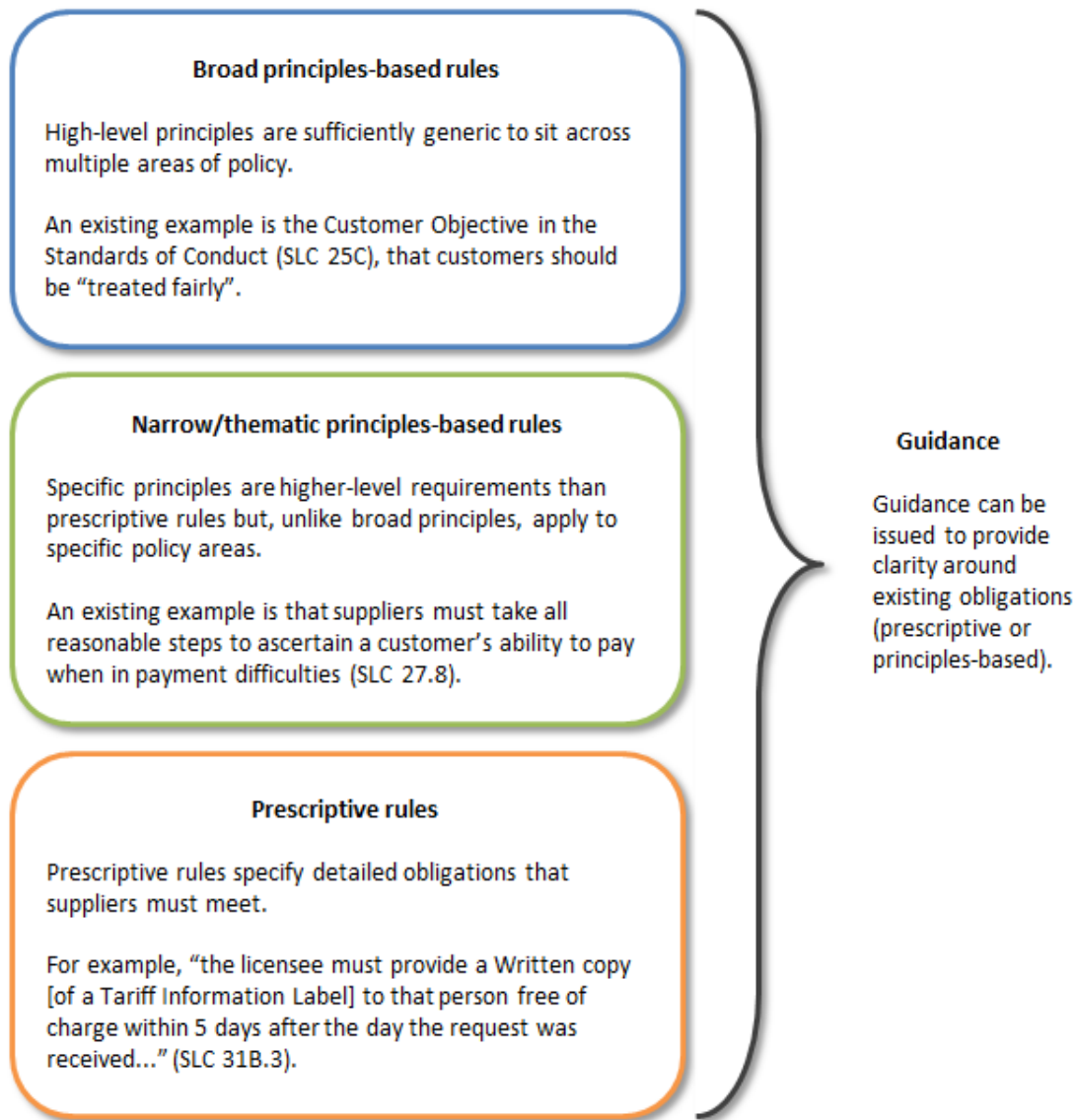
Regulatory building blocks

2.4. Each rule in the supply licences, whether prescriptive or principles-based, is intended to protect consumers' interests by managing risk. In some cases, specific risks will need to be addressed by prescriptive rules. In other cases, particularly relating to future risk or to protect consumers from things we can't predict, principles may well offer more effective protection.

2.5. One can consider the rulebook as a combination of various building blocks to help us manage this risk. These are shown in Figure 2 below. Combined, these provide suppliers with information about what is expected of them and what they can and cannot do. Rules, whether prescriptive or principles-based, are binding. Guidance provides additional information to help suppliers understand the rules.



Figure 2: Building blocks of regulation



An enduring role for prescription

2.6. Stakeholders told us that prescription is still needed in certain situations. We agree that a hybrid approach mixing principles and prescription will be needed. We consider that the use of prescription should be limited to scenarios where the greater detail it provides (to all parties, including consumers and their representatives) manages specific risks and delivers the right consumer outcomes. In particular, prescription could be required to deliver:

- **Specific minimum standards below which suppliers’ outputs should not fall.** Energy is an essential service and as such there are some basic

minimum standards consumers should expect. In these cases, the flexibility inherent in principles may not provide the certainty or clarity required, and detailed rules may be preferable. This is most likely to apply when the outcome is affected by a quantitative measure, such as time. For example, we specify that consumers should be billed at least twice a year. This is different from standardisation, as it still allows differentiation above the specified minimum standard.

- **Prohibition of a specific detrimental practice.** Consumer protection considerations may also lead us to ban unacceptable behaviours. We are particularly mindful of risks to health, safety and other significant consumer detriment. Commercial incentives may push suppliers in another direction, meaning that prescription is the best way to ensure the right outcomes.²² For example, we prohibit disconnections in winter for certain categories of customers in vulnerable situations. We know that such interventions may risk inadvertently preventing innovation and other beneficial outcomes, but we think that there will still be cases where a ban is the best way to manage consumer risk.
- **Standardisation across the market.** Standardisation is sometimes needed to make sure the market functions effectively. For example, we specify requirements relating to the interoperability of Advanced Domestic Meters. Another reason for standardisation is where the regulator is best-placed to define outputs, for example because a cross-market view is required. There may also be some instances where limited standardisation of the type and presentation of specific information is required to support consumer understanding and engagement with the market.

2.7. We would like to hear your views on what this approach might mean in practice when applied to specific areas of the supply licences.

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?

Using principles in supply licences

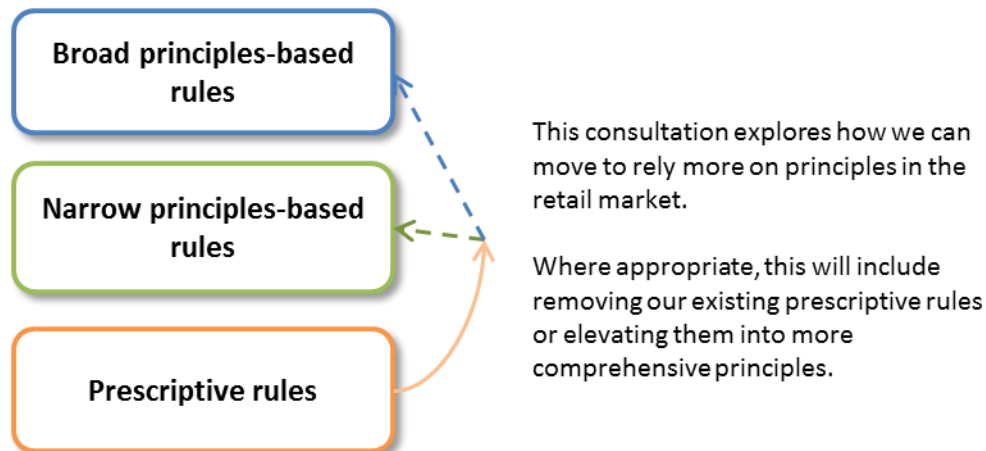
2.8. Currently licences use all three conceptual building blocks. Two years ago, we introduced, in the form of the SoC, a top-level, broad principle of ensuring that domestic customers are treated fairly. There is some limited use of the narrower, thematic principles in various parts of the licence. For example, in relation to certain types of sales and marketing activities (SLC 25), there is a principles-based Objective that sits above the more detailed requirements of the condition. And, as already explained, there are a large number of prescriptive rules in the licences.

²² Over time these incentives could change, for example if the switching decisions of consumers encourage greater competition on certain non-price factors.



2.9. If we think there is not a case for retaining the prescriptive form of certain requirements, we will seek to achieve our policy objectives through principles. We will look to elevate them to either narrow or broad principles (whether existing or new). We expect that this exercise could substantially reduce the amount of prescription in licences.

Figure 3: Elevating prescription to principles



2.10. Some obligations in supply licences stem from government policy (such as environmental or smart metering schemes) or EU legislation. We do not intend to review the licence conditions that are used to implement government schemes. For licence conditions used to transpose EU requirements, we would need to explore with government on a case-by-case basis the extent to which any prescription could be replaced by a principles-based rule.

Broad principles

2.11. At our July 2015 workshop, stakeholders generally agreed that the SoC are a good place to start when looking to expand the use of principles in licence conditions, rather than starting from scratch. For example, some suppliers have, in response to the SoC, changed their internal governance structures so they can better scrutinise the fairness of their existing and proposed products and services. Others have commented that the SoC Challenge Panel report has been a particularly useful publication.

2.12. We agree that the principle of treating customers fairly, although only recently introduced, is already bringing about positive change. As such we would envisage this principle forming an important part of our future framework of principles. Nevertheless, we may wish to modify this top-level tier of principles to ensure that it is as good a substitute as possible for some elements of prescription.

2.13. We might introduce additional broad principles to complement the SoC. Given that the SoC are designed to cover all interactions between suppliers (and their

representatives) and consumers, additional broad principles could focus on a different aspect of a supplier's activities. Any such principles would likely be few in number, compared with the potential for a higher number of narrow principles. For example, the FCA has 11 "principles for business", although many of those (such as relating to "financial prudence") do not appear to be relevant to the energy market.²³

2.14. We think that there may be merit in further exploring the following broad principles. This is not intended to be an exhaustive list. Rather, it is based on our initial view of where there could be useful additions to the existing SoC obligations.

- **Constructive engagement with the regulator.** A principle about interactions between suppliers and the regulator, such as "suppliers must be honest and transparent in their dealings with the regulator". For example, the FCA has a similar principle that also captures firms appropriately disclosing to the regulator "anything relating to the firm of which that regulator would reasonably expect notice". A broad principle along these lines would also help to emphasise the need for us to monitor suppliers' behaviour in a different way when regulating using principles.
- **Good record-keeping.** A principle about what records we expect suppliers to keep to demonstrate compliance with obligations. There are already various provisions covering this throughout the licences (for example SLC 25B.4, in the context of meter interoperability). Stakeholders have pointed out that it would be useful to approach all such obligations consistently. It may be possible to consolidate these existing requirements into a cross-cutting principle. This could both simplify the licences and clarify the need for adequate and proportionate record-keeping across all supplier activities.
- **Board-level assurance around embedding of principles.** A broad principle around the role of suppliers' boards in ensuring consumers are at the heart of all decisions. For example, it could help to highlight the importance of all parts of the business being run in a way that is aligned to the principles in the licence and that it is the responsibility of the board to ensure that this is being done. One specific manifestation of such a principle might be suppliers' development of "accountability maps", whereby named senior individuals are accountable (within their organisations) for various aspects of compliance with the rulebook.
- **Not putting consumer outcomes at risk.** A principle requiring suppliers to actively think about (and put plans in place to manage) risks to consumers when, for example, developing new products or changing business processes.

2.15. We are committed to supporting consumers in their understanding of, and engagement with, the retail energy market. The CMA has identified a provisional adverse effect on competition (AEC) relating to elements of the RMR "simpler choices" rules. It has indicated possible remedies to address this AEC, including removing restrictions on the number of tariffs, the structure of tariffs and the types of discounts and special offers a supplier can present to consumers. We are

²³ FCA (2014) [The FCA Handbook: Principles for Business 2.1 – The Principles](#).

considering actively how best to protect consumers both in the short- and longer-term if the “simpler choices” prescriptive rules are removed. This includes whether any additional principles would be required to sit alongside the SoC.

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

2.16. The SoC were designed to work alongside prescriptive regulation. If they are to perform a more central role in the future rulebook, we may need to explore a number of elements within them to test whether they remain appropriate in the context of the new regulatory framework.

2.17. This is likely to include the substance and scope of the “standards” (SLC 25C.4). For the “standards”, if we identified a cross-cutting theme in the supply licences that was not already covered by the SoC, this may be an appropriate location for it. A review is also likely to include the current “fairness test” (SLC 25C.2 and SLC 25C.3). The “fairness test” in SLC 25C provides that a supplier (or their representative) would not be regarded as treating a customer fairly if their actions or omissions significantly favour the interests of the supplier and give rise to a likelihood of detriment to the customer.

Narrow principles

2.18. Our use of this middle tier of rules is currently limited to a few instances such as the Objective²⁴ of SLC 25 (not to be confused with the Customer Objective of SLC 25C, the Standards of Conduct) and the requirement for suppliers to take into account customers’ “ability to pay” when setting repayment instalments (SLC 27.8). We think that they could play a more important role in the future framework. For example, it may be appropriate to have narrow principles which focus on providing information, billing practices, or other areas of the licence where we want to enable a range of delivery approaches and still secure a more specific consumer outcome.

2.19. Narrow principles may be useful in areas where, even if the policy objective is covered at a high level by broad principles, the greater detail in the narrow principles may increase the scope for removing prescription. And just as with the current marketing obligations (SLC 25), narrow principles could sit directly above remaining prescriptive rules. We would of course need to ensure that all three tiers of rules were consistent with each other.

2.20. We want to understand stakeholders’ views on the merits of this middle tier of rules and which policy areas it may suit. For example, at our workshop a number of stakeholders suggested using narrower principles in areas such as metering, where the SoC might be complemented by Ofgem’s specific expectations in this area.

²⁴ SLC 25.1 and 25.2 from the gas and electricity supply licences.

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

Incorporating consumer protection law into licences

2.21. Consumer protection law, such as the Consumer Protection from Unfair Trading Regulations 2008, includes principles-based requirements. This allows flexibility for regulators to consider commercial practices across multiple sectors and helps to “future proof” regulation as business models develop.

2.22. We can enforce certain provisions of consumer legislation, for example through powers under Part 8 of the Enterprise Act 2002. However, these powers do not currently enable us to impose financial penalties where a breach has been identified.²⁵ One option we are considering is whether it would be appropriate to incorporate compliance with consumer protection legislation into the supply licences or to recognise more explicitly that breach of general consumer law is likely to be taken into account in any finding of breach under relevant principles-based licence conditions within Ofgem’s rulebook. This would acknowledge the importance of suppliers complying with their legal obligations to consumers and could give us additional enforcement options.

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

Choosing between principles and outcomes

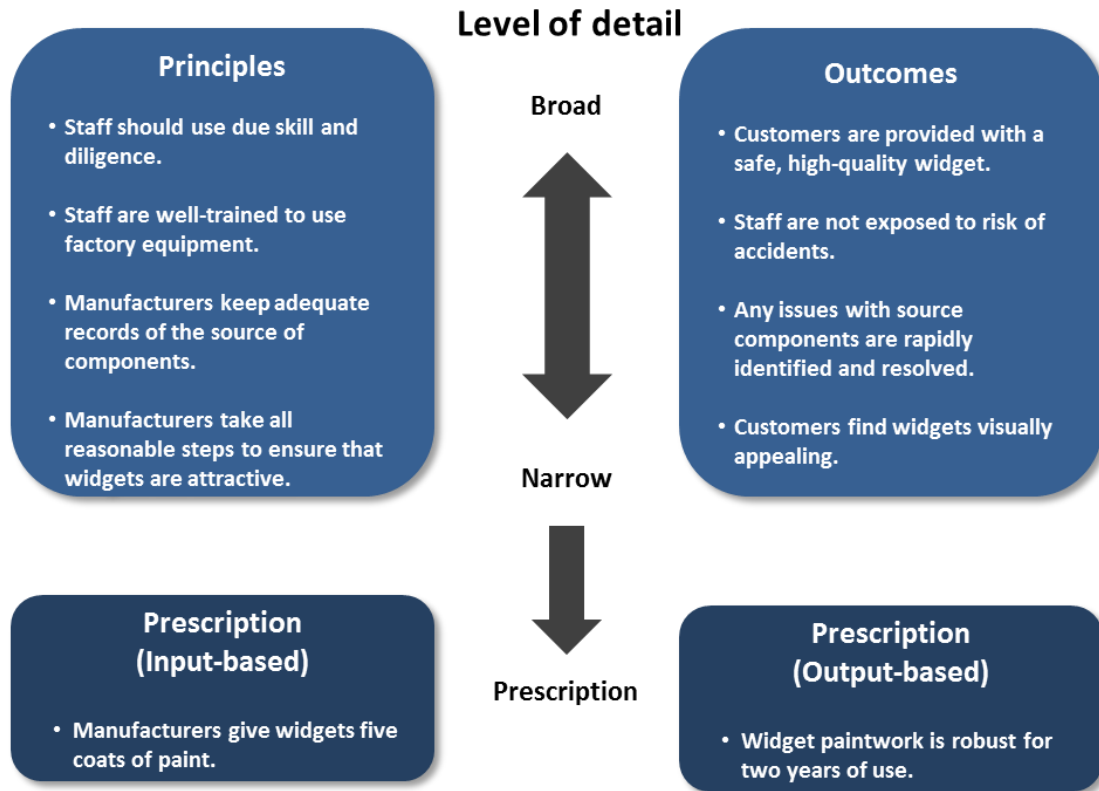
2.23. A wide range of descriptive labels can be applied to different types of rules and regulations. For the purpose of this document, we use “principles” to refer to rules and regulations that describe a requirement at a high level. To use a generic example, this could be “parties shall be open and transparent”. This can also include “outcomes”, for example “consumers are able to make informed choices”.

2.24. The following diagram illustrates how principles and outcomes can be used to achieve the same objectives, at different levels of detail (including prescriptive).

²⁵ The Government has announced that it will be consulting on the introduction of civil fining powers for breaches of consumer protection laws. Details can be found in HM Treasury (2015) [A better deal: boosting competition to bring down bills for families and firms](#).



Figure 4: Principles and outcomes in widget production



2.25. Principles and outcomes each have different advantages. On the one hand, it might be clearer to a consumer what they are entitled to under an outcome-focused form of obligation. On the other hand, it may be preferable to tell suppliers what they should do to achieve the desired outcome, for example if there is doubt that this would be self-evident. We'll likely need to decide on a case-by-case basis in the context of the policy objective that the rule is seeking to achieve. At our workshop, stakeholders tended not to distinguish between principles and outcomes, considering it a secondary question to the right balance with prescription. Therefore, except for in this section, we do not draw a distinction between principles and outcomes in this consultation.

2.26. It is worth noting that all our regulation is focused on achieving the highest-level consumer outcomes, such as "better quality of service" referred to in Chapter 1. Separate from the question of how a rule is framed, there is a question of how suppliers' compliance is monitored. For example, compliance with a principle may be best assessed via monitoring of the intended consumer outcome. This question is discussed in more detail in Chapter 3.

Obligations relating to consumers in vulnerable situations

2.27. Having regard to the interests of consumers in vulnerable situations is part of Ofgem's general statutory duties and intrinsic to our principal objective of protecting existing and future consumers. Vulnerability is a key focus area for us. We have explored with stakeholders the question of consumer vulnerability as there are specific issues relating to this group of consumers.

2.28. We want the market to deliver improved outcomes for consumers in vulnerable situations.²⁶ This includes these consumers being appropriately protected and suppliers making a genuine effort to help them move out of their vulnerable circumstances, where relevant. Views from stakeholders have been mixed as to whether a greater reliance on principles or more prescriptive rules is the best way of trying to achieve this. For example, principles may enable suppliers to develop approaches better tailored to meet specific needs. Conversely, prescriptive rules that spell out exactly what consumers should expect are potentially easier for consumers to understand and for frontline advisors to interpret and explain. We expect that focusing more on principles will help suppliers identify and respond to what their customers really need.

2.29. We are running several concurrent policy projects relating to consumer vulnerability that are taking into account the regulatory approach being addressed in this project. These include the PSR review and a recent consultation on improving outcomes for PPM consumers. Through these projects we are starting to consider the extent to which it is appropriate for us to use principles in these areas, and where we consider it is important to maintain prescriptive standards.

2.30. Final proposals for the PSR review²⁷ are updating the relevant licence requirements (SLC 26) so suppliers support customers in vulnerable situations based on their needs, offering services which provide equal outcomes and a better overall customer experience. Our recent follow-up to the PPM review²⁸ has made proposals about how we can improve outcomes for prepayment consumers in a number of specific areas. Both of these projects have an increased focus on outcomes, giving suppliers some flexibility to deliver the outcomes we want to see in a way that best meets those consumers' specific needs.

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

Guidance

2.31. A shift to principles means the onus will increasingly be on suppliers to understand and think for themselves about how to meet the needs of their

²⁶ For our definition of consumer vulnerability, see our [Consumer Vulnerability Strategy](#).

²⁷ Ofgem (2015) [Priority Services Register Review - Final Proposals](#).

²⁸ Ofgem (2015) [Proposals to improve outcomes for prepayment customers](#).

customers. We recognise that there may be multiple ways of delivering positive consumer outcomes, and this is something we will need to be comfortable with.

2.32. In our March 2014 open letter to suppliers on regulatory compliance,²⁹ we stated that “we expect companies to take ownership of compliance” and that “we do not believe that our role is to operate in an advisory function in the way that some stakeholders may prefer”. In the same letter we stated that “we undertake a variety of activities to make it easier for companies to meet their regulatory obligations”.

2.33. We recognise that suppliers, particularly smaller ones, will still need support to understand their obligations. As discussed in Chapter 3, we propose to enhance our one-to-one engagement with suppliers on their policies, procedures and processes to help ensure at an early stage that they are getting it right (rather than needing to put it right when things go wrong).

2.34. The Ombudsman Services: Energy plays a role in interpreting the rulebook and, as recommended in the 2015 review of its activities, this role is set to increase in importance. Informed by consumer complaints, it is in a good position to identify systemic issues causing poor consumer outcomes and to share such findings with suppliers and Ofgem.³⁰ We are committed to working with the Ombudsman over the coming year as it enhances its capabilities in this respect.

2.35. Beyond this engagement, we recognise that there will also be some instances where further help, in the form of guidance, is necessary. In this context, we are referring to guidance as any piece of written information made available by Ofgem to all relevant parties to aid their understanding of the rules. We see an important but limited role for guidance to support suppliers’ understanding of principles, including an increased role for sharing examples of both good and bad practice.

2.36. We do not expect our use of guidance on principles to be extensive. Stakeholders, including other regulators, have told us there are dangers in allowing guidance to proliferate and effectively create “prescription via the backdoor”. We want to avoid simply replacing prescriptive rules with detailed guidance that sits outside the rulebook. This would undermine the benefits of relying more on principles, including limiting the willingness of suppliers to innovate and take different approaches to delivering positive consumer outcomes.

The relationship between guidance, compliance and enforcement

2.37. We consider that not complying with guidance would not generally, in and of itself, constitute a breach and, as such, would not automatically trigger compliance

²⁹ Ofgem (2014) [Open letter on regulatory compliance](#).

³⁰ Ofgem (2015) [Review of the Ombudsman Services: Energy](#). This report, commissioned by Ofgem, sets out recommendations for enhancing the effective delivery of the Ombudsman’s functions.

or enforcement action.³¹ Nevertheless, in some circumstances, a supplier not having had regard to guidance could indicate a potential breach, particularly if we have published guidance on the consumer outcomes we expect to see and there is evidence that those consumer outcomes are not being achieved. Additionally, a supplier having had regard to guidance may be indicative of one or more of the factors we consider in determining whether to impose a financial penalty or consumer redress requirement and, if so, the appropriate level of penalty or level or type of redress. Failure to follow guidance may, for example, be indicative of whether a contravention or failure was deliberate or reckless or would have been apparent to a person acting diligently.³²

2.38. We have also considered the value from a learning perspective of previous enforcement decisions that involve the application of principles. In some cases, these decisions will provide examples of behaviour that is not compliant with the principles, and as such may help suppliers better understand our rules. Where we consider that suppliers should have regard to a specific part of a penalty notice, a reference may be included as part of our guidance. Where we have removed prescriptive rules as part of the move to principles, previous enforcement decisions that relate to those rules should not necessarily be taken as a guide as to our expectations under future principles: in some cases the point of removing prescription will be to enable approaches that in the past would have been non-compliant.

2.39. We have also noted stakeholder views on how we make such previous decisions available. To make such information as accessible and relevant as possible, we propose in Chapter 4 to select and consolidate on our website key case studies and lessons learned. And we will consider putting hyperlinks to relevant enforcement decisions in guidance, to provide illustrative examples of good or bad practice.

Accessing guidance

2.40. Stakeholders have emphasised the importance of guidance being concise, straightforward and located in a single, well-signposted place. We propose having a dedicated, highly visible point of access to guidance on the Ofgem website. In addition, prominent alerts to signal new guidance could be directly communicated to the target audience (for example via tweets or Ofgem's daily email alert). This guidance hub might also be a useful place to centrally locate other helpful information, for example about upcoming events.

2.41. Stakeholders also told us that online information could be more user-friendly in terms of searchability and presentation. Our proposed guidance hub should be easily searchable. We are also considering whether a wiki approach could enable stakeholders to engage and collaborate on guidance.³³ This could give us an early

³¹ Note that in some cases licence obligations may require suppliers to have regard to certain relevant guidance that we have consulted on.

³² Ofgem (2014) [Statement of policy with respect to financial penalties and consumer redress under the Gas Act 1986 and the Electricity Act 1989](#) ("2014 Penalties Policy").

³³ The Oxford English Dictionary defines wiki as: "a website or database developed

indication of issues to address. We will also consider “quick start” guides that might be of particular benefit to smaller suppliers or those considering entering the market.

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

Making the rulebook user-friendly

2.42. Our stakeholder engagement has brought to light some suggestions about how best to present the contents of the licence. Reviewing the substance of the licence is a good opportunity to make this information as accessible as possible. It should be easy for everyone to find and understand the licence obligations. Reducing these search costs could go a small, but meaningful way to keeping regulatory costs (and barriers to entry) down. Suggestions we have received include:

- Highlighting which rules are currently under review or consultation.
- Linking rules to the consultations and decisions that originated the rule.
- Linking rules to all relevant guidance and enforcement action.
- Flagging where the source of a rule was UK or EU legislation.
- Linking rules to relevant derogations that have been granted.
- Providing historic, time-stamped versions of the licences, to show how they have evolved over time.
- Consolidating all definitions in a single location.
- Managing duplication among existing rules.

2.43. We will consider these and other suggested changes as this work progresses and we will be mindful of the opportunity to join up with other licence modifications.

2.44. With a view to removing unnecessary duplication, we recently consulted on removing the licence obligations relating to two-yearly meter inspections. We consider that that our policy objectives in this area would be better achieved via other regulations and policies, such as safety obligations.³⁴

collaboratively by a community of users, allowing any user to add and edit content.”

³⁴ Ofgem (2015) [Reforming suppliers’ meter inspection obligations](#), p.1.

Additional considerations

Accountability and culture change

2.45. A move towards principles requires a culture shift so that suppliers embed consideration of consumer outcomes throughout their business. The Authority has considered whether it would be appropriate to highlight this by placing personal accountability on senior executives to ensure that it is done. The Authority does not consider that such a move is a necessary or appropriate approach at this time. Instead, as referenced earlier, we will consider other measures to promote accountability within suppliers, such as “accountability maps”.

Derogations

2.46. On occasion we grant derogations (exemptions) from certain licence obligations to individual suppliers if there is a good reason why they should not have to comply. We envisage a reduced role for this in a more principles-based framework. Principles are pitched at a higher level than prescriptive rules, and it is therefore less likely that specific situations arise where they should not apply. One of the benefits of principles is that suppliers can be more flexible in how they choose to comply with them. We will consider whether derogations should still play a role in relation to any of the remaining prescriptive rules.

3. Operating the rulebook: engagement and monitoring activities

Chapter summary

We want to engage more with suppliers to help them understand the rulebook. We will actively monitor compliance with principles to ensure that we spot potential problems as early as possible. We plan to enhance our current approach by exploring new ways of monitoring consumer outcomes. We also want to develop indicators that give us early warning of potential problems. We expect suppliers to do the same. Suppliers who do not engage with us in these early stages may face more intensive compliance and enforcement actions.

Questions for this chapter

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

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

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 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.

3.1. Relying more on principles will necessarily mean an increased focus on engagement and monitoring. This will be particularly important early on to help us understand the extent to which suppliers are in fact delivering the positive outcomes we want to see. These activities can help to quickly remedy or avoid altogether potential non-compliance. This may ultimately mean we can avoid formal enforcement action.

3.2. We know this will be challenging. We will need to identify early warning indicators that provide a realistic picture of what is happening in the market and let us spot existing and emerging issues. This chapter sets out our initial thinking, which we will develop further in the next phase of the project. For example, we will look to identify the specific indicators that are most appropriate to focus on. We welcome views on our proposals or other ideas you have.

3.3. We are especially mindful that our monitoring should be proportionate and not come at undue cost to suppliers, particularly smaller suppliers which may be more resource constrained. Under our proposals, suppliers who have successfully embedded the principles and who are serious about putting customers at the heart of their business will have an easier time. But suppliers who do not proactively embed these principles and achieve the required outcomes may face more intensive monitoring, compliance and enforcement activities.

Feedback from stakeholder engagement

3.4. Compliance with principles is less black and white than with prescriptive rules. We will therefore not be able to take a tick-box approach to confirming whether suppliers are or are not doing specific things. With this in mind, stakeholders have been vocal in calling for more open, frequent and early engagement between Ofgem and suppliers. Suppliers want to be able to raise questions about interpretations and for us to be able to help them without fear of enforcement action.

3.5. Some stakeholders suggested that as part of our engagement work, we should establish a similar function to the FCA's Innovation Hub.³⁵ The idea would be that suppliers could come to us for help understanding how specific proposals may fit with the principles and get some indication of whether these proposals would likely be compliant. Through our consultation on NTBMs, we have also heard strong calls for a wider "innovation space" that cuts across different layers of regulation, which could also be helpful for suppliers with more traditional business models.

3.6. Other regulators, in particular, have emphasised how important it is to have a monitoring framework with key indicators that suppliers report themselves against. Although many stakeholders mentioned the importance of us monitoring consumer outcomes through hard data, others (including consumer groups) suggested we take a more hands-on approach. For example, they suggested we listen to suppliers' call handling, explore examples of product development and testing, and do more site visits or audits.

Defining engagement and monitoring

3.7. "Engagement" primarily covers the work we do to help suppliers understand their obligations. This can take various forms from regular one-to-one meetings to suppliers contacting us to clarify the policy intent behind our rules or test a radically new idea.

3.8. "Monitoring" covers collecting data and information to understand what is happening in the market. In this context, we are specifically referring to monitoring how suppliers are complying with the rulebook, as opposed to broader market monitoring.³⁶ We collect data and information (both qualitative and quantitative) in a

³⁵ FCA [Innovator businesses: Project Innovate](#).

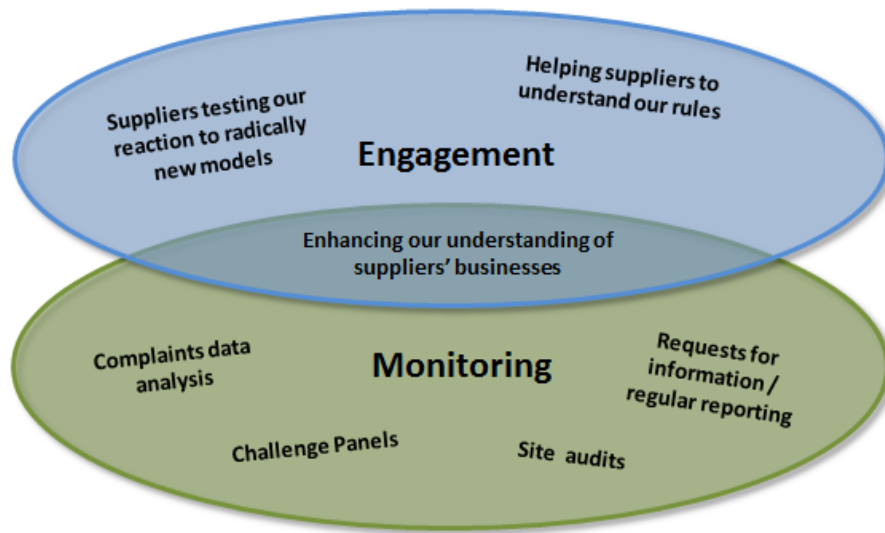
³⁶ Broader [monitoring of the retail and wholesale markets](#) is an important Ofgem function and



number of different ways, including through our different interactions with suppliers. This includes collecting data through regular engagement which we feed into compliance or enforcement activities, as appropriate. See Appendix 3 for a breakdown of how monitoring generally relates to compliance and enforcement activities.

3.9. Monitoring and engagement may at times overlap. For example, one-to-one meetings are a chance for suppliers to put questions to us and for us to better understand their businesses.

Figure 5: Examples of engagement and monitoring activities



Our proposals

Engagement

Proposal: 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.

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

3.10. As we consider the challenges of moving to an increased reliance on principles, there are opportunities for us to strengthen and build on our existing

not something that we propose to change. Our general monitoring of the retail market will feed into our monitoring of compliance but we do not discuss it specifically here.

engagement approach. We want to help suppliers understand their obligations, while ensuring they are taking responsibility for getting things right first time. This is in consumers' interests and will help suppliers to avoid issues arising that need to be escalated to the compliance or enforcement spaces (or both).

3.11. When suppliers have questions, we will aim to provide targeted advice to help them understand their obligations and the policy intent behind our rules. We propose to undertake this engagement with suppliers in a more structured manner so that they know who to contact to discuss a particular issue. Despite this, the onus is firmly on suppliers to understand and meet the needs of consumers. Any general views we share won't restrict our ability to later take compliance or enforcement action.

3.12. We are exploring ways to support innovation and the safe testing of new products and services. Approaches for safe regulatory spaces include innovation spaces, where new models can be trialled within existing regulatory arrangements. We will report on this as part of our Innovation Plan in spring 2016. We also propose to offer suppliers feedback on genuinely innovative ideas (for example, those that are significantly different from current offerings). Such ideas should offer a good prospect of identifiable benefit to consumers either directly or as a result of greater competition. Suppliers should have already invested appropriate resources in understanding the rules before coming to discuss a proposal with us.

3.13. In some professional sectors, new entrants are required to undertake training prior to becoming licensees. This includes ensuring they understand the spirit of applicable principles-based rules, and have a good understanding of what they need to do to meet those obligations. We will consider how our engagement can best help new and prospective entrants to understand the rules in the context of their limited resources, and whether any specific measures are needed for this group of stakeholders. This will build on steps we have already taken to date to improve our engagement with smaller independent suppliers, including through the Ofgem/DECC Independent Suppliers Forum.³⁷

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

3.14. Culture change is critical to getting the transition in this area right. Suppliers and Ofgem must work towards a closer relationship with one another. Requirements under principles are more fluid: suppliers can achieve compliance in different ways. Effective communication between the regulated community and the regulator reduces uncertainty on both sides. The majority of our stakeholder engagement has indicated that dialogue between all parties will be key to making an increased reliance on principles a success.

³⁷ See Ofgem's independent supplier [webpage](#) for more details.

3.15. We will encourage suppliers to share potential compliance issues with us early on. We would expect suppliers to be actively self-monitoring and let us know if something is not going right and what actions they are taking to put it right. This approach will help us better evaluate the issues and work quickly and positively towards an appropriate solution that protects consumers from harm.

3.16. Our Enforcement Guidelines recognise that the fact that breaches coming to light as a result of self-reporting may count in a company's favour when we decide what action to take. Nevertheless, we will not hold back from enforcing against breaches where deterrence is needed just because suppliers have brought an issue to our attention. Although we will engage with suppliers in the spirit of trust, cooperation and support, suppliers should understand that breaches of their licence obligations may result in enforcement action – especially if they are serious, persistent or otherwise meet our prioritisation criteria.

3.17. This requires a mature and open relationship between suppliers and Ofgem built on trust. We think this trust is a key pillar in the success of our future regulatory framework. Suppliers need to be confident that telling us about a potential problem will lead to positive outcomes. Specifically, this means knowing that we will recognise prompt, accurate and comprehensive self-reporting of potential non-compliance under our 2014 Penalties Policy, where suppliers have acted reasonably and in good faith. In return, we need to be confident that licensees are taking responsibility for their own actions, and will act promptly to put any problems right, to safeguard consumers' interests.

3.18. We emphasise that those suppliers who place consumers at the heart of their business, including watching carefully for signs of things going wrong and acting quickly to put right any problems, should see a reduced burden in complying with our rules.

3.19. The relationship that suppliers and Ofgem have with consumers and consumer groups will also require change. We want to make sure that consumers are aware of their rights and that we and suppliers are able to measure whether positive consumer outcomes are achieved. Some consumer groups have also told us that it is important they understand how to interpret the rules and are able to advise consumers on whether a breach may have occurred.

Monitoring

3.20. We are developing a framework for monitoring compliance with the SoC. We will look to build on this to make sure it is robust and fit for purpose for monitoring any new principles. We also need to improve our ability to identify and respond to indicators that may show when we need to take early action. Through our monitoring activities we want to be confident that suppliers are doing everything they can to achieve good consumer outcomes. We also want to be able to spot problems arising as early as possible to minimise or prevent consumer detriment.

3.21. We propose to continue monitoring consumer outcomes by analysing consumer contacts and complaints data. We have been and will continue to engage

with the Citizens Advice Service and the Ombudsman Services: Energy and other consumer groups to help ensure the monitoring each organisation does is as joined up and effective as possible in the light of a transition to a greater reliance on principles. We know that these organisations are looking to improve the way they do this. For example, Citizens Advice is investigating options to improve the evidence gathered through the local network of Citizens Advice to help inform its own advocacy work and our own activities. We also welcome views on any further data or consumer research that we should be aware of.

Proposal: 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.

3.22. Nevertheless, there are limitations to relying solely on consumer complaints data to monitor outcomes. This approach may not fully represent consumer outcomes across the whole market. For example, disengaged consumers may be generally less likely to complain about poor outcomes. Neither would a focus solely on complaints give us a good understanding of where consumer outcomes are improving as a result of the principles being successfully embedded.

3.23. This is why we're considering new ways of monitoring consumer outcomes, either quantitatively or qualitatively, in a regular and effective way. For example, we will consider using an online panel of consumers to do certain tasks (such as getting a quote or reading a bill) and report their experiences to us. We could also collaborate with suppliers on a survey to be distributed to their customers. We welcome views on these as possible options, as well as any other suggestions.

3.24. As part of a move to more principles-based regulation, we also consider that it will be necessary to shift to more proactive monitoring of leading indicators. Such indicators would provide early warning signs if suppliers did not have the right processes in place, or were not delivering good consumer outcomes in line with the principles. They would help us spot potential problems and discuss with suppliers how to put them right before consumers are affected. This will be particularly important as we remove prescription and rely more on the SoC, and also as and when new principles are developed.

3.25. We can use these indicators in many ways. There will likely be a greater role for suppliers to self-report – to demonstrate to us that they have arrangements in place to ensure that they are complying with the principles and achieving good outcomes for consumers. Other options include more regular one-to-one meetings, information requests and using further senior-level Challenge Panels. We welcome suggestions on how best to use indicators to understand whether suppliers are delivering positive consumer outcomes.

3.26. We may wish to use such monitoring activities to understand any customer research that suppliers are undertaking in order to test whether their actions will achieve the right consumer outcomes. It will be important for such research to be objective and this may be one area where it will be useful and appropriate for us to share examples of good practice with the wider industry. This will help ensure that

work done by individual suppliers is properly structured and reflects fully the outcomes experienced by consumers. We also encourage suppliers to share what they have learned from trials or other customer research, to help us understand how different policies and products can affect consumer outcomes.

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?

3.27. Through our monitoring of what suppliers are doing – and through more open and constructive engagement – we will gain a greater insight into suppliers' businesses to better understand their approach to complying with our rules. This should help us to spot potential issues earlier, including persistent issues with compliance across the business. By doing this for all suppliers we will be better placed to identify trends across the market that might require an industry-wide response. We also hope to learn more about suppliers' overall strategies and the way their businesses are run, rather than focusing only on those areas relating to compliance and enforcement.

4. Operating the rulebook: compliance and enforcement

Chapter summary

If suppliers are truly focused on delivering positive consumer outcomes, and are considering and managing risks well (and can demonstrate this), compliance and enforcement action should not be needed. But if we observe that consumer outcomes are poor, and that suppliers haven't done all they can to spot and address problems quickly, we will continue to take strong and swift compliance and enforcement action when needed.

Questions for this chapter

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

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.

4.1. Under this proposed new regulatory approach, there will be a much greater onus on suppliers, right up to board level, to work out what's right and fair for consumers rather than following a list of prescriptions from Ofgem. This requires a significant culture change where suppliers place consumers at the heart of their business, watch for any areas where they may not be getting things right for consumers and, if this happens, put them right quickly. How we operate the new regime will be a key driver for encouraging suppliers to embed this culture change. Our compliance activities and enforcement interventions are critical to this.

4.2. "Compliance" activity is the work we do with suppliers to resolve problems that have been identified. This is often informed by the engagement and monitoring activities discussed in Chapter 3 and set out graphically in Appendix 3. Where



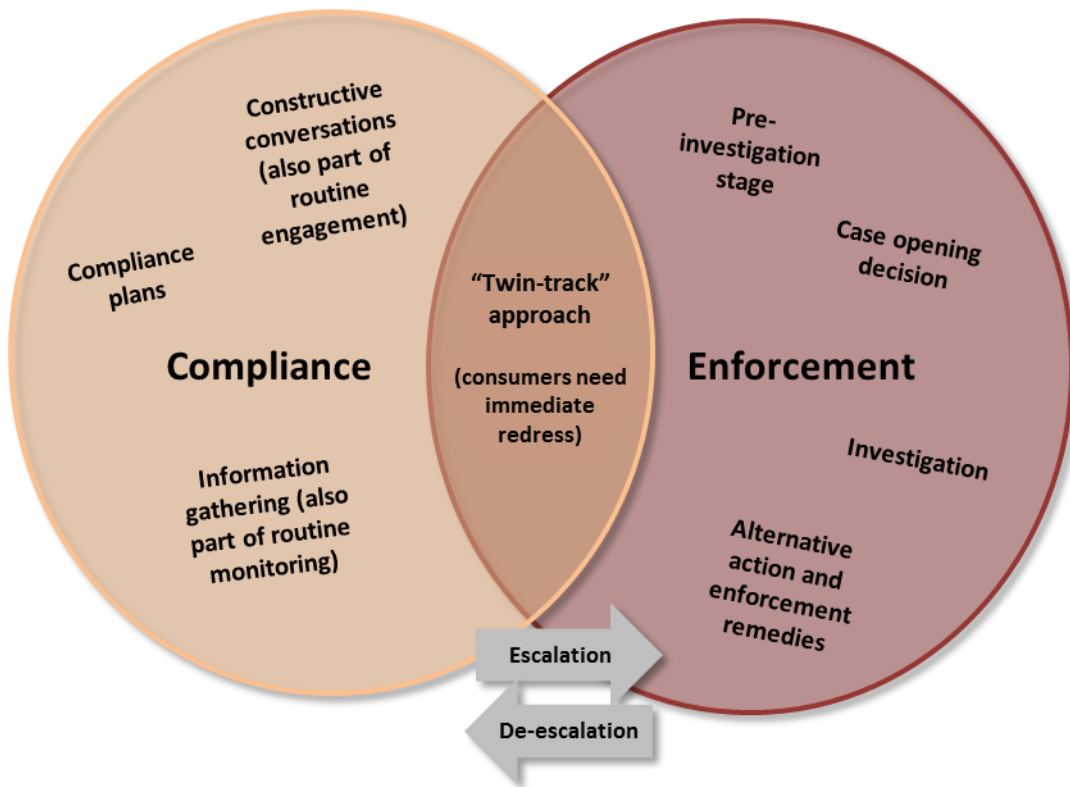
appropriate, to determine if an issue results in a breach of a relevant condition or requirement, we may refer it to enforcement and, where a breach is found, take enforcement action.

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

4.3. Our vision for enforcement is “to achieve a culture where businesses put energy customers first and act in line with their obligations”.³⁸ This is likely to have greater resonance as we transition to a greater reliance on principles, given the increased emphasis on suppliers to determine themselves what is best for consumers.

4.4. The following diagram shows the interaction between the two, including activities within them that are explored later in the chapter.

Figure 6: Overview of compliance and enforcement



4.5. If we have agreed a plan for resolving compliance issues with suppliers, we will monitor this to ensure they stick to the plan and come back into compliance

³⁸ Ofgem (2014) [Enforcement Guidelines](#), p.3.

swiftly. Similarly, following agreement on any alternative action or once an enforcement case has been closed, we will continue to monitor the behaviour of the supplier in question to make sure the issue is addressed. This is essential in correcting poor behaviour and making sure that suppliers are diligent about improving their procedures and compliance and, ultimately, delivering better consumer outcomes.

Feedback from stakeholder engagement

4.6. We've heard calls from stakeholders for more dialogue between the regulator and suppliers throughout the compliance and enforcement process. Some suppliers have called for a two-staged enforcement model, whereby issues are only escalated from compliance to enforcement if they cannot otherwise be resolved. Other suppliers have suggested a variant of this whereby if a supplier thought they had done something reasonably consistent with the principles, but Ofgem decided otherwise, then we should look to stop the behaviour rather than seek to enforce. They think that rapid enforcement should be reserved for reckless behaviour, rather than minor or technical breaches.

4.7. Stakeholders, particularly other regulators and consumer groups, have said that we need to show clearly that suppliers not focused on delivering the right consumer outcomes should expect enforcement and meaningful deterrence. Some stakeholders suggested that deterrence should become more severe to encourage good outcomes. This approach, however, must be accompanied by ongoing dialogue.

4.8. Principles require more judgement and interpretation than prescriptive rules. Suppliers have said that understanding our enforcement cases better will help them understand what we expect of them. Some stakeholders have asked for more information on how we make decisions in enforcement cases. Many stakeholders, including consumer groups, said that publishing examples of good and bad supplier practice would help. We have already begun to engage stakeholders, including through our enforcement conferences, where we have explained our approach to enforcement and held discussion groups to work through key issues.

4.9. Stakeholders have emphasised that our enforcement approach should assist our objective of supporting innovation and flexibility. In particular, we should make it clear that we are open to different solutions to achieve positive consumer outcomes and that we will take into account the circumstances of suppliers when they took their decisions. Suppliers would like to know how much space they have to take risks. We are considering how an "innovation space" (as discussed in Chapter 3) could assist with this.

4.10. Some suppliers say they will need time to embed any new principles before we take enforcement action. Conversely, we've heard consumer groups and some suppliers stress the importance of swift enforcement action under the new system to demonstrate that it is robust and to embed it effectively. Consumer groups are especially keen that our sanctions remain strong to maintain a credible deterrence.

What good looks like in a principles-based world

4.11. To address the challenges above and achieve our enforcement vision, we consider that our regime should have the following attributes:

- **Fair.** Suppliers and consumers must recognise and trust that enforcement action is proportionate and fair.
- **Consistently applied.** The enforcement regime must demonstrate a consistent application of the rules to a variety of supplier approaches.
- **Clear messaging.** Being transparent and sharing lessons from across enforcement work will help the whole market understand our approach.
- **Incentivises a consumer-centred culture.** Getting things right for consumers is preferable to fixing things later. Enforcement should contribute to this.
- **Credible deterrence.** Financial penalties must provide credible deterrence to benefit future consumers.
- **Swift remedy.** Enforcement needs to act fast to remedy consumer detriment.

4.12. The rest of this chapter focuses on our proposals for the aspects of compliance and enforcement that are most relevant or need consideration in the light of our move to relying more on principles. Details of what we currently do for each of these areas and more detailed feedback we've had from stakeholders are in Appendix 4. Please note that we are not attempting to review every aspect of the current enforcement regime here.³⁹

4.13. We expect this approach to reduce the regulatory burden on those suppliers that are most serious about putting consumer needs at the heart of their business. If suppliers have done this effectively, monitored the impact of their actions on their customers and taken action to put any mistakes right then they are less likely to require enforcement activity.

³⁹ The [Enforcement Review](#) was a major review of Ofgem's approach to enforcement. It took place between 2012 and 2014 and introduced a number of key changes to how enforcement works at Ofgem.

Our proposals

The relationship between compliance and enforcement

Proposal: We will retain our current flexible and discretionary approach to escalating issues to enforcement. But we will prioritise compliance activities where possible and appropriate.

4.14. We will engage in compliance activity before deciding whether to open an investigation in many cases. This will help to ensure that suppliers put things right as quickly as possible and avoid the need for escalation to enforcement unless necessary. And as explained in Chapter 3, our future approach to engagement and monitoring will help us spot potential issues early on. In time, we expect this will lead to a reduced need for enforcement intervention, as suppliers are increasingly on the front foot in delivering positive consumer outcomes.

4.15. We will continue to engage with other regulators to understand how best to design an effective and proportionate compliance regime for principles, which doesn't place undue costs on industry and the regulator. No supplier should have a poor compliance record on a regular basis. Poorly performing suppliers should realise they will face heavier scrutiny until their performance improves. Suppliers who are achieving good consumer outcomes should see reduced compliance burden, and less need to engage with Ofgem.

4.16. We want to improve the dialogue between regulator and suppliers before an investigation is opened, and after the enforcement team has become involved in a case. This includes engagement during the pre-investigation stage. We will continue to use alternative action (explained in Appendix 4) where timely and appropriate. However, we do not propose to formalise a two-stage approach that some stakeholders have called for. We think this would reduce incentives on suppliers to get things right in the first place and would restrict our ability to move quickly with enforcement action where needed and to provide deterrence. Although we don't propose to adopt a two-stage approach as a matter of course, we anticipate that there will be times when we only escalate the issue to enforcement after having given a supplier the opportunity to put things right in the compliance space (including providing appropriate compensation and/or redress where appropriate).

4.17. Sometimes it will be appropriate to move directly to enforcement action to prevent or limit harm. Where necessary, this may involve engaging compliance and enforcement processes at the same time – a “twin track” approach. There will also be times when, even if things have been put right, a penalty is required to deter future breaches or remove any gain from the breach in question.

4.18. We recognise the value of being clear about the relationship between compliance and enforcement and have reflected on potential factors that would be likely to move an issue from compliance to enforcement or vice versa. Examples of factors which may lead to a referral from compliance to enforcement include:

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- Evidence of significant harm (eg consumer harm, harm to the market or harm to our ability to regulate effectively).
- Evidence of reckless non-compliance by a licensee or evidence they are not taking compliance seriously.
- Instances where a licensee might refuse to acknowledge the potential breach or to make amends.
- Instances of widespread non-compliance and an enforcement decision is required to communicate the parameters of what is and is not acceptable to the whole market and to provide deterrence.
- A series of problems and poor engagement with the regulator leading up to the current issue.
- Instances where there may be a repeat breach, or the licensee's conduct may break a previous agreement or commitment made by the licensee as part of enforcement or compliance action.

4.19. It should be noted that these are factors which may indicate that a potential breach merits further examination in an enforcement context. However, the criteria for determining whether or not an enforcement case is opened remain those set out in our Enforcement Guidelines.⁴⁰

4.20. An issue can be de-escalated away from enforcement and back to compliance. Examples of factors which may lead to a referral from enforcement to compliance include:

- The breach does not appear to be caused by intentional or reckless conduct. This could include situations where a genuine attempt to deliver positive consumer outcomes through innovation goes wrong – but there is no widespread harm and the supplier is taking swift action to put it right.
- The breach is not found to be significant: for example, harm is limited and/or licensees have admitted the problem and are successfully working to correct it.

Investigation: case opening decisions

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

4.21. We currently gather evidence on a range of criteria in the pre-investigation phase to determine whether or not to open a case. With the move to a greater reliance on principles, we propose to focus on outcomes and consumer harm in particular (such as if consumers are being prevented from switching or are being disconnected). We will make an indicative assessment of harm before deciding on

⁴⁰ Ofgem (2014) [Enforcement Guidelines](#), pp.26-30.

whether to open a case. We don't propose to modify our criteria for prioritising enforcement cases, as we will continue to consider the other ones as well.⁴¹ We will continue to set out the principle that we believe has been breached.

4.22. This approach could potentially lead to a greater number of cases closing and/or being dealt with through alternative action rather than proceeding to a finding of breach. This raises a question about whether to continue publishing case openings. There is a risk of us giving undue publicity, with the potential for negative reputational implications for the supplier, to cases which may ultimately prove not to have been a breach. However, not publishing case openings would reduce the benefits that some stakeholders have said this transparency provides, such as providing an opportunity for disclosure by affected parties or whistleblowers.

4.23. We propose to continue publishing case opening decisions with a view to retaining transparency. We will continue to emphasise that opening an investigation does not mean we have made any findings about non-compliance. As at present, we will communicate the closure of any investigation if we don't find enough evidence of a breach, or decide to take alternative action to remedy harm without a finding of breach.

Investigation: approach to information gathering

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

4.24. We want suppliers to engage with us when things go wrong and be transparent about what has to happen to put it right. Any information we obtain through routine engagement or compliance conversations may later be pertinent to enforcement action and we will continue to share information across Ofgem in such cases. We recognise that some suppliers may be reticent to share information in the compliance space if they think it will lead to enforcement action. Sharing information will not automatically lead to escalation or enforcement action but will properly allow us to consider the factors including those that point away from enforcement. Moreover, our 2014 Penalties Policy (discussed below) incentivises early engagement.

4.25. Early engagement on a compliance issue is likely to demonstrate a positive attitude to getting things right and putting them right. And there are tangible incentives for suppliers to engage with us when things go wrong. Such engagement could support an issue being dealt with in the compliance space or through alternative action.

⁴¹ Ofgem (2014) [Enforcement Guidelines](#), pp.26-30.

Investigation: assessing compliance with principles

4.26. We have already introduced a bespoke enforcement approach for the SoC, which is discussed in Appendix 4. This takes into account the fact that companies can adopt very different approaches to complying with principles.

4.27. The SoC are a relatively new tool. However, early signs are that they are effective as a way to assess supplier behaviour. We therefore propose to continue using this approach to enforce any new principles. Nevertheless, we will consider whether this needs to be adapted as our work, including the introduction of any new principles, progresses.

4.28. We also emphasise that while we accept a certain level of risk as suppliers innovate and take new approaches, we absolutely will not accept risks that are not well considered, well monitored or well managed. Early engagement with us will be important.

Enforcement actions

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

4.29. Our range of enforcement tools (details in Appendix 4) allow us to provide the agile enforcement response that stakeholders have called for. For example, a provisional or final order can be used to address poor behaviours, outcomes and conduct and we can also ask for voluntary action to implement certain remedial or improvement actions, such as making voluntary payments to affected customers. We are continuing to monitor whether there are any gaps in our powers that limit our ability to act with even greater agility.

4.30. At this stage we believe that our 2014 Penalties Policy⁴² is flexible enough to accommodate moving to relying more on principles, specifically enabling us to incentivise the right behaviours with respect to early engagement (referred to above). For example, the 2014 Penalties Policy includes mitigating factors that would tend to reduce the level of any penalty, including the importance of early and active engagement with Ofgem to report the contravention and work towards compliance. The shift to principles will require much more of this early dialogue – we want suppliers to get things right first so that they don't need to put them right afterwards (including through enforcement action). Mitigating factors under the 2014 Penalties Policy include:

- Appropriate action to remedy the contravention or failure.

⁴² Ofgem (2014) [Statement of policy with respect to financial penalties and consumer redress under the Gas Act 1986 and the Electricity Act 1989](#).

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- Promptly, accurately and comprehensively reporting the contravention or failure to Ofgem.
- The extent to which the licensee has taken steps to secure compliance.

4.31. Conversely, there are several aggravating factors under the 2014 Penalties Policy that might mean any enforcement action will result in a higher penalty if this cooperation and dialogue does not occur. These include:

- Repeatedly contravening or failing to comply with previous non-statutory undertakings or agreed action.
- Continuing the contravention or failure after becoming aware of it.
- Continuing the contravention or failure after becoming aware of the start of Ofgem's investigation.

Sharing lessons: communicating our enforcement actions

Proposal: We will make it easier for all suppliers to learn lessons from enforcement outcomes.

4.32. We want to make it easier for all sizes of supplier and potential new entrants to understand how enforcement works and to learn lessons from enforcement cases that have resulted in sanctions. This includes those that were raised as issues but were resolved or addressed through alternative action before proceeding to case opening.

4.33. We will frame enforcement action communications carefully, to make them as helpful as possible while being clear that they are not "prescription by the back door". For example, where appropriate, we will make it clear that a provisional order is a remedial measure which by its nature may contain elements of prescription, but that there may be other ways of reaching the required outcome. Similarly, if appropriate, we will indicate in penalty notices that any specific examples of actions the supplier could have taken relate to a particular set of circumstances and do not necessarily constitute a prescriptive call to action. In general, information we expect to share via our annual enforcement conference and annual scorecard publication includes:

- How we apply the "plan, monitor, adapt" cycle (see Appendix 4) to different scenarios and the types of commitments that companies have successfully made to reduce consumer detriment.
- An annual summary of enforcement decisions, drawing out key themes and showing why particular actions breached the principles.
- Why some cases were closed without enforcement action and how alternative action could be used both in the pre-investigation and investigation stages (anonymised where necessary).

4.34. We also propose to publish enforcement-related case studies and key lessons on our website, alongside other good practice examples and lessons from compliance activity.⁴³

Enforcement transition

Proposal: Enforcement action will continue as usual throughout the transition to principles.

4.35. We've received mixed messages from stakeholders on handling the transition to principles. Several suppliers favour a "window" of time to allow them to make the necessary changes before we would consider launching enforcement action. Others believe that a move to a greater reliance on principles should not be a major change for suppliers that have successfully embedded the SoC, so there is no need for such a window.

4.36. Enforcement remains a key element of our regulatory approach and we consider that any kind of break from enforcement action could send misleading signals both to the market and could allow consumer harm. We share stakeholders' view that the regulator must continue to be robust and maintain a meaningful deterrence to harmful behaviour. So we do not propose to build in a general window of tolerance, although the specific facts of each case will of course be taken into account.

⁴³ Subject to statutory provisions on disclosure of information.

5. Managing the transition effectively

Chapter summary

We propose to take a phased, priority-driven approach to reforming the supply licences. Informed by responses to this consultation, we will determine our approach to principles and then begin removing unnecessary prescription, replacing it with new principles where appropriate. We will analyse the supply licences in stages, so we can prioritise key areas. This will enable us, and suppliers, to learn as we progress. This will help all parties to build the necessary trust and have greater confidence in the new approach.

Questions for this chapter

- Question 13:** How would you like to engage with us on our proposals and the broader work programme?
- Question 14:** Do you agree with our proposal to take a phased, priority-driven approach to reforming the supply licences.
- Question 15:** Which areas of the licences 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.
- 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.

5.1. We are keen to transition to a greater reliance on principles as soon as reasonably practicable. Nevertheless, we recognise that this will be a complex task. Evaluating the current rulebook and redesigning will involve a lot of work. There are also significant changes to be made to the way we operate, including to our culture.

5.2. These will all take time and we are keen to engage stakeholders closely throughout this process. Chapter 7 sets out our proposed next steps in terms of engagement during the consultation period. We welcome views on how best to do engage you (eg one-to-one discussions, written consultations, workshops, working groups). We ask that stakeholders give early consideration to how they will resource and actively participate in this engagement over the coming year.

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

Approach to implementation

5.3. There are different ways we could approach implementation of the changes discussed in this document. We have discussed these with stakeholders. They are:

- **“Big-bang” switchover** - Removing in a single reform all prescription that is no longer considered necessary in the context of the enduring framework of principles (and putting any new principles in at the same time).
- **Phased approach** - Reforming the licences in chunks, each covering a significant portion of the licences.
- **Gradual change** - For example, modifying one licence area at a time. This might entail moving towards principles only when an area is being examined as part of other work.

5.4. We think a phased approach is best. This will involve prioritising those areas with the most pressing need for reform, for example where stakeholders are telling us there is an active constraint on innovation, or that market developments are creating new risks for consumers. This will help us balance the desire to progress at pace with giving enough consideration to the far-reaching changes envisaged here. Stakeholders at our workshop suggested that this phased approach is also the best way to build up trust.

5.5. We don't think a “big bang” approach is appropriate for this project. Several stakeholders have cited the risks that this could bring for suppliers, as it would give them minimal opportunities to prepare (though it would take us longer to implement all the changes). Given the scale and scope of the licence, such an approach would risk producing unwieldy consultations. It would also not work well with the policy development currently ongoing in many areas. Neither would it allow us to prioritise the areas where reform is most urgent.

5.6. At the other end of the spectrum, we do not think that a very gradual approach would meet our desire to see progress and early realisation of consumer benefits. It would also work against our desire to develop a coherent set of principles. Moreover, stakeholders also told us that the work risks losing momentum if it takes too long.

5.7. Some stakeholders expressed the view that a gradual approach would allow a feedback loop to be built in, for example with a view to identifying any unintended consequences of the use of principles. We consider that our proposed approach will allow lessons to be learned between the phases. Our consultative approach to the work is intended to enable such considerations to be built in from the start. And the SoC are also already producing valuable lessons, for both suppliers and Ofgem.

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

5.8. We are keen to understand stakeholders' views on which areas of the supply licences should be prioritised for a move towards principles.

Question 15: Which areas of the licences 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.

Our proposed phasing

5.9. Our proposed phased approach is designed so we can move forward at an ambitious pace, while giving enough consideration to important decisions. For example, we are approaching the reform of the supply licences by first consulting on high-level considerations (in this consultation). We want to hear stakeholders' views on these considerations before determining our preferred framework of principles.

Figure 7: Proposed project phasing



Phase 1 – Scoping and strategy development

5.10. Since launching this work earlier this year, we have engaged extensively with stakeholders. Valuable points raised through this engagement have helped shape this consultation. We welcome further engagement throughout the course of the project.

5.11. This consultation will be open for 12 weeks. In the light of feedback on this consultation, we aim to publish our response by the end of June 2016. This will conclude Phase 1 and signal the transition to Phase 2. At this point, we will aim to have a clear view of where we are heading and how we will get there. This will include a decision around the appropriate framework for principles and a sense of the priority areas for policy development.

Phase 2 – Developing principles, priorities and preparing operations

5.12. This consultation lays the groundwork for developing more detailed proposals. We expect the next phase to include the development of the new principles and the priority areas for removing prescription.

5.13. We also want to start putting in place changes to our approach to engagement, monitoring, compliance and enforcement as soon as possible. This is important to prepare the ground for rulebook changes in future phases.

Future phases – changing the rulebook and operating the regime

5.14. After Phase 2, we will have a clear view of the enduring framework of principles and be in a position to make changes to the rulebook. This will happen in several priority-driven phases, the number of which will depend partly on the number and nature of any new principles we develop in Phase 2. We are also mindful of the potential volume of rulebook changes coming from other sources, such as any CMA remedies. We will endeavour to coordinate the timing of our phases with any other changes in order to benefit from potential synergies, for example with respect to consultation periods.

5.15. Prescription will therefore be removed in phases, according to the priority order identified in Phase 2. To ensure continuous consumer protection, any principles that will be used to replace prescription will be in place by the time the relevant prescription is removed. The exact sequencing will depend on the nature of any new principles. For example, it is likely that any narrow principles will be introduced at the same time as the relevant prescription is removed, to avoid duplicating rules unnecessarily. We will also not remove any prescription without the necessary changes to operations having been made, so we can be confident that consumers will still be fully protected by our regulatory regime.

Assessing the impacts

5.16. This work is primarily about changing the way we regulate, not the specific regulatory aims of the licence. Nevertheless, this approach will generally give suppliers more flexibility in the way they can comply with our rules. This may enable them to find more cost-effective ways of doing things (compared with being required to do things in a particular way by prescriptive rules). And a move to principles may have cost benefits through reduced supplier administrative costs associated with checking and demonstrating compliance.

5.17. We'll consider the question of costs and benefits in detail in subsequent phases of the project, once we have used this consultation to develop our forward approach. Nevertheless, even at this early stage, we are keen to understand stakeholders' views on how an increased reliance on principles might affect the costs (both saved and additional) of market participants. This applies to all parties who operate in the domestic market, including TPIs and consumer advisors. In particular,

we would like to know which broad categories of costs (for example, regulatory team resource) are most relevant here.

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.

Early deliverables

5.18. So that we can start to see the benefits of this transition as early as possible, there are several areas of activity that we propose to undertake simultaneously while developing our enduring approach. This will both help to prepare the ground for the wider transition, for example through early learning opportunities, and provide real benefits in the short term.

Continuous culture change

5.19. An essential ingredient of the project is culture change within both suppliers and Ofgem. As we transition to an increased reliance on principles, we must be confident in suppliers' responsibility for achieving positive consumer outcomes. If suppliers are not willing to accept this responsibility then they will not reap the benefits of a transition to principles. And, they will also be more likely to face enforcement action.

5.20. We recognise this change will not happen overnight. Fortunately, the retail market has already begun this journey through the introduction of the SoC in 2013. We have seen (for example through the SoC Challenge Panel process and our ongoing engagement) how some suppliers have begun to change their internal governance and culture in order to put customers at the heart of their business, although there is more work to be done.

5.21. It is important that this process of embedding the SoC continues apace during the development of our future approach to the retail market. This will help prepare the ground for the removal of prescriptive rules. We will need to be confident at this point that principles are being taken seriously by suppliers in all areas of their business.

5.22. We will continue our engagement with suppliers on the SoC. Following positive feedback on our last SoC Challenge Panel, we are planning to hold in the first half of 2016 at least one other event similar to our earlier Challenge Panel. One of these is discussed further in Chapter 6. We are also considering how to focus future Challenge Panels, perhaps including a specific theme such as consumers in vulnerable situations.

Managing new regulation in the interim

5.23. The regulatory landscape does not stand still. It is clear that, while we are developing our enduring approach to the future regulation of the retail market, policy work relating to specific areas of the licences will continue. This may be in reaction to emerging issues in the market or as part of proactive policy development (such as the PSR Review and PPM proposals).

5.24. When considering other retail policy interventions, we will take the aims of this project into account. In particular, when considering whether to introduce new prescriptive rules, we will look to apply the approach to prescription proposed in Chapter 2, namely considering prescription only when we think this is the only way to achieve positive consumer outcomes. We will work to ensure that our wider policy teams are engaged and consistently embedding our approach to principles in their own work, as part of a wider programme of culture change.

Exploring priority areas for reform

5.25. We have set out how we intend to take a priority-driven approach to streamlining the supply licences in future phases of the work. To support this process, we propose to take steps to rely on principles (and therefore to remove prescription) in one particular area of the licences, during Phase 2. The policy development in this area will provide a useful learning opportunity ahead of the changes to the wider licences. It will help us accelerate our thinking on how best to achieve specific policy objectives through principles, and whether there is any remaining need for prescription.

5.26. This approach will also help us think through some of the issues addressed in earlier chapters about how best to operate the rulebook in a principles-based regime, for example how to approach monitoring. The SoC also continue to provide us with lessons about using principles in practice. The key difference with the proposal here is that the SoC were an addition to existing prescription. By beginning to rely on principles, we will be better able to understand how a range of supplier approaches can deliver positive consumer outcomes.

5.27. In the next chapter, we set out which licence condition we intend to prioritise our policy thinking and our proposals for reforming it.

6. Exploring priority areas for reform

Chapter summary

We will explore as a priority the potential to reform the licence obligations on suppliers relating to sales and marketing activities. This provides an opportunity to consider our ability to rely on existing principles in the licence and, as a result, to remove unnecessary prescriptive rules in this area. We will also consider how best to monitor suppliers' sales and marketing activities. This process will help to accelerate thinking on issues raised in this document about how to progress this reform agenda.

Questions for this chapter

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)?

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

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

6.1. We have looked across the rulebook for potential licence conditions to explore reforming as a priority. We have chosen the licence condition relating to domestic sales and marketing conducted over the phone or face-to-face (SLC 25).⁴⁴ We consider that SLC 25 is well suited for these purposes.

6.2. First, effective consumer engagement is critical to making the market work. Sales and marketing activities are an important part of this. We think that there is scope for suppliers to innovate in how they market and sell in ways that can help consumers make well-informed decisions. For example, this could be through helping consumers to access price comparison websites on tablets in face-to-face settings. Such innovation may be enabled by removing prescriptive elements in SLC 25.

6.3. Second, SLC 25 already contains a set of principles that suppliers must follow in relation to sales and marketing, as well as over five pages of prescriptive rules that relate only to face-to-face activities. This means that we are able to go through the process of assessing whether our policy objective can be carried out by existing principles without the need for prescription.⁴⁵ Enforcement action to date shows that

⁴⁴ For the remainder of this chapter, "sales and marketing" relates to face-to-face and telesales activities that are regulated by SLC 25. For example this would not include sales and marketing carried out exclusively over the internet. We recognise that this scope may need to be reviewed in the light of such developments. The contents of this chapter relates to the current scope of SLC 25. References to SLC 25 in this chapter relate to both the electricity and gas supply licences.

⁴⁵ This is without prejudice to the future framework of principles that we plan to establish. For

we can be confident that the existing overarching principles (SLC 25.1 and 25.2) provide a robust means to protect domestic consumers' interests.

6.4. We will only remove prescriptive elements of SLC 25 and seek to rely solely on the principles in it if we are confident the transition can be managed effectively and we will remain able to protect consumers robustly from poor sales and marketing activities.

Our policy objective

6.5. Our policy objective remains that consumers should be able to make well-informed decisions about their energy supply in response to good quality, responsible sales and marketing activities by suppliers and their representatives. These activities can be an important driver of positive consumer outcomes. They can increase engagement in the market. In turn, this can provide benefits for individual consumers and more widely through increased competition.

6.6. Prior to 2009, SLC 25 was made up of purely prescriptive rules. Experience showed that these did not provide us with an effective way of enforcing against poor behaviour. As such, we introduced a set of principles in SLC 25 to cover both face-to-face and telesales activities, while retaining prescriptive elements that only focus on face-to-face activities.

6.7. The overarching principles in SLC 25 cover two aspects of sales and marketing. First, information provided during the sales and marketing process should be complete and accurate, understandable, appropriate and not misleading. Second, sales and marketing activities should be conducted in a fair, transparent, appropriate and professional manner.

6.8. The industry has had a poor track record in relation to sales and marketing. This is reflected in our enforcement action. We have used SLC 25 in six mis-selling cases since 2009, which have led to suppliers paying around £40m in fines and redress. Our enforcement cases have highlighted various instances of poor supplier practices relating to sales and marketing.⁴⁶ These cases indicate the sort of practices in this area that we would not wish to see in the future.

6.9. In several cases, suppliers gave inaccurate information to consumers, principally on how much they could save if they switched supplier. Consumers were being misled or misinformed in several different ways, including via misleading sales scripts or comparison information that was not based on accurate assessments of the customer's current energy usage.

example, sales and marketing activities could be covered by an overarching principle that we establish in the future. Therefore, this SLC may go through further change.

⁴⁶ The [Investigations section](#) of our website has more details.

6.10. There were several instances of management not having enough oversight of their sales and marketing activities. And there were problems with the financial incentives put on both sales teams and those who oversaw the activities of those teams. In particular, commission-only selling was considered a contributing factor to the poor outcomes.

6.11. In reviewing SLC 25, we want to have in place the most appropriate regulatory framework to enable consumers to benefit from good quality, responsible sales and marketing, while protecting consumers from poor supplier practices. We also want to see a strong push from the top of suppliers' organisations to deliver positive consumer outcomes as a result of their sales and marketing activities.

Our proposal

Reforming the rulebook

6.12. We propose to rely on the existing principles in SLC 25 to protect consumers and enable positive consumer outcomes. This is already how we regulate telesales – our proposal is to also regulate face-to-face activities by principles alone. We are not convinced that it is necessary to continue to be prescriptive about the ways in which suppliers need to achieve positive outcomes. This is in line with our thinking set out in Chapter 2 in relation to scenarios when prescription may still be appropriate.

6.13. The existing principles have proved to be effective in tackling non-compliance in this area and so provide robust protection for consumers against poor behaviour. Therefore, we are minded to eliminate all the elements of SLC 25 apart from the principles (ie remove SLC 25.3 to SLC 25.17). We consider that the policy intent behind the existing prescription is covered by the principles (or other SLCs)⁴⁷ and that we should be comfortable with suppliers finding multiple ways to achieve good consumer outcomes.

6.14. The removal of the prescriptive rules might enable innovations to emerge that could better achieve our policy objectives. Responsible face-to-face selling by TPIs is an example of where innovation might deliver positive consumer outcomes.⁴⁸ In particular, it could help engage certain groups of consumers, such as those whose lack of internet access makes it harder for them to use price comparison websites.

6.15. In line with our proposals relating to guidance in Chapter 2, we would not expect to publish detailed guidance alongside changes to SLC 25. We will keep this position under review, in light of stakeholder feedback. Nevertheless, since we propose to retain the existing principles, our previous enforcement decisions relating

⁴⁷ We also have powers to enforce certain consumer protection legislation which may also cover behaviour relating to SLC 25. While we believe consumer law will act as added protection for consumers, we wish to ensure that there is enough protection within sectoral regulation to promote consumer trust and confidence in the market.

⁴⁸ In April 2015, we held a workshop to understand challenges faced by TPIs wishing to offer face-to-face services. Some stakeholders felt that SLC 25 was a barrier to innovating in this area. The [note of the workshop](#) has more details.

to them (including the examples set out above) are likely still to be of relevance to, and may inform, our future decisions.⁴⁹

6.16. The prescriptive rules in SLC 25 relate to activity undertaken before, during and after selling takes place, including the selection and training of staff and necessary management arrangements. For example, SLC 25.12 sets out the specific items of information that customers must be provided with on entering into a contract. We would be interested to hear whether you believe there are any prescriptive elements of SLC 25 that we should keep and the reasons why.

6.17. SLC 25.6 includes a pre-contractual requirement on suppliers and their representatives when conducting face-to-face sales to provide an estimate of annual charges and, where the consumer has a PPM or a savings claim is made, to provide a comparison with the consumer's existing contract. As shown in our enforcement cases, noted above, misleading comparisons can cause serious consumer detriment. We think that the principles in SLC 25 could achieve the necessary consumer protection in this respect. Although some of our enforcement cases relied on both the overarching principles and the prescriptive rules in SLC 25, we consider that the principles would cover situations relating to the provision of inaccurate information. They set out that all information provided to the customer (which would include any savings claims) to be (among other things) "complete and accurate", not mislead and be otherwise fair. Suppliers must take all reasonable steps to achieve these standards.

6.18. We are interested to hear whether stakeholders consider it necessary to continue to prescriptively set out when and how suppliers and their representatives should offer comparisons. There may be benefits of requiring a standardised approach in this area of potentially significant consumer detriment.

6.19. Another example of where there may be a case for keeping prescription is SLC 25.10, regarding the retention of comparison information. Stakeholders may feel it is more prudent to initially have this set out in prescriptive rules. We will consider whether the issue of information retention can be addressed as a broader principle when we complete our overall review of the supply licences.

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)?

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

Operating the rulebook

6.20. Our analysis of the existing obligations in SLC 25 will help us learn how best to translate our policy objectives into a robust principles-based framework. Considering

⁴⁹ Such decisions may also still be relevant where an enforcement investigation considers a regulated party's compliance with obligations in place in the past. For past decisions that dealt with specific licence obligations no longer in place, that commentary would no longer be relevant, except to the extent that the decision also considered the principles.

how this regime will operate in practice also requires us to reflect on, for example, how best to monitor that positive outcomes are being achieved. This process will help us to further develop some of the initial thinking set out in Chapters 3 and 4.

6.21. In Chapter 3 we set out our proposed approach to monitoring of principles in general, including a greater use of tools such as Challenge Panels. As such, we are considering focusing a Challenge Panel on sales and marketing activities. We would hold this before any licence modification took effect. This could be one way of understanding how suppliers intend to comply with the principles in SLC 25. Such engagement could inform more in-depth dialogue with suppliers where we have concerns.

6.22. Potentially as part of such engagement, we would explore with suppliers the role that testing of new services (for example, via pilots) could play in building confidence in their ability to comply with the principles of SLC 25. Suppliers should carefully consider the risks that their activities might entail, put in place any mitigation and then monitor the consumer experience so that they can put things right quickly if problems become apparent.

6.23. We will continue to analyse customer complaints data in this space, in particular focusing on complaints where consumers consider that they have been misled. As part of our broader effort to enhance our monitoring, we will bolster this analysis where possible, for example maximising the use of data from Citizens Advice. We will also seek to develop other early warning indicators. For example, commission-only sales could be a risk factor and this is something that we will monitor. We welcome any suggestions for other ways we could actively monitor compliance with SLC 25.

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

Implementing the changes

6.24. During the consultation period we will look to engage actively with stakeholders about the issues raised in this chapter. Depending on feedback from these sessions and formal responses to this consultation, we intend to issue a statutory consultation to modify SLC 25 by the end of June 2016. Again depending on stakeholder responses, we aim to be in a position publish our final decision and for the licence changes to come into effect by the end of 2016.

6.25. As mentioned earlier, we will only proceed with these reforms if we are confident that the changes can be made in a way that maintains effective consumer protection. To inform our decision, we will seek evidence that suppliers have put measures in place to mitigate the risks relating to their sales and marketing practices. We will also be robustly testing our own systems so we can be confident that we can monitor and quickly address any behaviour that might be non-compliant through compliance and/or enforcement action.

7. Next steps

7.1. Strong engagement and collaboration will be critical to successfully transitioning to relying more on principles in the retail market. This consultation will run until 11 March 2016, and we hope that stakeholders' will engage with the proposals in this document and beyond. We will hold workshops during the consultation period to explore the questions and proposals in this document in greater detail. We have greatly valued stakeholder engagement in this process to date, and look forward to continuing this dialogue.

7.2. We will send invitations to our consultation workshops in due course. These workshops will most likely focus on:

- **Rulebook.** The framework of principles and possible removal of prescription.
- **Operations.** Our approach to engagement, monitoring, compliance and enforcement.
- **Sales and marketing.** Removal of the prescriptive elements of SLC 25 and how this would work in practice for Ofgem, suppliers, consumers and their representatives.

7.3. We recognise the resource constraints on smaller market participants. We are happy for these parties to submit thoughts on our proposals by email or to phone the team as part of their response.

7.4. We intend to publish a response to this consultation by the end of June 2016. This will set out a clear way forward for reforming the rulebook and how we will operate it. Next year, we will also consider how best to ensure consumer protection in light of the CMA's proposed removal of the "simpler choices" RMR rules. We will continue to work closely with the CMA on this subject. We will also consider our approach to effective billing, including the suitability of principles to protect consumers and enable innovation in this area.

7.5. We are likely to progress subsequent policy development through a series of working groups, if stakeholders agree this is the preferred approach. Given the significant implications of this work programme for the market, it will be important for stakeholders to give early consideration to how they will resource and actively participate in this engagement over the coming year. More details will follow on the structure and themes of these working groups, which will be informed by the outputs of the earlier workshops.

7.6. We also want stakeholders to actively engage with us on the proposed removal of prescription from SLC 25, and are keen to hear stakeholders' views on the questions raised in Chapter 6. In order to collect as much stakeholder feedback as possible, we plan to set aside some time in future stakeholder engagement events, mentioned above, in order to specifically discuss SLC 25. If we proceed with our proposal, we will conduct a statutory consultation incorporating a full proposal for



amending SLC 25. We will aim to publish our final decision on the content of SLC 25 during 2016.

7.7. Following the SoC Challenge Panel⁵⁰ in 2014, where suppliers explained how they had embedded the principle of treating consumers fairly into their businesses, we plan to hold similar panels to focus on sales and marketing. We are considering using these panels to gather evidence on whether suppliers have systems in place to deliver positive consumer outcomes.

⁵⁰ Ofgem (2015) [Standards of Conduct – Findings from the 2014 Challenge Panel](#).

Appendix 1 – Consultation response and questions

- 1.1. We would like to hear your views on any of the issues in this document.
- 1.2. We would especially welcome responses to the specific questions at the beginning of each chapter heading and set out below.
- 1.3. Please send us your responses by email to futureretailregulation@ofgem.gov.uk by 11 March 2016.
- 1.4. Unless marked confidential, all responses will be published by putting them in Ofgem’s library and on our website, www.ofgem.gov.uk. You can ask for us to keep your response confidential. We’ll respect this request, subject to any obligations to disclose information, for example, under the Freedom of Information Act 2000 or the Environmental Information Regulations 2004.
- 1.5. If you want your response to remain confidential, you should clearly mark the document/s to that effect, and include the reasons for confidentiality. Please send us your response both electronically and put any confidential material in the appendices to your response.
- 1.6. We will publish a summary of responses and details of any further work in spring 2016. Any questions on this document should be first directed to:

Adhir Ramdarshan or Kiera Schoenemann – Retail Markets
Tel: 0207 901 7000
Email: futureretailregulation@ofgem.gov.uk

Chapter 2: Reforming the rulebook

Questions for this chapter

- 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?
- 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.
- Question 3:** Where might narrow principles be more appropriate than broad principles or prescription?
- Question 4:** What are your views on the potential merits or drawbacks of incorporating consumer protection law into licences?
- Question 5:** How should we use principles and prescription to most effectively protect consumers in vulnerable situations?
- Question 6:** Do you agree with our proposed approach to guidance?

Chapter 3: Operating the rulebook: engagement and monitoring activities

Questions for this chapter

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

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

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 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.

Chapter 4: Operating the rulebook: compliance and enforcement

Questions for this chapter

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

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.

Chapter 5: Managing the transition effectively

Questions for this chapter

- Question 13:** How would you like to engage with us on our proposals and the broader work programme?
- Question 14:** Do you agree with our proposal to take a phased, priority-driven approach to reforming the supply licences.
- 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.
- 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.

Chapter 6: Exploring priority areas for reform

Questions for this chapter

- 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)?
- Question 18:** What, if any, prescriptive rules are needed in addition to the principles in SLC 25 to deliver good consumer outcomes?
- Question 19:** What engagement and monitoring process might be required to best operate SLC 25?

Appendix 2 – Other regulators that have moved towards principles

1.1. The move to using more outcomes and principles in regulation is increasingly viewed as the hallmark of good regulation and is shared by a number of regulators around the world.⁵¹ A principles-based approach also has links to a wider transition towards ethical regulation, which is developing in the UK.⁵²

1.2. To help ground our thinking on the future of retail regulation in real-world experiences and learnings, we have considered examples of where other regulators have taken a principles-based approach. This research has been based on analysis of public documents and discussions with key regulatory bodies. We are grateful to the many regulators and academics who took the time to engage with us during this process. We have set out a few of these learnings below, although this is by no means exhaustive.

Financial Conduct Authority

1.3. In 2007, the UK Financial Services Authority (the predecessor organisation to the Financial Conduct Authority) published a report outlining its approach to moving towards more principles-based regulation. It had recognised that detailed rules were becoming an increasing burden on industry's resources and acting as a barrier to entry. It wanted to develop an approach that would adapt to the rapid pace of change in the market and principles were considered the most appropriate tool to achieve this. The FSA had already introduced 11 high-level principles in 2001 including the "treating customers fairly" principle. In 2007, its aim was to rebalance their rulebook further towards principles.⁵³

1.4. The FCA now uses a mix of high-level principles and specific rules and guidance. They have so far found that effective regulation requires a combination of broad principles supported in certain circumstances by specific rules and/or guidance. Driven by the FCA's objective to promote competition, in October 2014 it set up Innovation Hub which offers direct support to innovator businesses by providing advice and informal steers about applicable regulation. The Innovation Hub also works to identify areas where the regulatory framework needs to adapt to enable further innovation in the interests of consumers (for example, the Innovation Hub is working on setting up a regulatory sandbox). The Innovation Hub is widely considered a success and several other jurisdictions have adopted the FCA's approach.⁵⁴

⁵¹ Black, J (2015) Regulatory styles and supervisory strategies.

⁵² Hodges, C (2015) Law and corporate behaviour.

⁵³ FSA (2007) [Principles-based regulation – focusing on the outcomes that matter](#).

⁵⁴ FCA (2014) [Objectives of Innovation Hub](#).

Solicitors Regulation Authority

1.5. In 2011, the Solicitors Regulation Authority (SRA) introduced its new rulebook (“Handbook”) which initiated a shift from prescriptive rules to binding principles and outcomes. Their approach has involved a rapid removal of prescriptive rules with the aim to shorten and simplify their Handbook. The SRA recognised that its previous approach was too detailed and hindered flexibility in approaches. It wanted to ensure that its regulation was appropriate for a greater range of legal service providers and kept pace with change – a principles-based approach was a way of achieving this.⁵⁵ The SRA expect to further revise its Handbook in this context and will be consulting on changes in 2016.⁵⁶

1.6. To help firms comply with the new principles, the SRA has published non-binding “indicative behaviours” which set out, but do not constitute an exhaustive list of, the kind of behaviours which may demonstrate compliance with the principles. The SRA has various soft tools to provide guidance to firms, ranging from an ethics guidance team which acts as a helpline for queries on the SRA Handbook to a compliance e-newsletter which provides updates on compliance and regulatory news on an informal basis. The SRA has recognised the risks around the proliferation of guidance and is aiming to reduce the amount of guidance it publishes and instead rely on soft tools to assist firms.

Civil Aviation Authority

1.7. The Civil Aviation Authority (CAA) has moved to regulating through more principles in safety operations. Its previous prescriptive-only approach had been successful in bringing aviation safety to a high level, however it recognised that performance-based regulation could provide a more holistic approach allowing entities with more flexibility to find the best solutions and implement the latest developments.

1.8. Its performance-based approach involves the CAA working with industry to identify effective ways of sharing best practice. The CAA has highlighted that the sharing of best practice has been supported by a collective “safety culture” throughout the industry. A key learning from the CAA is the importance of trust, transparency and accountability being embedded throughout the industry.

Australian Privacy Act

1.9. In Australia, the Privacy Act – the law regulating the handling of personal information – was moved to a principles-based approach in 2014. The Australian Law Reform Commission (ALRC) advised Parliament on taking this approach. One of the benefits identified was that principles would enable a more holistic approach to

⁵⁵ SRA (2010) [Outcomes-focused regulation – transforming the SRA’s regulation of legal services](#).

⁵⁶ SRA (2015) [Approach to regulation and its reform](#).

regulating organisations from different industries and would help to futureproof the Act.

1.10. The ALRC advised that guidance should only be published when necessary on the grounds that too much guidance could risk undermining the transition to principles. It also recommended enhancing the powers of the regulator in its enforcement and monitoring activities in order to provide a credible deterrent to non-compliance.⁵⁷

International Financial Reporting Standards

1.11. The International Financial Reporting Standards (IFRS) are principles setting out global standards for financial reporting.⁵⁸ These are governed by the International Accounting Standards Board (IASB). Since 2001, over 120 countries have required or permitted the use of IFRS. There have been mixed views over the appropriateness of principles in financial reporting. International financial institutions deemed principles to be appropriate, due to the flexibility and durability provided. Principles have also been effective in harmonising different countries' practices and future proofing the standards. This is of particular importance to the IASB as it has been difficult to predict what forms of commercial entities may emerge in the future.⁵⁹

Ofwat

1.12. Ofwat's move to outcomes-focused regulation was one of the key innovations of the 2014 price review (2014).⁶⁰ It was the first time that Ofwat had applied outcomes in order to focus its price control on what companies deliver rather than how they deliver it. Ofwat considers this has generally been successful as it has allowed companies to be more innovative in proposing their own outcomes and better reflecting customer priorities.

1.13. Under the previous prescriptive-based framework, companies had become dependent on Ofwat defining outputs. The move to outcomes has empowered consumers and consumer groups to monitor outcomes as these have become easier to understand. It is hoped that this increased accountability will reduce the level of dependency on the regulator and lead to a consumer-centric focus among companies.

⁵⁷ ALRC (2008) [Regulating Privacy – ALRC's preference for principles-based regulation](#).

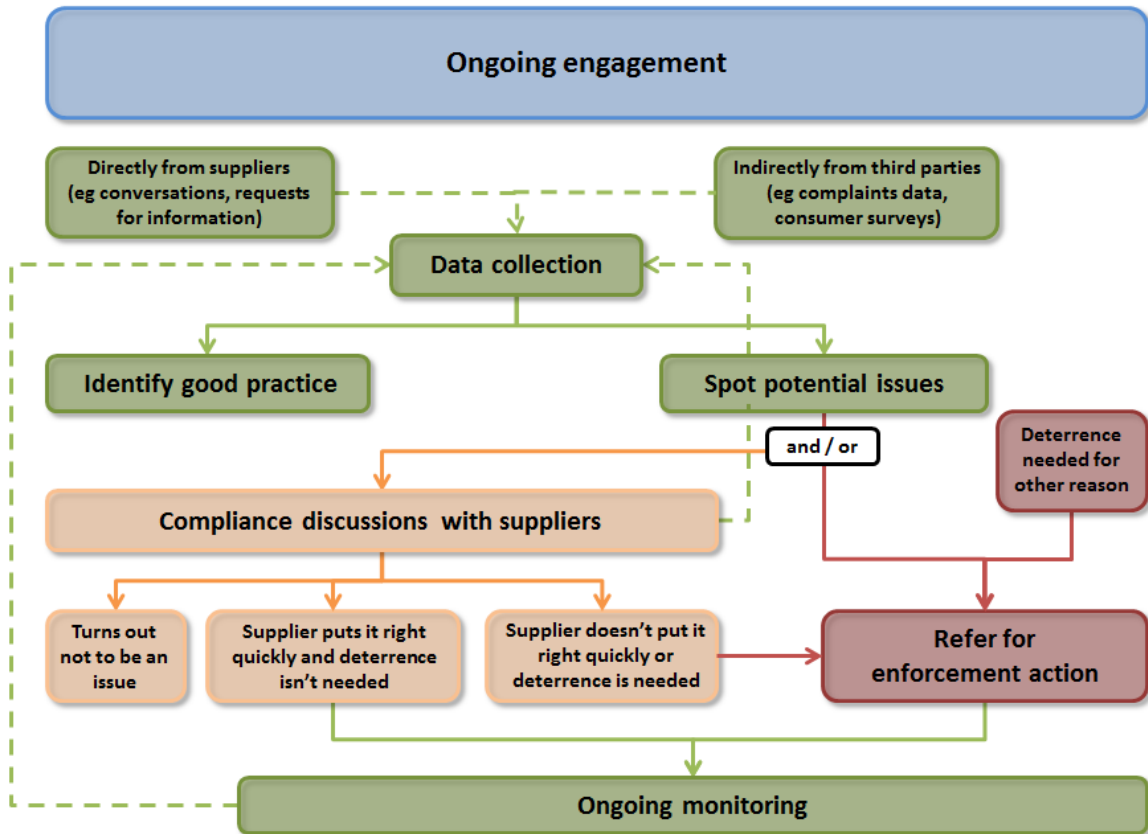
⁵⁸ IFRS (2010) [International Financial Reporting Standards: framework-based understanding and teaching](#).

⁵⁹ Agolia et al. (2011) Principle-Based versus Rules-Based Accounting Standards: The influence of standard precision and audit committee strength on financial reporting decisions.

⁶⁰ Ofwat (2015) [Towards 2020 – policy issues: customer engagement and outcomes](#), p.2.

Appendix 3 – Information flows

Figure 8: High-level overview of issue identification and resolution



Appendix 4 – Current approach to compliance and enforcement

Introduction

1.1. The compliance and enforcement chapter sets out our response to stakeholder comments and our proposals for compliance and enforcement activities when we move to a more principles based approach. This appendix provides some context to those proposals by setting out an overview of our current activities in these areas and some of the key messages that we've heard from stakeholders.

Moving from engagement and monitoring to compliance

What we do now

1.2. Where we notice potential compliance issues through our engagement and monitoring activities, these are escalated for compliance action. The relevant policy teams then work with suppliers to bring them into compliance. This allows minor issues to be resolved quickly. We have sent clear signals to suppliers that we are open to discussing compliance matters and, where appropriate, would rather resolve issues collaboratively than refer them to enforcement.

Feedback from stakeholders

1.3. There is broad consensus that increased engagement between suppliers and the ourselves is essential to making the move to principles a success. This will help suppliers to understand more about what is expected of them.

Moving from compliance to enforcement

What we do now

1.4. The enforcement team typically becomes involved in matters where there appears to be a breach of their obligations and it appears that enforcement intervention is necessary to address the issue. These considerations are informed by evidence gained through work in the monitoring and compliance space. The involvement of enforcement does not necessarily entail the end of dialogue to resolve the problem in the compliance space. It is important to note that even within enforcement an issue can be resolved via alternative action, which stops short of an enforcement investigation or remedy (discussed below).

Feedback from stakeholders

1.5. There is broad consensus across stakeholders that we should focus more on dialogue and resolving issues in the compliance space before taking enforcement action. Stakeholders say that adversarial processes can incentivise the wrong behaviours by suppliers when a compliance issue is raised, such as denying any breach and engaging in a legalistic defence rather than acknowledging and resolving the issue.

1.6. During the recent Enforcement Guidelines consultation, stakeholders generally supported the use of alternative actions as a way to further the dialogue and put things right without opening a case. Stakeholders felt that companies would be more likely to enter into open dialogue over potential or actual licence breaches if they felt that Ofgem would act proportionately and look at alternatives before enforcement.

1.7. Some suppliers have specifically argued that this dialogue would be best delivered by a two-stage enforcement process:

- Stage 1: Focus on averting a formal investigation. Ofgem would work with the company to understand the breach or to justify the action and to see if the issue could be resolved. It is only if Stage 1 fails that Stage 2 begins.
- Stage 2: A formal investigation in line with the existing Enforcement Guidelines, which could lead to a financial penalty and/or an enforcement order.

Opening cases

What we do now

1.8. The Enforcement Oversight Board (EOB)⁶¹ decides whether to open a case based on the prioritisation criteria as set out in the Enforcement Guidelines⁶² and any evidence-gathering by the enforcement team or through engagement, monitoring and compliance activities. These criteria include considering whether Ofgem has the power to act (eg whether a breach is likely to have occurred) and whether the issue is a priority matter for Ofgem. The latter is determined by looking at a range of factors, including “harm”.⁶³ If a case is opened, this decision is publicly communicated, unless this would adversely affect the investigation.

⁶¹ The Enforcement Oversight Board is an internal body that provides strategic oversight and governance to our enforcement work and oversees the portfolio of cases.

⁶² Ofgem (2014) [Enforcement Guidelines](#), p.26.

⁶³ Harm is not limited to consumer harm. We may also gather evidence on parameters such as harm to competition and harm to our ability to regulate effectively.

Feedback from stakeholders

1.9. The range of potential approaches to achieving compliance could prolong our initial evidence-gathering activities. There is a risk that if we applied our current expectations of evidence to case opening decisions relating to potential breaches of principles, the preliminary evidence-gathering stage would be unduly lengthened, thus compromising our ability to take swift action.

1.10. We have heard that some stakeholders welcome the transparency of case opening decisions. It allows suppliers to understand where we are focusing enforcement activity and make sure they are doing the right things themselves, and gives consumer groups assurance that action is being taken.

Information gathering

What we do now

1.11. Enforcement routinely uses various sources of information from monitoring and compliance activity. Enforcement also has its own information gathering powers to obtain evidence relevant to determining breach, gain and detriment.

Feedback from stakeholders

1.12. Our proposals for engagement, monitoring and compliance mean that we will usually gather significantly more data than we currently do prior to the investigation stage. This means that during investigations the enforcement team could have access to a greater breadth of relevant data.

1.13. In this context, several stakeholders have raised concerns that they may be reluctant to share information in the course of compliance conversations as it might be used against them in any future enforcement action.

Assessing compliance with principles

What we do now

1.14. In the Enforcement Guidelines we outlined a bespoke approach to the enforcement of the SoC, to recognise that there are multiple ways of delivering the same outcomes. We developed this because of the principles-based nature of these licence obligations, recognising that there were a number of ways in which suppliers can comply with principles and that assessing breaches involves a more complex judgement than for prescriptive obligations. This approach involves considering

whether “a reasonable person, intent on complying with the SoC, would have acted in the way the supplier did in its interactions with consumers”.⁶⁴

1.15. The Enforcement Guidelines specifically consider compliance with the SoC in relation to the following three elements of a supplier’s behaviour:

- **Plan.** Developing new policies or processes and amendments to existing policies and processes.
- **Monitor.** Monitoring its implementation of new initiatives and operation of existing policies and processes.
- **Adapt.** Taking remedial action where any adverse consequences for customers come to light.

1.16. These elements form a virtuous circle and are a useful way of ensuring that enforcement can appropriately assess multiple approaches to achieve compliance. We expect suppliers to place consumers at the heart of their plans, to watch carefully for any signs that they are failing consumers and to put things right quickly when they find evidence of such failures.

Feedback from stakeholders

1.17. Several stakeholders have said that a key element of the necessary culture change is Ofgem becoming comfortable with a variety of approaches to achieving compliance. Some suppliers have low confidence that we will be flexible in our approach to compliance and enforcement, and take the circumstances of individual suppliers into account.

Enforcement actions

What we do now

1.18. Before exercising our statutory enforcement powers, we generally consider the possibility of pursuing alternative action. This entails looking at alternatives to seeking to establish a breach. Examples of this alternative action are:

- Dialogue or correspondence with a company.
- Agreeing a period of reporting to ensure that behaviour is not repeated and action has been taken.
- Request that the company engages auditors or other skilled persons to conduct a review.
- Agree voluntary action, such as implementing remedial or improvement action, press statements and/or redress.

⁶⁴ Ofgem (2014) [Enforcement Guidelines](#), pp.8-9.

- Accept non-statutory undertaking or assurances to comply.

1.19. The Enforcement Guidelines highlight that this type of resolution could be achieved instead of a case opening or after case opening. Failure to comply with any agreement obtained through alternative action could lead to enforcement action and the Authority⁶⁵ may take a more serious view of any resulting breach found.

1.20. If alternative action is not deemed appropriate, we look to exercise our statutory powers to remedy poor practice. We have four ways of delivering enforcement remedies with the powers we have as set out in section 2.3 of the Enforcement Guidelines:

- **Take interim action.** Provisional Orders (POs) can be used to require a regulated person to do or not do something to prevent loss or damage that might arise before a Final Order (FO) can be made. In practice agreements on interim action can often be reached without the formal imposition of an order.
- **Take final action.** If the Authority is satisfied that a regulated person is contravening or is likely to contravene any relevant condition or requirement, it may impose a FO or confirm a PO in order to bring a breach to an end.
- **Impose a financial penalty.** If satisfied that a contravention has occurred or is ongoing, or that a regulated person has failed or is failing to achieve any relevant standard of performance, the Authority may impose a financial penalty.
- **Make a consumer redress order (CRO).** The Authority may make a CRO where a contravention has occurred or is ongoing and, as a result, one or more consumers have suffered loss, damage or inconvenience. Our 2014 Penalties Policy covers what should be included in a CRO.

Feedback from stakeholders

1.21. Stakeholder feedback, particularly from consumer groups, has highlighted the need for quick and effective enforcement tools to tackle consumer detriment in the context of a rapidly changing market. Effective deterrence will be needed for companies that do not create a culture that facilitates good outcomes for customers and positive engagement with the regulator.

Sharing lessons: communicating our enforcement actions

What we do now

1.22. The communications associated with our actions depend on the type of action in question. When we use our statutory powers, we are obliged to meet certain communication requirements set out in the Electricity Act 1989 and Gas Act 1986.

⁶⁵ The Authority has delegated enforcement decisions to Settlement Committees and the Enforcement Decision Panel.

For example, when we impose financial penalties or CROs, we publish a notice setting out relevant details.

1.23. Our communications in this space may be detailed and prescriptive. For example the scope of a PO is to set out what is required to ensure compliance.⁶⁶

1.24. We currently share where we think lessons could be learned from recent investigations at our annual enforcement conference. This is intended to make it straightforward for suppliers and other stakeholders to access this information, with a view to avoid making the same mistakes as others.

Feedback from stakeholders

1.25. Stakeholders want to know how emerging enforcement decisions should influence their behaviour. There have been specific calls for us to publish more “good practice” case studies to learn how to turn situations around from enforcement to alternative action or compliance.

Conclusion

1.26. The content of this appendix should be read in conjunction with the proposals in Chapter 4 where we offer solutions to the challenges posed by stakeholders.

⁶⁶ For example, mandating contact centre opening hours.

Appendix 5 – Glossary

C

Competition and Markets Authority (CMA)

A non-ministerial government department that works to promote competition for the benefit of consumers. The CMA's aim is to make markets work well for consumers, businesses and the economy. The CMA is currently undertaking an investigation into the energy market.

D

Derogation

A regulatory arrangement that relieves a licensed supplier from its obligation to comply with a requirement in its supply licence, in specific circumstances and to a specified extent. For more details, please see our RMR derogation guidance (available [here](#)).

Domestic consumer

A consumer that uses energy for non-commercial purposes.

E

Enforcement Oversight Board (EOB)

The Enforcement Oversight Board is an internal body that provides strategic oversight and governance to our enforcement work and oversees the portfolio of cases.

I

Industry codes

The industry codes set out the detailed 'rules' which underpin the operation of the electricity and gas industry arrangements. Licensees are required to maintain, become party to, and/or comply with the industry codes in accordance with the conditions of their licence. Unlicensed parties may also be party to some of the industry codes.

N

Non-traditional business models (NTBMs)

Companies operating in the energy sector with business models offering new products or services, or new ways of delivering these, that are different to those traditionally provided in the existing energy market. Those offering such services have diverse motivations (technological, social and environmental as well as financial) and ownership arrangements, and operate at various scales. Over time NTBMs have the potential to transform the existing energy system.

P

Prescription

Prescriptive rules specify detailed obligations that suppliers must meet. They may detail steps suppliers should take to deliver consumer outcomes (input-based) or specific outcomes that they must deliver (output-based).

Principles

Principles-based rules contain less detail than prescriptive rules. As such, they give suppliers more flexibility in how to comply with them. For the purposes of this document, “principles” is used as shorthand for both high-level input-based rules (eg required behaviours) and high-level outcome-based rules (eg consumer service outcomes).

R

Retail Market Review (RMR)

Ofgem’s reforms to make the retail energy market simpler, clearer and fairer for consumers.

S

Standards of Conduct (SoC)

A licence condition (SLC 25C) introduced as part of the RMR with the aim of improving supplier behaviour, consumer trust and engagement in the market. The SoC require suppliers to treat domestic and microbusiness consumers fairly.

Supply Licence Conditions

The legally binding conditions that licensed gas and electricity suppliers must meet to supply to domestic and non-domestic customers, in accordance with the Gas Act (1986) and Electricity Act (1989).

Supplier (licensed supplier)

Any person authorised to supply gas and/or electricity by virtue of a Gas Supply Licence and/or and Electricity Supply Licence.

T

Third party intermediaries (TPIs)

Organisations that interact with energy consumers, including switching websites, energy brokers and energy efficiency advice providers. TPIs can offer advice and products to assist with a range of functions including energy procurement, efficiency and management.

Appendix 6 – Feedback questionnaire

1.1. Ofgem considers that consultation is at the heart of good policy development. We are keen to consider any comments or complaints about the manner in which this consultation has been conducted. In any case we would be keen to get your answers to the following questions:

- Do you have any comments about the overall process, which was adopted for this consultation?
- Do you have any comments about the overall tone and content of the report?
- Was the report easy to read and understand, could it have been better written?
- To what extent did the report's conclusions provide a balanced view?
- To what extent did the report make reasoned recommendations for improvement?
- Do you have any further comments?

1.2. Please send your comments to:

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