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11 March 2016

The Future of Retail Market Regulation.

Dear Sirs,

SmartestEnergy welcomes the opportunity to respond to your consultation on the Future of Retail Market Regulation.

SmartestEnergy has been an aggregator of embedded generation since 2001 and a supplier in the electricity retail market serving large corporate and group organisations since 2008. SmartestEnergy does not have a domestic supply licence.

Although this consultation concerns the regulation of the domestic market and Ofgem state that they 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), we note that Ofgem will welcome early views from stakeholders on this potentially wider scope. We are particularly interested in the use of principles to remove many of the micro-business regulations.

SmartestEnergy is largely supportive of the move from compliance-based to principles-based regulation. However, we are cognisant of the fact that this will come with its own difficulties, especially in terms of coming to agreement on whether principles have been met. Some kind of dispute resolution is required that does not involve a judicial review. We also feel that Ofgem will need to define in detailed non-binding guidance what is expected of suppliers, especially where prescription has already resulted in good, consistent outcomes. The status of this guidance should not be prescriptive but should rather reflect examples of things suppliers should be doing so that it is not lost for the benefit of new entrants. It is also still appropriate to maintain a compliance mindset with regards to the lower level Codes (such as the Balancing and Settlement Code) so that suppliers are seen to be playing fair.

We note that Ofgem have said that they see this change as a move to better regulation, rather than more or less regulation. Ofgem need to be mindful of the fact, however, that what works best for Ofgem could well be more onerous for suppliers and this would increase the regulatory burden and hinder innovation and new entry.

There is nonetheless a clear advantage to moving away from strict compliance-based regulation. SmartestEnergy may be more inclined to enter into the domestic market if the

regulations were not so prescriptive. It is important, however, that a new regime does not result in Ofgem making more burdensome requests for information through self-reporting.

We welcome the overall aim of reducing the length of the licence and, as Ofgem themselves note, "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 domestic section runs to approximately 180 pages and we can see value in reducing this through greater use of principles. However, much of the licence is made up of FiT arrangements as well as Green Deal and Smart metering (which altogether make up 150 pages of the licence) and if Ofgem are not contemplating removing these, as stated on page 15 of the consultation document, (and they are indeed repeated in lengthy guidance documents in the case of FiTs), the number of pages is never going to be drastically reduced.

Please note that our response is not confidential.

Answers to specific questions:

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?

> Much of the focus of the consultation document is on the use of the licence to ensure that customers are treated fairly and we agree that this should, by and large, be dealt with through principles-based regulation. It must not be forgotten, however, that another important aspect is maintaining standards so that all suppliers are playing by the code rules. These should continue to be compliance based.
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> Prescription is also going to be required where consistency (treatment of vulnerable customers) and comparability (of various bill items for example) are essential.
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> Prescription may also be most appropriate for areas where Ofgem have particular concerns regarding supplier processes. For example a principle of 'keeping good records', could entail different suppliers prioritising different records to be kept. If suppliers are prescriptively required to keep records of certain processes (transactions, dispute resolutions etc.) there can be no argument over whether it was necessary to keep a record of something or not. Principles are more useful for consumer outcomes e.g. 'treating customers fairly.

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

> We note that Ofgem's initial proposals for additional principles are:
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> - Honesty and transparency in dealings with the regulator
> - Good record keeping to demonstrate compliance with obligations
> - Suppliers' boards to ensure consumers are at the heart of all decisions

- 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

These are all very sensible and generally good practice; it is important to get feedback from customers when developing new products. However, this approach could lead to disagreements between Ofgem and suppliers over what constitutes a good result from a survey and this requires further consideration. There is always going to be an element of risk when innovating and it is not clear whether, say, 90% satisfaction with a product/behaviour is acceptable.

It appears to us that the principle to "actively think about (and put plans in place to manage) risks to consumers" is really a kind of prescription.

We are also slightly concerned that it will be difficult for Ofgem to make a distinction between suppliers who have successfully embedded the principles and who are serious about putting customers at the heart of their business and suppliers who have token paperwork in place.

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

We consider the application of the term "micro-business" to be used too strictly and more latitude should be allowed where micro-businesses are fully engaged with the market and taking advantage of commercial agreements. Such customers can be treated fairly without the need to offer them the same protections as domestic customers. In other words the application of narrow principles should only be used where "micro-businesses" behave like domestic consumers. Alternatively, and preferably from our perspective, all micro-business regulations should be removed and it should be up to the supplier to determine whether it is fair to treat them as domestic or business.

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

Consumer law already applies therefore there is no requirement for it to be drafted into the licence. The real question is why is consumer law not deemed protection enough for the energy market? And if there is a need for further regulation, how can principles best target the areas where consumers require further protection?

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

This is probably an area where prescription needs to remain. Ofgem have created this concept of vulnerability to identify a certain sub-set of customers who should be treated equally. It does not seem appropriate for suppliers to offer different levels of

service because of differing interpretations of "treating customers fairly" when Ofgem require special treatment.

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

It is stated in the consultation document that Ofgem do not expect their guidance on the use of principles to be extensive. We also note that Ofgem do not believe that their role is to operate in an advisory function in the way that some stakeholders may prefer. If there is to be little guidance or advice, Ofgem must make sure it has the resources to commit to substantial bilateral engagement. But a lack of guidance or advice will place participants in a difficult position. There will be a natural inclination for responsible suppliers to take a cautious approach and seek legal opinion to interpret the scope of principles and this will not be easy. It could also be damaging for competition if some more "cavalier" suppliers do not take such a cautious approach to understanding the licence. The situation is a lot more clear-cut in a compliance world. We welcome, however, the proposal to offer suppliers "feedback on genuinely innovative ideas."

As stated elsewhere in our response, we are of the view that comprehensive guidance will be very useful for new suppliers to learn from the good practice that has been put in place during the compliance-based approach. Ofgem need to make a distinction between mandatory guidance (i.e. like the FiTs guidance) and best practice (which gives indications of approaches suppliers may wish to consider.)

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

We welcome Ofgem's proposal to expand their engagement with suppliers to enhance their understanding of suppliers' businesses and "help them better understand Ofgem's rules so they can get things right first time." Ofgem need to think about defining in advance what "getting things right first time" means. Whilst Ofgem probably do not wish to have their hands tied it is important for their own internal consistency (staff move on) that expectations are written down.

Whilst Ofgem themselves say that they are going to have to get comfortable with Suppliers taking different interpretations of the principles, they are also going to have to accept that Suppliers will want greater clarity either in the form of agreed minutes for one-to-one sessions and more of a formal advisory service.

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

Many good business practices have come about through the use of compliance; making information available to customers, for instance. Clearly, established players will continue to do this but there will be no imperative for new suppliers to be so precise. This could lead to poor customer outcomes and differences between suppliers. We think that there should be non-binding guidance which highlights many

of the good practices which may be specifically removed from the licence. In other words, before removing any piece of prescription, Ofgem will need to ask themselves whether there is benefit in incorporating it in some good practice guidance.

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?

The consultation document states that in the context of "monitoring" Ofgem are specifically referring to monitoring how suppliers are complying with the rulebook, as opposed to broader market monitoring. Ofgem should not under-estimate difficulties of monitoring compliance with principles.

We welcome the suggestion of regular one-to-one meetings. We are, however, concerned at the suggestion of further information requests. We are already massively overburdened by requests from Ofgem and DECC. On average we have responded to one mandatory RFI per month throughout 2015. RFIs such as those required for advanced metering, smart metering, non-domestic objections etc are increasingly asking for more additional and complex information and responses are very time consuming to prepare. These RFIs, in addition to the introduction of regular reporting for TRAS and quarterly reporting of compliance with Guaranteed Standards, put considerable strain on Small Suppliers who may not necessarily have dedicated resource for producing reports of such a complex nature which are required in order to provide the requisite information.

We would also require further detail on what is expected under self-reporting (demonstrating that suppliers have arrangements in place to ensure that they are complying with the principles and achieving good outcomes for consumers) if this is to be rolled out into the non-domestic space.

Ofgem should use a suite of monitoring options, rather than placing all monitoring under one method or by using purely quantitative data. This should include both forward-looking and ex-post indicators for Ofgem to assess. Further thought needs to be given as to how this comes together into an overall assessment of compliance. The use of "dashboards" is a possibility.

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.

Please see our response to Q7. As a supplier in the non-domestic space we have no comment to make on Citizens Advice and the Ombudsman services.

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

As previously stated, this is not going to be easy but it is important that Ofgem write down what their expectations are, if only for their internal purposes. However, it would be useful for this to be made public.

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 certainly agree with Ofgem retaining their current flexible and discretionary approach to escalating issues to enforcement. We do not necessarily believe Ofgem should constrain themselves to prioritising compliance activities over more general principles; the deciding factor should be the level of consumer harm.

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

We agree with this.

• 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 cannot disagree with this. However, if Ofgem is to enforce on the basis of consumer detriment, there is little incentive, once things have started to go wrong, for suppliers to engage with the regulator early. However, it needs to be determined whether there was customer detriment or not, and suppliers should be able to use a 'due diligence' defence to show that they took all reasonable steps to avoid customer detriment, alongside merit-based appeals.

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

This is easier said than done. There will be issues of consistency and proof.

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

We agree with this.

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

We cannot disagree with this.

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

We are comfortable with a combination of one-to-one discussions, written consultations and workshops. It is important, however, not to be overly reliant on working groups as these can often be closed and opaque.

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

Yes. That said, consideration must be given to the manner in which principles replace prescription and how this will interact with remaining prescriptive licence conditions.

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.

Standards of Conduct have only just been reviewed and we believe these should remain in place while Suppliers gain experience from these changes. The first areas to start on in our opinion should be directly related to treating customers fairly and relatively straight-forward. These would be in the area of marketing and tariff/billing information.

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.

It is difficult to give an early indication of costs and benefits without knowing the content of the principles and the clarity of any associated guidance. As referred to in our response to question 6, there may be a need to engage legal opinion on a periodic basis to assist us in the interpretation and scope of principles to ensure that we are compliant and this would attract additional cost.

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)?

We think that an overarching principle ensuring that information provided during the sales and marketing process is complete and accurate, understandable, appropriate and not misleading should suffice. It is important, however, that "complete and accurate" relates not only to the supplier's own terms and information but also relates to comparisons with all other suppliers who have at least 250,000 customers.

Until Ofgem state what the goals of reforming SLC25 to principles are, suppliers cannot comment on whether the proposed changes facilitate these goals or not. As

Ofgem does not seem to have considered what it wants to gain from using SLC25 as a 'trial run', it needs to be considered whether this is the appropriate SLC to be using. If SLC 25 is changed to a principle based regulation, there should also be a review period built into the timescale for reform, so that benefits and challenges of the transition can be assessed before moving onto other licence conditions.

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

We do not believe any prescriptive rules are necessary over and above the overarching principle mentioned above but we would expect suppliers to provide any relevant information they are asked for.

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

We agree with the greater use of panels as well as surveys to help Ofgem understand the state of the market (these may be best used to indicate wider systemic issues affecting all consumers). As stated above further thought needs to be given into how this translates into determinations of whether Suppliers have complied with the principles.

It is important to establish whether Ofgem want data or comforts that controls/processes are in place. The latter could result in audits becoming effectively mandatory.

Should you require further clarification on this matter, please do not hesitate to contact me.

Yours sincerely,

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