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“Reviewing the Consolidated Segmental Statements - Our initial proposals” – So Energy
Response

Dear Andrew,

So Energy is a leading energy supplier providing great value 100% renewable electricity to homes across England, Wales and Scotland. We have consistently been recognised by our customers and the wider industry for our outstanding customer service since we were founded in 2015, including being a Which? Recommended Provider and have topped the Citizens Advice’s Supplier League Table. So Energy is one of the early adopters of the EUK Vulnerability Commitment launched in 2020, helping create a better customer experience for vulnerable customers year on year. In August 2021, So Energy merged with ESB Energy, and our combined business now supplies over 300,000 domestic customers. As one of the last challenger suppliers left in the market and one that is backed by ESB’s resources and expertise, So Energy is able to provide a unique view of the quality of service in today’s energy market.

Since the 2021 ‘final proposals’ consultation Ofgem has made a welcome improvement in removing the Additional Financial Information requirement. We greatly appreciate this. However, we have significant concerns about this consultation. Our key concerns are as follows:

1. Ofgem has retained the requirement for vertically integrated energy companies to submit a generation component of the CSS. The justifications provided are consistency (i.e. vertically integrated suppliers have always been required to report on the generation component) and transparency around transfer pricing. As is highlighted in the consultation, vertical integration is no longer a significant market feature. When the market changes, the reporting requirements should change also. With regards to transfer pricing, in the 12 years CSS has existed, there has never been any evidence of this taking place. Ofgem has acknowledged the additional reporting burden it has placed on suppliers in recent years and has committed to reducing that burden, where possible. This is a clear opportunity for Ofgem to follow through on that commitment.
2. The timelines for implementation are not realistic or proportionate for newly obligated suppliers. Companies House requires businesses to file statutory accounts within 9 months of year-end. This proposal requires suppliers to publish CSS, based on statutory accounts within 4 months of year-end. In other words, at the point the consultation was published, suppliers may still not have filed statutory accounts for 2022 but will now be expected to file statutory accounts for 2023 and publish related CSS reporting by 30 April 2024. A transition period is needed in the first year. Further, because smaller suppliers are now being captured, longer time should be provided every year to account for the smaller resource pool available to smaller suppliers when it comes to preparing statutory accounts and additional Ofgem reporting.

We have prepared responses to each question below.

Q1. What are your views on proposal to expand the market coverage of the CSS?

We agree with the proposal to expand market coverage, provided a suitable transition period is provided to allow newly mandated suppliers meet the requirements.

Q2. Do you have any other thoughts on the CSS?

We note that the aims and objectives of the CSS has changed considerably. When it was introduced as part of the Energy Supply Probe in 2009, CSS was intended to address concerns about transfer pricing brought about as a result of vertical integration:

The Probe highlighted the need for more transparency with regard to the relationship between the generation and supply activities of the large, vertically-integrated companies (the Big 6). As not all Big 6 produce separate segmental accounts (for gas supply, electricity supply and electricity generation) it can be difficult for current and potential market participants to assess the profitability of these different activities. In addition, there is little transparency regarding the transfer price used by the supply and generation businesses to exchange wholesale energy, giving rise to concerns about cross-subsidisation.¹

In this consultation, Ofgem acknowledges that “*vertical integration is no longer a significant feature in the market*”. However, the generation component of the CSS requirement remains.

What has also changed significantly in recent times is the level of regulatory and reporting burden placed on suppliers and generators. Ofgem has acknowledged this reporting burden and has committed to reducing this burden where possible. It is incumbent on Ofgem to consider options that allow the fulfilment of its statutory objectives while reducing the regulatory burden.

Ofgem’s stated reason for retaining the generation component is “*because providing a split of profits between generation and supply allows companies to be transparent about the allocation of costs between the two activities.*”

To be clear, the additional burden placed on energy companies by including a generation component is *significant*. It requires the filing file two sets of subsidiary accounts at breakneck pace instead of one. In the 12 years CSS has existed, there has never been any evidence of transfer pricing taking place between generation and supply activities.

Overall, Ofgem has adopted a more reasonable and common-sense approach to reporting burden in this initial proposals consultation than in the August 2021 final proposals. Placing significant additional burdens on suppliers on the off-chance that the market shifts back towards a vertically integrated model and then on the off-chance transfer pricing takes place is completely unnecessary.

We implore Ofgem to take a more reasoned approach here also. To acknowledge the overall increase in regulatory burden, the growing need to manage that burden where possible and to remove the generation component, given it is irrelevance to today’s energy market.

Q3. Do you agree with our consideration that the current proposal will not impose significant costs upon newly obligated suppliers? If you consider otherwise, then please let us know and provide any supporting evidence.

We disagree.

Companies House requires businesses to file statutory accounts within 9 months of year-end.

¹ <https://www.ofgem.gov.uk/sites/default/files/docs/2009/08/retail-package---decision-document.pdf>

This proposal requires suppliers to publish CSS, based on statutory accounts within 4 months of year-end. In other words, at the point the consultation was published, suppliers may still not have filed statutory accounts for 2022 but will now be expected to file statutory accounts for 2023 and publish related CSS reporting by 30 April 2024.

This step change in turnaround time represents a clear and significant additional requirement, both on an enduring basis and especially in the first year of the obligation. Owing to the broadening of the scope of CSS to include smaller suppliers, additional time should be provided to publish CSS accounts each year. Each additional month that can be provided to suppliers is extremely valuable. In addition, a further extended timeline for newly obligated suppliers will be necessary, given the lack of notice provided by Ofgem on these CSS changes, which were dropped during the energy crisis.

Finally, Ofgem does not appear to have considered the possibility that some of the newly obligated suppliers may also be vertically integrated, through investment in wind, small scale solar etc. These suppliers would face still higher cost, although this can be addressed by removing the generation component of the CSS requirements. See our response to Q5.

Q4. What are your thoughts on our proposal to publish a list of obligated suppliers to our website in December each year?

No rationale has been presented as to why Ofgem has proposed it or what issue this proposal is attempting to solve. We aren't aware of any issues with investors, prospective suppliers or interested consumers accessing CSS information.

If there are no issues to resolve or clear benefits, then Ofgem, as a regulator subject to the Better Regulation Framework, should not commit to additional work. It will ultimately increase consumer costs through an increased levy on bills.

Vertical integration and threshold:

Q5. Do you agree with our proposal remove the requirement for suppliers to be vertically integrated suppliers to submit a CSS?

Yes, vertical integration is no longer a feature of the market. However, we disagree with the proposal to retain the generation component for suppliers who continue to form part of an energy company with generation activities.

We note that the aims and objectives of the CSS has changed considerably. When it was introduced as part of the Energy Supply Probe in 2009, CSS was intended to address concerns about transfer pricing brought about as a result of vertical integration:

The Probe highlighted the need for more transparency with regard to the relationship between the generation and supply activities of the large, vertically-integrated companies (the Big 6). As not all Big 6 produce separate segmental accounts (for gas supply, electricity supply and electricity generation) it can be difficult for current and potential market participants to assess the profitability of these different activities. In addition, there is little transparency regarding the transfer price used by the supply and generation businesses to exchange wholesale energy, giving rise to concerns about cross-subsidisation.²

In this consultation, Ofgem acknowledges that “vertical integration is no longer a significant feature in the market”. However, the generation component of the CSS requirement remains.

What has also changed significantly in recent times is the level of regulatory and reporting burden placed on suppliers. Ofgem has acknowledged this reporting burden and has

² <https://www.ofgem.gov.uk/sites/default/files/docs/2009/08/retail-package---decision-document.pdf>

committed to reducing this burden where possible. It is incumbent on Ofgem to consider options that allow the fulfilment of its statutory objectives while reducing the regulatory burden.

Ofgem's stated reason for retaining the generation component is "*because providing a split of profits between generation and supply allows companies to be transparent about the allocation of costs between the two activities.*"

To be clear, the additional burden placed on energy companies by including a generation component is *significant*. It requires the filing file two sets of subsidiary accounts at breakneck pace instead of one. In the 12 years CSS has existed, there has never been any evidence of transfer pricing taking place between generation and supply activities.

Overall, Ofgem has adopted a more reasonable and common-sense approach to reporting burden in this initial proposals consultation than in the August 2021 final proposals. The removal of the Additional Financial Information requirement is very welcome. However, placing significant additional burdens on suppliers on the off-chance that the market shifts back towards a vertically integrated model and then on the off chance transfer pricing takes place is completely unnecessary.

We implore Ofgem to take a more reasoned approach here also. To acknowledge the overall increase in regulatory burden, the growing need to manage that burden where possible and to remove the generation component, given it is irrelevance to today's energy market.

Q6. Do you agree with the proposal to lower thresholds for the domestic and non-domestic market?

Yes, we support the lower threshold, although we note that the market has consolidated considerably since the August 2021 decision.

Additional Financial Information:

Q7. What are your views on our proposal not to request additional financial information?

We welcome the change of approach. The level of regulatory and reporting burden placed on suppliers has increased substantially. Ofgem has acknowledged this reporting burden and has committed to reducing this burden where possible. This is a fine example of Ofgem taking a more proportionate approach and collecting only what's necessary.

We note that the Additional Financial Information requirements were never really workable in any case, as it requested data at a level of granularity beyond what suppliers collect for their own purposes. This had significant knock-on implications for the quality of the reporting, depending on the approach Ofgem would take to address this issue:

Approach 1: Allow suppliers to make assumptions on how to allocate costs where data otherwise isn't available. The suppliers CSS would include an explanation of how they have allocated costs. Suppliers know their business better than anyone else, so are best placed to make sensible and realistic allocations of cost. However, different suppliers will take dramatically different approaches to allocating costs, partially down to different suppliers having different structures and partially down to matters of judgement. This introduces the risk that CSS reports will not be comparable across suppliers.

Approach 2: Ofgem clearly identifies assumptions on how suppliers should allocate their costs through detailed guidance. Given the diversity of businesses in the retail market, it's likely for some suppliers that in allocating costs according to Ofgem guidance, they would be presenting a misleading picture of their costs to the market. This could cause potential investors in energy to make poor decisions. In addition to this, when using this data to, for example, assess the state of competition in the market, Ofgem risks falling into a dangerous causal loop. Ofgem

imposes assumptions about how suppliers should allocate costs under the CSS and then has those assumptions confirmed when they look at the reports. However, setting aside the issue of whether or not the reports are reflecting what is actually happening in the market, they will allow for easier comparison between suppliers.

For this reason, we support Ofgem's removal of the Additional Financial Information requirements.

'Other' Activities

Q8. What are your thoughts on our proposal to include an additional column for reporting 'other' activities separate to the supply or generation business?

It is a significant improvement on the previous Additional Financial Information requirement. We understand Ofgem's rationale. However, the proposal has implications for implementation timelines. The splitting of financial activities into 'supply' and 'other' constitutes new unforeseen work. This is all in the context of added burden placed on financial reporting colleagues through enhanced financial reporting as well as the EBSS and EPG schemes. A significantly longer implementation timeline must be provided to suppliers to enable these changes. This is especially the case for suppliers whose financial year ends in December.

Transition Period

Q9. What are your thoughts on our proposal not to include a transition period for the first year of reporting now that the additional financial information and the audit requirement have been removed?

The proposal, as set out, is unworkable without a transition period.

Audit Requirement

Q10. Do you agree with our proposal to remove the audit requirement and instead propose the CSS must reconcile back to statutory accounts?

Yes, we agree that routine auditing should not be required. Our understanding is that data provided to Ofgem by suppliers cannot be false or misleading and we do not believe that suppliers would intentionally provide false data. In practise, submitted data is likely to be of a poor quality because the requirement wasn't phrased clearly and/or insufficient guidance was provided. The best way to ensure quality is to be consultative and collaborative in developing the requirements and associated guidance and then work with suppliers to identify and resolve any potential misunderstandings early in the reporting process.

Allowing suppliers to report in line with company year-end brings benefits in terms of better-quality information and substantial cost savings as a great deal of duplication of work can be avoided. An additional focus on quality of reporting takes place for a company's financial year end (in preparation for financial audits) rather than for monthly management accounts, leading to better quality CSS reporting. Avoidance of duplication of work is especially valuable to smaller, less well staffed suppliers.

Q11. Do you agree with the proposal that Ofgem retains the right to request an audit where there may be cause for concern?

We support the proposal for Ofgem to retain the right to request an audit but only in limited circumstances. We suggest that the generation component CSS be removed for vertically integrated suppliers. However, if Ofgem has concerns that transfer pricing is taking place between generation and supply components of a vertically integrated supply company, that Ofgem can request an audit. This would be more proportionate approach to CSS, given vertical integration is no longer a feature of the market.

Yours Sincerely,

Paul Fuller
Head of Regulation

