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Dear Alban,

Response to Reviewing the Consolidated Segmental Statement - Our Initial Proposals

Drax Group plc (Drax) owns two retail businesses, Haven Power and Opus Energy, which together supply renewable electricity and gas to over 350,000 business premises. Drax also owns and operates a portfolio of flexible, low carbon and renewable electricity generation assets – providing enough power for the equivalent of more than 8.3 million homes across the UK. This is a joint response on behalf of Haven Power and Opus Energy.

In summary, we are broadly supportive of the underlying aim of requiring more licensees to submit an annual Consolidated Segmental Statement (CSS) to give Ofgem a broad view of licensee profitability. However, we do not believe there is sufficient justification for some of the proposed changes that would have far-reaching and costly impacts. We propose an alternate pragmatic approach below which would give Ofgem increased market intelligence, without placing unnecessary administrative costs and burdens on licensees.

The key points of this alternate approach are as follows:

- All suppliers should be required to submit a CSS as prescribed under the current requirements, aligned with their existing financial reporting schedule. This will avoid suppliers having to create additional fixed reporting dates and incur the sizeable costs of making changes to systems and drastically realigning reporting and cost accounting principles and processes.
- The annual audit requirement should be removed with Ofgem retaining an option to impose an audit in response to any significant concerns. Suppliers should be permitted at least 3 months to submit a CSS after the end of their existing financial reporting date in order to afford suppliers who are subsidiaries of listed entities the option to voluntarily audit their CSS submission alongside their prevailing financial reports. This will provide assurance that the data stands up to the same rigour and due process.



- There is no benefit to publishing individual entities CSS. Consumers will not benefit nor will there be any beneficial impact on Ofgem's ability to fulfil its statutory duties. We see no issue in providing the data directly to Ofgem to enable it to undertake its statutory duties including evaluating the financial health of the market, but there is no clear rationale for Ofgem to require suppliers to publish potentially commercially sensitive information in the public domain. Should there be a need to share certain information publicly, we would be satisfied with Ofgem publishing an anonymised and aggregated summary report that doesn't enable individual suppliers or their parent company to be identified.
- Through a second phase, Ofgem should work with suppliers to identify any additional information that can be enshrined in the CSS template. We are concerned by the apparent disconnect between what data Ofgem thinks suppliers collect and what data suppliers actually collect in practice. It is therefore imperative for Ofgem to work together with industry to devise any additional information request to ensure that it limits burdensome changes to systems and processes and avoids placing any unnecessary costs on suppliers and thus consumers. Ofgem should be mindful that even with clear guidance, the provision of data that steers industry away from recognised financial reporting standards and definitions, risks the production of increasingly subjective and inconsistent information. Therefore, each additional data request should have a clear justification to avoid unintended consequences including burdening consumers with unnecessary costs.

Separately, we note that Energy UK has proposed a further alternative approach, utilising a streamlined and recurrent RFI that they believe would place less burden upon suppliers, while still meeting Ofgem's primary aim of market monitoring. In principle, we are not averse to this approach, but we are concerned that reporting timelines would still fall outside of supplier's existing financial reporting schedule, impacting the ease and costs of auditability. We are also concerned that an RFI could evolve over time with no formal consultation with industry and risks becoming substantially more complicated and difficult to produce, compared to a static and more dependable CSS requirement that suppliers can plan for.

Our response to the specific consultation questions are appended as Appendix A. We have also detailed an indicative cost comparison of certain approaches in Appendix B which must be treated as confidential. Appendix B details how we expect audit and resource costs to increase disproportionately as the reporting requirements become more bespoke and complex.

If you would like to discuss our response in more depth, please do not hesitate to get in touch.

Yours sincerely,

Matt Young
Group Head of Regulation
Drax Group plc



Appendix A – Consultation Questions

Chapter 1 Question: What are your views on how a transition period could work if and when revised CSS licence conditions come into effect? We would like to understand whether any transition period should apply to all obligated suppliers or only to those suppliers who have not previously submitted a CSS?

The length of a necessary transition period will depend upon what is finally implemented. Based upon Ofgem’s proposed arrangements, we believe that suppliers who have not previously submitted a CSS should be afforded at least an 18-month lead-time before submitting their first CSS. A lengthy lead-time would be required in order to:

- Establish a proper process for the gathering and reporting of required data points;
- Make and robustly test system changes; and
- Align our reporting and cost accounting principles from the start of the reporting year ending March, to allow us to report at the end of that year, rather than introducing the requirement part way through a year and having to retrospectively back-calculate the data.

We are concerned that Ofgem is trying to introduce too much change simultaneously by both increasing the number of suppliers captured by the CSS requirement and expanding the scope of reporting. We believe that it would be more pragmatic to introduce the changes in sequence, specifically by firstly widening the net to bring more/all suppliers into scope of the current CSS requirements. In parallel, Ofgem could conduct coordinated engagement with suppliers to understand what additional information can be provided without undue changes, which once agreed could thereafter be introduced in a subsequent reporting year.

Chapter 2 Question: What are your views on the aims of the CSS?

We are broadly supportive of the aims of the CSS, but we no longer consider it appropriate for Ofgem to publish the data in the public domain. It is our view that consumers do not use this information to make informed choices when determining their energy supplier, and we have considerable concerns that this would require us to publish commercially sensitive information to a granularity that would otherwise remain confidential.

Chapter 3 Question: Do you agree with the considerations we have identified for reviewing the CSS? Have we missed anything in our analysis?

We agree that now is an appropriate time to review the CSS in light of the significant energy market changes of the last decade. As further outlined in our response to Chapter 4 questions, the reducing market shares of the largest suppliers in conjunction with the trends in recent market exits mean it is appropriate and proportionate for Ofgem to extend the CSS requirements to cover all suppliers, enabling full transparency of the whole of the market.



Chapter 4 Questions

Question 1: Do you agree with our proposal to require vertically integrated suppliers and suppliers who hold only a supply licence to submit a CSS.

Yes – We believe all suppliers in the market should be captured by these requirements in order to give Ofgem the fullest market insight.

Question 2: Do you agree with the proposal to lower the customer base threshold from 250k to 50k?

Yes, although we believe the threshold should be removed entirely and the whole market be required to submit a CSS. This allows Ofgem to monitor the financial health of the smallest suppliers (i.e. those with <50,000 customers) operating in an area of the market where a significant number of failures have been observed in recent years, and are arguably most likely to have reduced Corporate Governance in place and are at highest likelihood of financial difficulty. These failures have contributed to substantial scheme obligation and other costs being spread across other suppliers through mutualisation mechanisms which are ultimately passed on to consumers.

Question 3: Do you agree with the proposed cost categories, and the detailed allocation of cost items between these categories? Do you agree with the additional information to be disclosed?

We are not supportive of Ofgem introducing additional cost categories without closer engagement with suppliers to understand what can be reported without making substantial system and process changes. As noted in our covering letter, the more detailed Ofgem makes the data request and the more it diverges from recognised financial reporting standards and definitions, the more likely it is that suppliers will each interpret the request differently. This will undermine the usefulness of the data and negate any ability to compare like-for-like.

We also need clarity on what Ofgem wants to see on a balance sheet regarding customer credit account balance positions. Currently, Drax only reports its balance sheet at a statutory entity and Group level. To provide a combined balance sheet for our retail businesses would be a costly exercise, particularly as we would expect it to be subject to a comprehensive audit as a new financial statement.

Question 4: How feasible would it be to break down costs, revenues and profits by tariff type? How can we ensure consistency? What would be the one-off and ongoing costs of this?

It would be extremely challenging to do this and would likely require a subjective and/or arbitrary allocation of costs. The one-off and ongoing costs of doing this would depend on the level of accuracy and specificity required in the CSS. If high-level allocation is sufficient, then our costs should be relatively low. However, if more granular data is required then this would necessitate significant investment in our systems and additional resource to produce and maintain the additional level of detail.



Question 5: How feasible would it be to breakdown non-domestic costs, revenue and profits into microbusinesses and other? What would be the one-off and ongoing costs of this?

It would not be feasible to disaggregate non-domestic costs, revenue and profits into smaller cohorts (i.e. microbusinesses, SME and I&C) in any comparable way given the variety of ways in which these 'definitions' are interpreted and applied in practice. Moreover, as explained in previous answers, any disaggregation of costs in this way would be entirely subjective and/or arbitrary, and would not facilitate Ofgem achieving its statutory duties.

In terms of one-off and ongoing costs, as per our previous answer, the associated costs would depend on the complexity of any prescribed breakdown, but they would in any case be material, with no apparent benefit to Ofgem, consumers or the market.

It should be noted that, the largest microbusiness suppliers currently submit a quarterly *Revenue by Contract Type* RFI to Ofgem. Rather than seeking to make complex, impractical and costly changes to the CSS, Ofgem could widen the number of suppliers who submit this report, as it would go some, if not all the, way to affording Ofgem transparency of revenues across the smaller end of the non-domestic market.

Question 6: How feasible would it be to breakdown indirect operating costs into customer service, bad debts, metering, sales & marketing, central service and other?

While we could theoretically breakdown indirect operating costs, our primary concern is that there would be a large degree of subjectivity dependent on how each supplier operates. Recognised financial reporting standards do not provide extensive guidance as to the individual line items included within financial standards. Accordingly, each supplier could define each of the sub-categories differently given none of these terms are recognised definitions in finance and accounting guidance.

Notwithstanding that, we fail to see why Ofgem needs such granular insight. Breaking these costs down, in no way enables Ofgem to better fulfil its duties. Suppliers are not price-controlled (except for the default tariff cap which is determined separately) and so Ofgem has no reason or need to capture this data. Moreover, suppliers operate in a competitive market and they each operate very different commercial and operational models, making any arbitrary comparison of cost items across suppliers, for instance metering or sales costs, unnecessary and meaningless.

Question 7: How feasible would it be to report costs associated with serving different types of customers, such as those on the PSR? What would be the one-off and ongoing costs of this?

As a supplier of non-domestic customers only, we cannot comment on the feasibility of reporting the costs to serve PSR customers. However, as discussed previously in relation to disaggregating non-domestic consumer types, segmenting portfolios beyond their market definition (i.e. non-domestic and domestic) would be complex and costly, requiring significant system and process changes – the materiality of which depends on the detail required – and an appropriate lead-time for implementation.



Question 8: Should we put in place a standard method for allocating costs?

Yes, although Ofgem should remain mindful that introducing new standards and/or guidance in an unaudited environment does not eliminate the risks of a subjective and inconsistent allocation of costs.

Question 9: How feasible would it be to split “other revenue” into more specific revenue categories (i.e. beside income from energy generation and retail supply)? What would be the one-off and ongoing costs of this? and Question 10: What specific categories should the “other revenue” item be separated out into?

The feasibility of this depends on whether the final requirements match up with the level of segregation already recorded in our systems. The level of audited disaggregation Drax currently produces is disclosed in a breakdown of our revenue in our 2019 Group annual report¹.

Question 11: What are your views on providing the additional information reporting requirements that we have listed? What would be the one-off and ongoing costs of this?

As noted in our covering letter, the more detailed Ofgem makes the data request and diverges from financial reporting standards and definitions, the more likely it is that suppliers will incur significant one-off and ongoing costs. Further, it is likely that Ofgem would then incur significant extra cost in ensuring that all of the data was consistent and comparable.

One-off costs would include, but not be limited to:

- Agreeing and documenting internal definition for any new requirements
- Enacting system changes so that we can gather data to satisfy the requirements, and
- Upskilling our people to understand the requirements, processes and reporting.

Ongoing costs would include, but not be limited to:

- Preparation, review and sign-off of each report
- Monitoring and maintenance of systems and processes
- Additional auditing costs
- Potential disaggregation of data to align with any change to the CSS reporting period, and
- Monitoring CSS regulation and responding to subsequent proposals.

Question 12: Of the additional financial information requirements discussed, which ones should be given priority in submitting as part of the CSS?

We have no view on the prioritisation of the additional financial information requirements.

¹ Note 2.2. of our *Consolidated Financial Statements*, pg. 140-141: https://www.drax.com/wp-content/uploads/2020/03/Drax_AR2019_Web.pdf



Question 13: Please state if any of the additional information reporting requirements we have listed are commercially sensitive and why?

It depends on the level of detail required. For instance, we are contractually bound not to share the income from some ancillary service agreements.

More generally, we do not agree that the CSS in its entirety should be made public given the commercial sensitivity of the information. The reporting period and final submission date may also risk our CSS disclosing key financial performance indicators ahead of announcements to the market.

Question 14: How much would you expect it to cost in terms of FTE staff to meet new CSS reporting requirements based on our preferred options?

The expected internal cost varies significantly based on a number of factors, notably the complexity of the final CSS requirements, the level of assurance required and the deadline following the reporting date for submission. We note that Ofgem's preferred option – for a relatively detailed and complex CSS statement, prepared to the year ending March – would likely fall at the higher end of these estimates.

We have estimated the resourcing costs of Ofgem's preferred option and two alternate approaches in Appendix B.

Question 15: How much does it cost, or would cost, to audit the CSS? Please provide evidence.

We have estimated the audit costs of Ofgem's preferred option and two alternate approaches in Appendix B.

Question 16: Do you agree with the proposal to remove the audit requirement but for us to retain the right to request an audit when we have concerns? Do you have any views on how best to ensure that information provided to us via the statements are robust?

In principle, we agree with this proposal on the basis that suppliers complete the existing CSS template and reconcile it to their audited annual financial statements.

However, Ofgem should be mindful that the requirement to submit additional data in an unaudited environment, whilst removing the requirement to reconcile that data to annual audited financial statements, risks subjective, inconsistent categorisation which could need a relevant level of assurance (e.g. a lighter touch review signed by an auditor in lieu of a formal audit) to give confidence that the information is robust, comparable and prepared in accordance with the requirements and guidance set by Ofgem.

It would be important for suppliers to clearly understand the criteria that Ofgem would be considering when deciding on what constituted '*concerns*' so that this was a fair and transparent selection. It is noted that both the internal resource costs and external audit costs of an *ad hoc* audit, potentially at much shorter notice, are likely to be significantly higher than the annual cost of a



recurring audit planned in advance – e.g. identifying a suitable auditor would be challenging and cost more than instructing a typical audit.

Question 17: Would removing the requirement to audit the CSS on a regular basis enable suppliers to submit the CSS earlier? How much earlier?

We think it is likely that some suppliers will opt to have their CSS report audited voluntarily, be that as a result of other financial reporting requirements or to mitigate the risk, consequences and costs of an unplanned audit, as noted above. Additionally, a sizeable number of the suppliers brought into scope by the proposed reduction in the customer threshold and the removal of the vertical integration trigger, are likely to be smaller and non-listed entities that are currently only required to file statutory financial information 9 months after the end of their financial year.

As a result, the ability of companies to submit sooner than the current CSS obligation of 4 months after the end of the financial reporting year will depend upon their current circumstances, processes and resources, regardless of the requirement for an audit. Mandating an earlier submission could risk suppliers having to expedite existing processes and providing unreliable information. Therefore, we think it is unreasonable to expect suppliers to submit a CSS substantially earlier than currently required.

However, it is likely that a submission that does not require an audit could be submitted earlier than a submission that does require an audit, where all other facts, circumstances, processes, and resources are the same.

Question 18: What are the average costs of preparing an RFI with detailed financial information?

We have detailed the estimated resourcing costs of Energy UK's alternate approach centred around a recurring RFI in Appendix B. This data demonstrates that the one-off costs of preparing an RFI will depend upon the amount of data that we currently collect in practice. The requirement to provide more detailed information is expected to require system and process changes and will also drive higher ongoing preparation costs.

Question 19: What are the pros and cons of changing the reporting year to the year ending March instead of the company year end?

We are particularly concerned with proposals to change the reporting year to the financial year ending March. We believe that this proposal has no 'pros' for any company with a financial reporting schedule other than the end of March. The costs and challenges could be significant and Ofgem will need to balance these costs and challenges against the perceived benefits to be gained.

It would significantly increase our costs to produce a CSS. Many suppliers, including Drax, currently report to the end of the calendar year to align with their corporate financial schedule, and would be compelled to establish an additional fixed reporting date and make costly and burdensome changes to systems, processes and principles, or otherwise risk providing unreliable data to Ofgem. If the CSS



needs to be audited, is to be published in the public domain, and/or includes data that is not captured or reported in existing financial reports, these costs and risks are exacerbated.

We do not believe that Ofgem needs suppliers to report to a fixed date to be able to be able to aggregate and compare submissions, and by allowing suppliers to align the CSS report with their own financial reporting schedule would enable suppliers to take advantage of economies of scale, including utilising existing controls and quality checks covering a large degree of the data required in the current CSS.