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FAO: Alban Asllani

Gazprom Energy Response to the Consolidated Segmental Statement (CSS) Review

Thank you for providing the opportunity to comment on the review into the Consolidated Segmental Statements (CSS). Whilst we have set out our responses to the specific questions in the annexe attached to this letter we would also like to take the opportunity to set out some other points. **We are happy our response to be shared with interested parties**.

We **do not agree** with the proposals set out by Ofgem to extend CSS reporting to the non-domestic market. We believe imposing this reporting requirement on Industrial and Commercial Suppliers is detrimental as it introduces a disproportionate cost burden to smaller suppliers as the work required to provide this information is significantly more onerous and fixed whilst in contrast the savings suggested from not issuing RFIs is marginal and not comparable.

In terms of costs we estimate the **annual cost of supporting this proposal is circa £50k** however this excludes the cost of any audit and set up costs, which would be dependent on a number of factors yet to be decided upon.

In relation the **audit** we would note **our annual audit costs are ca. £100k**. Since the full company financials are being taken into account in CSS reporting this figure could be taken as a proxy. If the reporting period is Jan-Dec and the auditor is the same as our statutory auditor then there may be synergies that might reduce the costs significantly. However this would be a new type of audit to auditors so first-year costs could be quite high due to auditors needing to establish new audit processes & procedures and audit reporting. Also fees might depend on the level of audit materiality to be applied in such a reporting process.

The issue around comparability is especially important i.e. suppliers with difference basis of prep (IFRS vs GAAP) cannot be compared on a like-for-like basis. For example if we would need to start reporting on a GAAP basis, this could increase our costs of the reporting significantly.

The information required by Ofgem relates to domestic issues, such as credit balances from budget schemes, and is built around domestic concerns, such as tariff pricing being deliberately uneconomic to win market share. Such concerns do not exist in the non-domestic market were tariffs are not used. To aid further understanding we have summarised the fundamental differences between the two markets below:

Domestic	**Non Domestic**
Budget Schemes prevalent due to seasonal nature of costs	Majority of customer pay on receipt of monthly bill
Credit Balances protected (mutualisation risk)	**Credit Balances not protected (no mutualisation risk)**
Consumers can build up large credit balances during summer to offset winter costs	Customers pay on receipt of monthly bill
Billed Quarterly	Billed Monthly
Low prevalence of Smart Meters enabling remote meter reads	High Prevalence of AMR Meter enabling remote meter reads
Seasonal use (heating)	Non seasonal more diverse use
Tariffs	Contract Price
Price Control	No Price Control
Obligation to supply	No obligation to supply

These proposals will simply add significant resource burdens onto non-domestic suppliers and so should instead be limited to large suppliers in the domestic market.

This intervention may also jeopardises the delivery of other industry programmes, such as Faster Switching, Retail Energy Code; Mandatory Half-Hourly Settlement; Microbusiness Review; Smart Metering Rollout programme and CEP directive implementation **by creating a substantial and unanticipated system change** in middle of the delivery of these other major industry programmes.

Whilst we do not support the implementation of these changes we would note that **should Ofgem wish to make such changes a reporting threshold of 150,000 customers should be applied**, to avoid disproportionate costs being imposed on smaller suppliers

Should you have any questions in relation to our response please contact me directly

Yours

Steve Mulinganie
Regulatory Manager

Appendix 1 – Gazprom Energy response to the questions in the consultation document

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?

To deliver the new reporting framework, we will need to develop new processes from scratch with significant system changes. At the same time Suppliers are also currently developing several other significant changes mandated by Ofgem & BEIS including: -

- Faster Switching
- Retail Energy Code
- Mandatory Half-Hourly Settlement
- Microbusiness Review
- Smart Metering Rollout programme
- CEP directive implementation

The current implementation date is therefore challenging to deliver without jeopardising delivery of these other programmes. Whilst we do not see any value in extending this reporting requirements to smaller suppliers any implementation of these proposals must be considered alongside these other critical industry changes and scheduled in accordingly.

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

The original aim of the CSS reporting regime was to ensure that vertically integrated companies do not use their generation assets to subsidise their retail market offering. Whilst we understand that Ofgem has used this information to inform other activities, we do not see that repurposing the CSS reporting regime to achieve unrelated goals is justified simply as it is convenient.

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

No comment

Chapter 4. Do you agree with our proposal to require vertically integrated suppliers and suppliers who hold only a supply licence to submit a CSS?

No. We do not see any justification as to why non-domestic suppliers with comparatively small overall market share should be required to provide this detailed and commercially sensitive information. In contrast to the domestic sector, no significant non-domestic suppliers have exited the market in an uncontrolled fashion. Instead exits have been achieved through trade sales of viable businesses. Therefore the non-domestic market does not need the level of monitoring proposed to watch out for market issues.

The information required by Ofgem focusses on domestic issues and built around domestic concerns, such as tariff pricing being deliberately uneconomic to win market share. Such concerns do not exist in the non-domestic market.

To aid understanding we have summarised the differences between the two markets below:

Domestic	**Non Domestic**
Budget Schemes prevalent due to seasonal nature of costs	Majority of customer pay on receipt of monthly bill
Credit Balances protected (mutualisation risk)	**Credit Balances not protected (no mutualisation risk)**
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These proposals will simply add significant resource burdens onto non-domestic suppliers and so should be limited to large suppliers in the domestic market.

Do you agree with the proposal to lower the customer base threshold from 250k to 50k? Information on costs:

No. Ofgem state their target is for the regulatory requirement to capture 90% of the market. Ofgem's own analysis demonstrates that reducing the threshold below 250,000 supply points is unnecessary to achieve 90% market coverage.

Vertical integration	Threshold	Number of suppliers	Number of customers	Market share
Vertically integrated and supply only	250k customers	16	51,012,422	91.6%
	200k customers	16	51,012,422	91.6%
	150k customers	19	52,010,735	93.4%
	50k customers	36	54,763,776	98.4%
	90% of market share	14	50,133,345	90.0%

The proposed cut-off of 50,000 customers will more than double the number of suppliers caught by the scheme, significantly increasing the cost to the market. **By comparison over 93% of the market is covered by the 150,000 limit with only a modest increase in the number of Suppliers affected**, which we note is the limit for a number of industry schemes such as the Supplier Export Guarantee, Warm Home Discount, ECO and a number of smart metering obligations.

As we have noted the costs of developing and implementing a compliant CSS reporting framework are relatively fixed, and so the costs will be disproportionately higher for smaller suppliers leading to increased costs for customers, up to £1 per customer per year (based on our estimated cost of £50k) if the target threshold of 50,000 customers is imposed (this excludes other costs such as audit and start-up and audit costs).

Whilst we don't support any change to the existing arrangements we would note that to strike an appropriate balance between cost to the industry and provision of information, moving to the industry standard 150,000-customer limit would seem more appropriate were Ofgem to move forward with these proposals.

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?

No. In line with the rest of our response **we do not agree** with the CSS reporting regime being extended to smaller suppliers.

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?

We do not provide Tariffs. Tariff is a defined term in the supplier licences and currently only applies to domestic suppliers. There is no legal concept of “Tariff” in the non-domestic market. Non-domestic suppliers do not develop tariffs for customers. Instead a contract for a non-domestic customer is developed from several price components including credit worthiness of the customer and commodity prices which change daily and commonly within-day.

At present therefore non-domestic suppliers would be unable to complete the table to align with the Tariff split. It would be necessary to split reporting out by contract type if visibility of price composition is required. This would result in significant cost as it would potentially require thousands of reporting lines.

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?

At present we are not aware of a universally applied definition of SME/I&C/Non-profit customer so if Ofgem required information on such a defined level, it would also require suppliers to develop and implement a common classification process. To ensure consistency we would expect that a common definition would need to be developed and systemised, which will believe would be very difficult to do in the timescales proposed considering the disruption and cost this would entail.

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

Unlike domestic suppliers who incur relatively constant costs from each customer supplied (owing to similarity in energy use, metering and transportation costs), the costs for a non-domestic customer widely varies, owing to;

- variations in the number of sites in a contract,
- significant variations in consumption at a site,
- significant differing transportation rates for the site,
- significant differing metering costs,
- Variations in wholesale price costs depending on specific treatment of energy prices (based on exchange prices, basket of forward prices, etc.) for customers and when energy is bought/sold to cover customer demand.
- Credit worthiness.

Many of these costs are fixed for a certain period and then vary according to market conditions or reconciled from initial estimates. The wide variability of these costs within the proposed customer brackets will make meaningful comparison between prices very difficult, even with standardised treatments

To create the artificial split by customer type would require development of standard methodology to ensure consistent treatment of costs. Implementing a new methodology will be a cumbersome and cost intensive process.

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?

Non-domestic suppliers are not obliged to track or provide services to Vulnerable Customers and so do not have any way of identifying such customers; it is impractical to require this. Please see our comments to questions 5 &6 regarding our concerns splitting out costs by non-domestic customer type.

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

As set out in the rest of the consultation, little of the proposed information is collated in the form proposed in the CSS reporting framework and so no default ways of working exist. To avoid optimisation of costs and profits through beneficial interpretations, it would be necessary therefore to standardise cost treatments and formal definitions will need to be developed. Such areas would include:

- Gas and Power fuel/commodity costs are commonly hedged as a portfolio and therefore the final actual cost can be optimised through hedging however there is limited ability to apportion such optimisation between segments
- Many transportation costs and other direct costs are invoiced at a portfolio level and may not be agreed and apportioned to the consumption at a meter level so allocation may be arbitrary on volumes whereas charges might have uneven weighting factors such as different peak/non-peak spreads or charge types
- Internal resources may not be easily apportioned as direct teams may be flexible to work between segments, indirect teams might not require the same level of effort for every customer (i.e. key accounts, payments type, geographical location, industry type) and if the supplier does not maintain detailed timesheet data for all employees then an arbitrary allocation would be made
- Some direct and indirect costs such as postage, payment processing, IT licence use, rates, travel etc. cannot be easily allocated to segments and products
- Defining the expected accountancy treatments (i.e. should IFRS or UK GAAP be applied) would also be required.

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? What specific categories should the 'other revenue' item be separated out into?

Unregulated income is nothing to do with regulated energy supply.

We might expect companies to create separate companies to operate this function if these proposals were implemented and therefore we believe it would be impossible to maintain reporting consistency in this area.

It is also outside of Ofgem's remit to oversee unregulated activities by energy suppliers. **We do not believe it is appropriate for such information to be requested and any reporting framework should not seek to capture this information.**

We also believe it is unnecessary. As we stated elsewhere in this response, if our members are compelled to provide this information it will be a specific report to meet these requirements as reporting timescales will not align with the standard reporting cycles and so such information could be omitted.

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

In line with our other questions we do not believe that the CSS reporting framework should be extended in scope, either to capture suppliers that are not vertically integrated, or to be expanded to cover other areas. We do not believe that the CSS will result in a net reduction in resource requirements from reducing the need for RFI request, which have a comparatively low resource burden. We therefore do not see any justification or value in providing the additional information suggested as part of this process.

Please state if any of the additional information reporting requirements we have listed are commercially sensitive and why.

Organisations that currently provide information under the CSS regime are all large companies who are required by legislation to publish account information. By contrast, many of the smaller suppliers are not currently required to put such detailed financial information into the public domain.

We consider any and all of the information required to be put into the public domain by the CSS process to be commercially sensitive as it will provide information on the fundamental financial workings of the supplier.

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

Our Initial assessment of the proposals have *indicated* an **annual ongoing cost of circa £50,000 per year** to provide this information. This excludes start-up costs and audit with initial development costs being expected to be higher. Please note that this is a conservative estimate assuming that information is not required to for every contract

As noted this is significantly higher than comparable annual costs for relevant RFI requests from Ofgem.

As the costs of supporting the request are fixed, irrespective of size of the supplier, the costs will be proportionately higher for smaller suppliers. Based on the proposed threshold this will incur a cost of circa £1 per customer per year to provide this data and so will introduce a cost distortion into the market for smaller suppliers.

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

In relation annual audit we would note **our annual audit costs are circa £100,000**. Since the full company financials are being taken into account in CSS reporting this figure could be taken as a proxy. If the reporting period is Jan-Dec and the auditor is the same as our statutory auditor then there may be synergies that might reduce the costs significantly. As this would be a new type of audit to auditors so first-year costs could be quite high due to auditors needing to establish new audit processes & procedures and audit reporting. Also Fees might depend on the level of audit materiality to be applied in such a reporting process

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?

We support any proposal that manages regulatory burdens on suppliers and if the CSS reporting regime is extended to small suppliers, then not imposing a requirement for an audit as part of that will reduce the overall increase in regulatory obligations.

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

Clearly removing this proposed obligation would reduce the burden on Suppliers however it is impossible to comment on the effect it would have on the ability to submit the information earlier albeit one may expect it to deliver some efficiency.

What are the average costs of preparing a RFI with detailed financial information?

A suitable comparison would be with the recent COVID-RFI reporting request that requested financial information at very short notice. Though the costs of this activity were intensive in terms of resource and costs, **we estimate that the provision of the information took no more than five workdays.** This is a fraction of the ongoing annual resource costs that would be required to operate the CSS reporting framework.

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

We operate a calendar (1 Jan - 31 Dec) financial year as part of an international group and in line with the standard accounting practice of the country of the parent company. **Moving to the UK reporting standard for this process will require effective duplication of the annual reporting process and creation of two sets of statements creating significant extra work** and cost as noted above.