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Dear Sabreena,

RE: Statutory Consultation - Reviewing the Consolidated Segmental Statement – Ofgem's initial Proposals

Thank you for the opportunity to comment on the above consultation.

Utilita is a smart prepayment specialist, offering high quality, prepay services to the prepay sector.

Utilita agrees with the general view that Ofgem should retain a mechanism to provide a whole-of-market view of supplier financial and operational performance in order to assist with the delivery of their objectives. However, we do not believe the current proposals in the Consolidated Segmental Statement (CSS) consultation will achieve this. We share Energy UK's concerns that the exact aim that Ofgem are seeking to achieve is not clear enough and therefore we have not been able to provide a full and informed response at this time.

Ofgem have not provided a detailed explanation as to how they will use the data captured in the proposed CSS to ensure supplier financial stability or how this would be used to protect customers. Ofgem already have extensive powers to request information and audit suppliers however they were not exercised historically, despite critical red flags such as suppliers using unsustainable pricing models that were far below the price caps. We ask that Ofgem provide their reasoning as to how they have drawn the conclusion that obtaining this level of information from suppliers will be to the benefit of customers and how this cannot be achieved with existing information and powers at their disposal.

Further, we believe that many of the requirements proposed in this CSS consultation are duplicated or overlap with other reporting requirements already in place. We believe that the general policy intent behind the consultation is better served under the proposals for the Supplier Licensing Review, Statutory Consultation published on 25 June 2020.

The proposals, in their current form, will not aid Ofgem in drawing any meaningful conclusions due to the inconsistency in the treatment and allocation of costs between suppliers.

The extremely granular level of the data that Ofgem are seeking to collect under these proposals is not currently held or collected by Utilita. In order for us to accommodate the reporting requirements, we will need to amend system processes and training packages. These requirements would come at a time when there are other market reforms taking place requiring significant supplier resource and cost. Particularly where suppliers are recovering from the effects of COVID. Before any changes can take place, Ofgem should provide greater clarity on the data metrics proposed through the amended CSS.

Lastly, we consider the information requested under the CSS to be commercially sensitive. This information is not currently held internally and therefore neither is it provided externally. The proposals will compromise our business interests and could distort competition. Potentially the information is provided at a level of detail that may provide interested parties to draw incorrect conclusions.

Energy UK's Alternative Approach for Efficient Market Monitoring

We are in support of Energy UK's response on this area, particularly their proposal for a regular, streamlined approach to requesting this information. This method will give Ofgem a reliable, updated view of supplier performance in order to best address financial performance in a more timely manner. The current proposed requirement to post financial information 12 months after the date will not provide Ofgem with the information required to scrutinise, or mitigate against, a supplier's financial performance. The current proposed Licence Conditions under the Supplier Licensing Review will better aid Ofgem's policy intent here.

In place of the CSS, Ofgem should require suppliers to complete a regular (quarterly) financial Request for Information. We believe that this request should be targeted and proportionate in its scope. Gathering this information at a greater frequency will also provide a more real-time view of the market. Any request of this nature should also be consistent with current reporting requirements and those that are being developed through the Supplier Licensing Review proposals.

This Request for Information should be applicable to all suppliers, regardless of size. As evidenced by the recent supplier failings, it is the smaller suppliers that are more likely to fail, most of whom were under the 50,000 customer threshold. Supplier failures, particularly those not caught by the existing or proposed new licence conditions, may undermine consumer confidence in switching to challenger supply companies, which could have the adverse effect of encouraging greater competition.

We outline our responses to the questions posed in the Consultation below:

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?

We do not agree with the proposal to only require vertically integrated suppliers and suppliers who hold only a supply licence to submit a CSS. The scope of the requirement under the supply licence should be limited to activity covered by that specific licence. Should Ofgem require detailed generation performance, this should be covered under the generation licence.

We question Ofgem's authority to collect data on unregulated activity, neither do we consider this to be of any value to Ofgem as differing business structures may distort and mislead Ofgem's decision making. We are also concerned about Ofgem's overall approach to industry engagement on the review of CSS, including significant policy questions asked outside of formal consultations, which has limited our ability to scrutinise the proposals in full.

We do not agree with the current categories to be published under the CSS. Were it made into Licence, we consider it more appropriate to split the profit and loss sheets by prepayment customers, Direct Debit customers, Standard Variable tariffs, Fixed Term tariffs, Microbusiness customers and (larger) Commercial customers. This would limit the number of Profit and Loss sheets to 12, which would still be rather onerous for suppliers to maintain a full reconciliation of costs. We would like Ofgem to provide more detail on the proposed categories.

While Utilita support Ofgem's intent to maintain a consistent view of the entire market, the changes proposed will lead to additional cost for suppliers which will ultimately be borne by the customers. Any additional costs must also be factored into the price caps. We require further information on the detailed definitions that Ofgem are requiring from suppliers, in order to give an accurate view on likely costs. However, from the vague proposals, we anticipate an additional £250,000 a year with around £500,000 upfront cost for changes to existing systems and processes and the implementation of new tools.

Given the substantial impacts on suppliers both from resourcing and cost perspectives, we would suggest that any reforms of the CSS should not be changed for at least five years after they come into force. Any subsequent changes should give at least two years' notice of changes (e.g. similar to the requirements of changes to accounting standards).

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

No, we believe that all suppliers should have to provide financial information. While we agree that larger suppliers represent a larger risk to industry in the event of their failure, it is more likely that a smaller supplier will fail. This is evidenced by the many recent SoLRs. Failure of smaller suppliers also undermines consumer confidence to switch to challenger suppliers further reducing competition.

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 agree that the cost categories are relevant however we have not seen detailed definitions of these. Without detailed definitions, any information provided by suppliers will appear misleading, this is due to inconsistencies with the approach in capturing and allocating the data.

It should also be noted that suppliers can adopt different accounting treatments, which will also need to be taken into consideration when comparing results, for example some suppliers may expense upfront sales costs while others defer these.

Once guidance is provided on the definitions, we anticipate the requirement to change our internal reporting, which will add overhead costs. We do not currently internally report on the information proposed to be gathered by Ofgem for the CSS. Its unlikely we will adopt the reporting requirement into our internal processes which will mean the requirement to maintain an internal and external categorisation methodology so that our management team can understand the numbers.

We disagree with the cost allocation at such a granular level. We do not currently hold this information meaning that it will cause considerable system and process change to be able to report this. While the draft templates do not currently make clear how these will be gathered, we assume that the proposal would require us to maintain up to 31 Profit and Loss sheets that are reconciled to our Statutory accounts. This would be extremely onerous.

P&Ls
Tariff types - 3
Customer Types -4
Fuel - 2
Sub Total – 24 (3*4*2)
Plus
Non-Domestic – 3
Fuel - 2
Sub Total 6 (3*2)
Unregulated 1
Total 31 (24+6+1)

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?

We do not currently report profit down to tariff type. In the current price cap environment, we have very little control on price and costs so there has been little incentive for us to do so.

We do not believe Ofgem will achieve consistency at the granular level suggested. To achieve consistency, Ofgem would need to reduce the requirements and be very specific with definitions and allocation rules.

It is estimated that we would likely require two accountants and one data analyst. In addition to the implementation of a new application system to handle and store the allocation of the results, as well as changes to existing core systems to provide data for input. The estimated additional cost is £250,000 per annum, (at 31p PA for 750,000 customers), plus up to £500,000 for implementation (at 62p PA).

Cost Breakdown
2 x accountants £140,000
1 x data analyst £50,000
Application, infrastructure, license and support £60,000

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?

This will require changes to our current system to provide data for input into a new tool for allocation. Given the additional complexity within non-domestic supplies and Utilita's relatively small portfolio, this would be a disproportionate and material additional cost to our portfolio of customers. The additional cost is included in the above illustration.

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

We would like Ofgem to provide detailed definitions for each category. In particular, how should suppliers allocate group functions such as IT and Premises to Customer Services given the varying and changing business models. The range of interpretations and methodologies adopted by suppliers will lead to inconsistent comparable datasets and will provide no meaningful insight.

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 have a means to do this at present. Further guidance on Ofgem's expectations is required to answer this fully. For example, is Ofgem expecting costs to be allocated on drivers such as call length or simple estimated weighted averages?

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

Yes – without a prescribed method, the data Ofgem receives will not be comparable and it will not achieve its policy aims. We recommend that Ofgem creates a working group to agree with suppliers a set of robust but pragmatic allocation rules. Noting that any changes to internal methodologies will require additional supplier administrative and development costs.

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?

Ofgem should not collect details on other revenue, other than a total line for reconciliation purposes. This will not be comparable for Ofgem due to different group structures. Suppliers may circumvent this requirement by moving other revenue to non-licensed entities to avoid the publication of sensitive information and onerous reporting requirements.

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

None – Other should be a single line for reconciliation purposes only. If Ofgem require details on non-licensed other revenue they must provide details on what basis they are requesting this information.

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 agree that a high-level balance sheet with credit balances is reasonable, however detailed definitions should be given in order for this to be achievable and comparable. For example, are credit balances to be offset against unbilled amounts?

We agree a monthly Cash flow should not be in the CSS.

We note that comparatives are to be included, we do not currently capture data at the level required therefore this data would not be available for at least 12 months from implementation. Alternatively, high level weighted averages could be used however Ofgem would need to accept that these comparatives would not be like for like and we would be unable to provide detailed commentary and therefore we do not see what value this adds to Ofgem in delivering on its objectives.

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

We would not want to see these requirements drip fed in. Segmenting our financial result will be onerous but should be done as a one-off exercise to limit costs and impact to business processes. Additional changes over time will increase the resources required to implement.

Suppliers have little control over the gross margin with the price cap adjusting accordingly. If Ofgem were to prioritise an area, it should be the customer cost to serve. Clear definitions need to be given as to what costs are included in cost to serve, i.e. how do Ofgem propose suppliers allocate the cost of group functions which directly support the cost to serve such as IT and premises.

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

We consider it all to be commercial sensitive. Very little is required to be made public and the timelines in which Ofgem are considering would likely mean the data that is within the CSS would be made available within the public domain prior to release to other stakeholders.

<u>Cost to suppliers:</u>

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?

It is estimated that we would likely require two accountants and one data analyst. This would be expensive as they would require a professional qualification in finance with data and energy sector experience.

Question 15: How much does it cost, or would cost, to audit the CSS? Please provide evidence. This would depend on the level of assurance that Ofgem required.

We expect it would between £50,000-£75,000, excluding internal resource. We would seek clarity from Ofgem whether this audit would be in addition to the audit that may be required under the Supplier Licensing Review. If in addition to, how does Ofgem expect to draw conclusions from these audits, in addition to the Audit that is required under the Companies Act legislation?

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?

We agree with the removal of the audit requirement but would also like to understand the level of assurance sought from an audit and the scope of it as well as how and when Ofgem would request an audit.

We also request Ofgem consider the impact of requiring an independent audit of a supplier's financial status where the supplier is already governed to carry out a financial audit under existing legislation. Suppliers are already governed by existing legislation to carry out a financial independent audit under the Companies Act 2006. This financial audit is carried out by Registered Auditors who are required to form an opinion of the truth and fairness of the Company accounts and inter alia form an opinion on whether the organisation is a going concern.

We would ask Ofgem to explain their reasoning for their perceived benefit of another additional independent audit of the financial status? We would also ask whether Ofgem intend to impose their own financial audit requirements; and whether these would conflict with the current framework under the Companies Act. ARGA (Audit Reporting and Governance Authority) is set to replace the Financial Reporting Council in April 2022 as a direct response to corporate failure. Ofgem should be leveraging and influencing the above reviews not imposing their own.

We would request that Ofgem provide more information on what the additional financial audit would be concluding. In particular, what happens If the additional independent audit finds that the company is not a going concern? Would this call into question the parameters and governance of the previous Companies Act audit? This would undoubtedly have an impact on the company shareholders and other related parties.

We would seek to understand how Ofgem will take into view the findings of the ongoing reviews around audit practices currently taking place? The CMA, Kingman and Brydon have already published recommendations on the extension of Public Interest Entities, which is likely to extend to many energy companies that are not currently included. Ofgem may benefit from interacting with these reviews, or the new licence requirement may risk undermining or conflicting with them. The duplication or conflict of differing legislative requirements could cause wider political and economic concerns.

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

Yes, it would. Our audit is usually signed off circa nine months after year end. However, Ofgem would need to accept that there may be adjustments made after the submission.

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

We would require additional clarity around the proposals before we are able to give a robust estimate.

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?

Utilita's year end is March and so we agree with changing the reporting to 31st March.

We would also support a more regular RFI on a quarterly basis that would allow Ofgem to consolidate the results from suppliers with differing year ends (assuming the majority of year ends are December, March, June or September).

This concludes our response. We welcome the opportunity to work in partnership with Ofgem to ensure that it effectively achieves Ofgem's aims while better suiting market conditions.

Yours sincerely,

By email only

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