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Sent by e-mail

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Dear Alban,

Reviewing the Consolidated Segmental Statement – Ofgem’s initial proposals

We welcome the opportunity to respond to Ofgem’s consultation on behalf of SSE Business Energy (SSE Energy Supply Limited).

SSE agree with Ofgem that it is necessary to review the existing CSS requirements, and that ‘do nothing’ is not a viable option given the current requirements no longer remain fit for purpose. However, we remain concerned with the proposals to introduce the level of granularity detailed within the consultation.

Whilst we recognise the aims Ofgem is seeking to achieve, we do not believe Ofgem has provided sufficient evidence to demonstrate why it needs this level of granularity (e.g. commercially sensitive data) and what benefit this will provide. The proposals would require significant investment to produce the information being requested and, as Ofgem acknowledge, suppliers would be required to make several assumptions regarding the allocation of costs, fundamentally undermining the value that could be derived from any analysis of the outputs.

We welcome Ofgem taking steps to understand the financial health of the market but do not consider the proposals will provide the information needed to effectively monitor this. For example, several of those suppliers who have recently been subject to a Supplier of Last Resort event would fall below the reporting thresholds proposed by Ofgem as part of this consultation. As a result, we believe that the existing Covid-19 RFI, combined with the dynamic and milestone assessments proposed as part of the Supplier Licensing Review, should provide Ofgem with the necessary powers to require additional information from those suppliers it considers represent the greatest risk to the market.

We consider that removing the requirement to produce the Consolidated Segmental Statement from the Supply Licence Conditions is the most appropriate outcome and that this would provide Ofgem with the opportunity, consistent with the aims of the Supplier Licensing Review, to take a risk-based approach to monitoring. Should Ofgem consider that there remains significant value in retaining the obligation to produce a Consolidated Segmental Statement we would agree with its proposals to broaden the requirements of the existing obligation to capture a greater proportion of the energy supplier market.

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In addition, we would welcome a review of supplier regulatory reporting requirements to streamline and improve the consistency of existing regulatory reporting requirements, removing the potential for duplication and ensuring that future proposals by Ofgem to enhance reporting requirements will be easier for suppliers to adequately consider.

We have provided further detail in response to Ofgem's questions in the attached appendix and would welcome the opportunity to discuss this further.

Yours sincerely,

Victoria Burkett

Regulation Manager – Customer Solutions GB

Chapter 1 questions:

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?

We do not fully agree with Ofgem's proposals to broaden the CSS to include additional granular financial information. Should Ofgem's final proposals include these requirements we believe a transition period of at least 12 months would be required for all suppliers to provide sufficient time to put in place the necessary processes and system changes needed to produce the information being requested.

However, should Ofgem's final proposals simply broaden the existing obligation to include a greater number of suppliers, then we would not anticipate a transition period is needed for any supplier given the majority of this information should be being prepared by suppliers as part of their existing financial reporting processes.

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

Ofgem note that the CSS was "...originally introduced to provide transparency on profitability in the energy sector, particularly profits of the large vertically integrated suppliers". We agree with Ofgem's conclusion that this aim no longer remains applicable given the energy market has evolved considerably since the CSS obligation was originally introduced.

First, the number of suppliers has now increased and in recent years has been between c. 60 - 80 and, second, the CMA concluded that 'we have not identified any areas in which vertical integration is likely to have a detrimental impact on competition for independent suppliers and generators. In addition, we consider that there may be some efficiencies resulting from vertical integration, which may be passed through to customers. As a result, our conclusion is that firms' vertically integrated structure does not give rise to an AEC (adverse effect on competition)'.¹

We recognise that Ofgem consider that there remains a need for suppliers to publish this information in a consistent format. We do not have any strong views on the revised aims of the CSS but, as Ofgem note that it is a primary beneficiary of the CSS, we consider that Ofgem need to effectively assess the cost/benefit analysis of introducing this requirement versus relying on supplier financial accounts given the cost/operational burden it places on suppliers.

¹ CMA, Energy Market Investigation, Final Report, Page 20 - <https://assets.publishing.service.gov.uk/media/5773de34e5274a0da3000113/final-report-energy-market-investigation.pdf>

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Chapter 3 questions:

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

Whilst we broadly agree with the considerations identified, we do not believe Ofgem has fully taken these into account when producing these proposals. As identified within the consultation, the removal of the auditing requirement is proposed largely due to the cost to industry. However, the introduction of the additional granular reporting requirements will result in a substantial increase in supplier cost which is likely to outweigh this benefit.

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Chapter 4 questions:

Vertical integration and threshold:

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.

As noted within Ofgem's consultation, the energy market has changed significantly making the CSS no longer fit for purpose.

Our preference would be Option 2, to remove the requirement from the Supply Licence as this would reduce the regulatory burden being placed upon suppliers at a time when other Ofgem consultations are seeking to increase the regulatory burden (e.g. Supplier Licensing Review). We consider this would also provide Ofgem with the opportunity, consistent with the aims of the Supplier Licensing Review, to take a risk-based approach to monitoring. For example, the Supplier Licensing Review proposes that Ofgem should have powers to conduct milestone and dynamic assessments. We consider that aligning any requirement to provide Ofgem with additional information with these mechanisms ensures that reporting obligations are proportionately applied to those suppliers Ofgem deem to represent greatest risk to the market.

*Should Ofgem conclude that Option 2 is not feasible, we would favour Option 3B. Our view is that this would be strongly preferable and would remove the requirement for vertically integrated suppliers to amend their processes on two occasions within a short period of time. It also remains consistent with the CMA's conclusions, acknowledged by Ofgem, that the CMA 'have not identified any areas in which vertical integration is likely to have a detrimental impact on competition for independent suppliers and generators.'*²

We note from the consultation that Ofgem is considering whether it should consult on a new CSS requirement for generators, therefore, we believe the current generation obligation should be removed from the supply licence.

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

Should Ofgem conclude that Option 2 is not feasible, we believe a threshold reduction is necessary if Ofgem are to achieve the aims it has set as part of this consultation. However, consideration will need to be given to how this is managed in practice to ensure there is clarity on when the reporting requirements apply. Aligning the obligation to comply with this licence condition to Ofgem's annual customer number notification process (for WHD, ECO, FIT etc) would ensure clarity on when a supplier is required to comply. This is important given customer numbers will fluctuate throughout a supplier's financial year – for example, although a supplier may not have the required customer number at the beginning of the financial year, they may gain customers throughout that reporting period. This would also work in reverse, where a supplier may be obligated at the beginning of the reporting year and lose customers. This was discussed at the February workshop however this does not appear to have been covered in the consultation.

Ofgem will also need to be considerate to the terminology used. For example, clarity will be required on whether the new threshold will be based on the number of customers or the number of supply points a supplier has in their portfolio, and on whether this applies to a supplier's individual or aggregate portfolio (e.g. gas, electricity, domestic / non-domestic etc). This will ensure there is a consistency across the reporting year for each obligated supplier.

² CMA Energy Market Investigation Final Report, Page 20 -

<https://assets.publishing.service.gov.uk/media/5773de34e5274a0da3000113/final-report-energy-market-investigation.pdf>

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Information on costs:

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?

Ofgem's aims are to 'Provide transparency and market intelligence', 'Ensuring consumers are treated fairly' and 'Supporting policy development and limiting regulatory burdens on industry'. Ofgem have not provided sufficient evidence to demonstrate how the provision of this additional information will support it to meet these aims. We have not identified in the proposal any data which will help Ofgem to recognise where interventions will be required or to enable Ofgem to identify when a supplier may come in to financial difficulty. Ultimately, a supplier could make a profit but still trigger a SoLR event.

As a result, we do not consider that this additional information is required and do not believe Ofgem has demonstrated that it will provide additional value.

Ofgem will note, from SSE's published CSS, that our indirect costs are significantly lower than the direct commodity / non-commodity costs. These costs include employee salaries, systems, buildings, metering, marketing and debt collection costs. In each case, the allocation of these costs across different customer / tariff types will require each supplier to make their own assumptions – which are likely to be vastly different. This would wholly undermine the aim Ofgem seeks to achieve. For example, each supplier would need to consider how to allocate the Ofgem licence fee across customers / tariffs. This might lead some suppliers to conclude it should be allocated equally on a 'per customer' whilst others might allocate it on a 'per supply point' basis or according to consumption. In addition, some might conclude that it is reasonable to weight this cost towards those areas of the market which are afforded greater regulatory protection (e.g. domestic customers, MBCs). These decisions would need to be made by each supplier for every line item to facilitate an allocation across customer types/tariffs. There may also be differences between suppliers based on their business ethics (e.g. whether they pay living wage) and geography (e.g. suppliers with a base in London may incur higher salaries / property costs etc). Accordingly, the burden imposed by Ofgem on suppliers to provide such granular information is unlikely to provide any meaningful basis upon which to reach sound conclusions when seeking to compare supplier performance at a granular level.

Notwithstanding the points above Ofgem need to be mindful that there are a number of incremental financial reporting and accounting differences between the suppliers and therefore the CSS submitted. These differences could be considered under the following points –

- 1. Reporting presentation – There is limited statutory guidance on the presentation / aggregation of costs within the income statements – for example, whether staffing costs should be treated as direct or indirect.*
- 2. Accounting convention – Larger suppliers will use International Financial Reporting Standards (IFRS) which set common rules so that financial statements can be consistent, transparent and comparable around the world. Smaller suppliers are likely to use Financial Reporting Standards (FRS) 102 or Generally Accepted Accounting Principles (GAAP) which is based on the IFRS for SMEs, this is a simplified IFRS standard developed by the International Accounting Standards Board for non-publicly accountable entities. There is already a divergence between these in terms of revenue recognition such as leasing and bad debt which could make the comparison of the statements meaningless. For example, the IFRS requires companies to apply an expected credit loss model for bad debt provisions, whereas the FRS 102 /GAAP is less restrictive and follows more of a traditional provisioning model.*
- 3. Judgements inherent – There are some key judgements involved in determining elements of the income statement and balance sheet. For example, the Unbilled revenue will depend on assumptions made around Unidentified Gas (UIG), meter estimates and tariff considerations, to name a few. Bad debt provisioning will depend on customer profiles, assumptions around future economic conditions and the level of focus on chasing aged debt.*

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Therefore, if the scope of the CSS is widened to smaller suppliers then we see the only way this could be reasonably resolved is to set an expectation of the accounting standards which all suppliers must follow. Ofgem do need to be aware that this would put an incremental compliance burden on such suppliers where they will need to confirm accounting principles to a consistent standard.

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?

Ofgem currently receives information from non-domestic suppliers on revenue from MBC customers as part of an ongoing request for information.

As mentioned above it is not feasible to allocate costs between customer segments/tariffs given the significant number of assumptions this would require a supplier to make across every cost category e.g. buildings, insurance, employee salaries, systems, consumption bands, TPI acquisition, metering, marketing, cost to serve and debt collection costs.

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?

Ofgem already receives revenue for MBC customers and as stated in our response to Question 4 undertaking a breakdown of costs would be subject to a high number of assumptions. Whilst it would be feasible to complete this it would be subject to a number of considerations. First, the definition of MBC is fluid given it's a subjective test (i.e. it can either be consumption or a combination of revenue / number of employees). From a financial reporting perspective, it would be easier to achieve this using consumption only. Second, achieving this breakdown would nevertheless be complex and would require additional investment to achieve.

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

Most of our costs are segmented based on the operating costs listed above, although further work would be required according to any final proposal made by Ofgem. However, due to fact suppliers will allocate costs differently, we would question whether this breakdown would offer significant value.

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?

We do not consider that this requirement applies to non-domestic suppliers.

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

Allocating costs across customer types or tariffs is not practical due to the reasons stated in previous questions. As soon as suppliers must start making significant numbers of assumptions – consistently or not – it devalues the purpose of the exercise given it's no longer a genuine comparison but is a constructed view of performance.

The creation of an independent method from the current financial processes already in place, creates another set of reporting standards which suppliers will need to abide by.

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Other information:

Question 9: How feasible would it be to split “other revenue” into more specific revenue categories (ie, beside income from energy generation and retail supply)? What would be the one-off and ongoing costs of this?

This would be feasible to achieve given “other revenue” typically only includes Residual Cashflow Reallocation Cashflow (RCRC). However, other suppliers may include other items within this category.

Question 10: What specific categories should the ‘other revenue’ item be separated out into?

We believe Ofgem need to request what is recorded and reported in the ‘other revenue’ category, which could be covered with a note by the supplier to detail what has been included, as opposed to including more detail within the CSS.

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?

We have set out our views on the additional information reporting requirements in response to the questions above. However, we consider that the additional information reporting requirements specified in Paragraphs 4.31 – 4.32 could introduce more transparency for Ofgem and would have minimal additional costing.

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

We recognise Ofgem wishes to gain a further understanding of the market and that the current CSS is no longer fit for purpose. However, further consideration should be given to developing reports that can flag early issues such as cashflow, working capital, and mutualisation risks to ensure Ofgem is able to identify suppliers at risk of failure.

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

We believe that all the proposed additional information is commercially sensitive as this will be linked to our pricing and could provide other suppliers with information that would otherwise be unavailable. There is a significant risk that this could impact upon competition if the data is accessible to all market participants.

Cost to suppliers:

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?

Assuming the requirements are broadened out to additional suppliers, with no additional reporting requirements, there will be no additional costs given we are already subject to this obligation. However, should Ofgem increase the volume/type of information reported we would anticipate this would require a significant investment in cost reporting which could require up to an additional 1 FTE on an enduring basis (with a small project team required initially to scope and deliver the additional reports needed).

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Depending on the final proposals this could also have a significant IT impact which would require us to evaluate the cost of this additional information, once it has been determined.

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

As the CSS audit is included in our year end audit fee, we do not have this cost information.

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?

Yes, we believe this approach would be beneficial to help reduce the additional costs of completing this, however, the supply licence condition relating to the right to request an audit must be clear and concise. These must contain the appropriate accounting standard obligations and must provide precise details to confirm what Ofgem consider to be a material breach of the obligation and how they can audit a supplier if they believe they are in breach of the obligation. We consider there would be merit in aligning this with the proposed Independent Audit obligation under the Supplier Licensing Review.

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 aim to publish our CSS as soon as reasonably practicable, therefore removing the auditing requirement would not have any impact on our ability to issue the statement. It is important to recognise that we are unable to publish our CSS in advance of our annual results given our financial reporting obligations (e.g. under the Market Abuse Regulations). We would not anticipate that removing the requirement to audit the CSS would, therefore, enable SSE to submit its CSS earlier than present.

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

The cost of an RFI is wholly dependent on the detail which is being requested. In circumstances where information exists in the format being requested, we would expect this to equate to 0.1 FTE (annualised) for a monthly request for information. However, this excludes costs associated with processes put in place to assure the data, and ensure it is appropriately signed off by senior management teams. This will vary according to the volume, complexity and type of information being requested. In circumstances where information does not exist in the format being requested this cost would be significantly greater – this might reasonably include system-related costs, and additional staffing costs. It is not possible to provide accurate estimates of these costs given they will vary according to the nature of the RFI.

Reporting year:

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 do not have any views on the proposal to amend the reporting year as our current financial year end aligns with this date.