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15 October 2021.

Sent by email to: [stephanie.ward@xoserve.com](mailto:stephanie.ward@xoserve.com)

Dear Stephanie,

## **2022 Business Plan First Draft**

Thank you for the opportunity to respond to the above consultation. This is a non-confidential response on behalf of the Centrica Group.

The first draft of the 2022/23 Business Plan (BP22) as presented does not allow us to assess whether the proposed budget is economic and efficient and, ultimately, whether the proposals are in consumers' interests. Stakeholders' engagement with the detail of the proposals has been restricted by the exclusion of supporting information necessary to explain the proposals and by the information presented not being transparent. Some aspects of the proposals have not been justified and the efficiency of the proposed expenditure has not been demonstrated. It is for these reasons we provisionally conclude the proposed budget is not fit for purpose.

The proposals consulted on are incomplete and require significant revision to allow stakeholders to meaningfully scrutinise and provide feedback. We provide further detail below.

### **The proposals need to be improved to reflect the change in circumstances:**

In our response to the *Principles and Approach*<sup>1</sup> consultation we explained that the approach to developing CDSP business plans necessarily needed to be changed because:

#### *Revised regulatory requirements:*

The regulatory requirements relating to the business planning process were revised in response to what Ofgem considered to be "...important questions around the transparency and robustness of the budget process..."<sup>2</sup>. We believe the first draft of BP22 does not satisfy the revised regulatory requirements. Particularly, supporting information necessary to explain the proposals has been excluded from the draft and the information presented is not transparent. The ways in which the

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<sup>1</sup> Business Plan 2022 Principles and Approach Response – Centrica:  
[https://www.xoserve.com/media/42588/xoserve\\_bp22\\_principles\\_centrica-response\\_210721.pdf](https://www.xoserve.com/media/42588/xoserve_bp22_principles_centrica-response_210721.pdf)

<sup>2</sup> Letter sent to Xoserve on 6 April 2021, page 1.

revised regulatory requirements can be satisfied have been explained in our response to the *Principles and Approach* consultation.

*The creation and sale of Correla and Xoserve's shift in focus:*

The creation and sale of Correla and Xoserve's shift in focus away from direct service provision to contract management and assurance mean that the types and granularity of information that supported previous business plans for the Central Data Services Provider (CDSP) are no longer sufficient nor appropriate.

In our response to the *Principles and Approach* consultation, we identified key information needed to allow stakeholders to assess the proposals, such as the basis for funding and cost recovery of investment in assets needed to deliver CDSP Services but which have been transferred to Correla. None of the key information we identified has been included in the first draft. These factors are critical to understanding the proposals and need to be addressed in subsequent drafts.

**The efficiency of the proposed expenditure from the consumer perspective needs to be demonstrated:**

Analysis demonstrating the efficiency of the proposed expenditure has been excluded from the first draft of BP22. This exclusion is not appropriate - efficiency of the proposed expenditure from the consumer perspective needs to be demonstrated. We highlight below key issues that need to be addressed in subsequent versions of the proposed budget and further detail can be found in our response to the *Plan Principles and Approach* consultation.

*General:*

Xoserve states future efficiency savings in (Maintaining the Business) MTB activities were reflected in the value of the sale of Correla and those efficiency savings were passing on via a reduction in charges in 2021/22<sup>3</sup>. It is unclear how this statement aligns with commentary in the *Annual Review 2021*<sup>4</sup>, letters notifying customers of the rebate<sup>5</sup> or information published on Xoserve's website<sup>6</sup>. It is also unclear how the expected efficiency savings were valued and why it has been implicitly assumed no further efficiency gains can be achieved. This should be clarified.

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<sup>3</sup> "Principles and Approach - Feedback and Responses" page 15:

<https://www.xoserve.com/media/42585/2022-business-plan-principles-and-approach-feedback-and-responses.pdf>.

<sup>4</sup> The Annual Review states: "We subsequently sold Correla to Northedge Capital LLP, who were chosen for their commitment to the market, to service performance and to investing in innovation. Having successfully closed the deal by the end of the year, we were able to return a charges rebate to customers as a result of the sale at a time when they needed additional funds the most - coming out of a tough pandemic year". See page 7 of: <https://www.xoserve.com/media/42551/xoserve-annual-review-20-21.pdf>.

<sup>5</sup> The rebate letter states: "The Board of Xoserve has approved a rebate of net sales proceeds to its customers, subject to the matters set out below. This is a rebate against the charges payable under Business Plan 2020-21".

<sup>6</sup> The Frequently Asked Questions states "A cash rebate to our customers is expected at the current time, however this remains subject to the Go/No-Go criteria applied to the Sales Transaction processes being fulfilled". See page 3 of: <https://www.xoserve.com/media/41785/customer-handbook-frequently-asked-questions-06-april-2021.pdf>.

Given Xoserve's shift in focus away from direct service provision to contract management and assurance and the procurement of services from Correla, we believe market-based testing is an appropriate way for Xoserve to demonstrate that the expenditure consumers will be required to fund is efficient. To mitigate potential conflicts of interest, it is essential that Xoserve conducts market-based testing rather than relying on that conducted by any third party from which it will procure services. External challenge/reporting, as suggested by Ofgem, may be an appropriate way of confirming to stakeholders that market-based testing suggests the expenditure proposed by Xoserve is efficient.

Any non-zero value of the margin included in CDSP charges needs to be robustly justified and well-evidenced given the shift away from service provision to contract management and assurance.

*Maintaining the Business costs:*

In the final version of the *Principles and Approach* document, Xoserve confirmed it will not provide details relating to MTB costs<sup>7</sup>. Xoserve justifies its approach by, for example, stating MTB costs have always been presented as a whole and an efficiency review was conducted in 2018<sup>8</sup>. These factors are irrelevant. As described above, the creation and sale of Correla and Xoserve's shift in focus fundamentally change the requirements of the supporting information necessary to explain the proposals. Xoserve also states the Budget and Charging methodology provides a breakdown of how costs are allocated to service areas<sup>9</sup>. This, too, is irrelevant - the allocation of costs to service areas, by definition, cannot demonstrate the efficiency of the costs being allocated.

Xoserve's decision not to provide detail is problematic because it is a barrier to stakeholders assessing efficiency of the proposed expenditure. It is not credible that stakeholders can meaningfully scrutinise the proposed budget given the detail relating to Maintaining the Business (MTB) costs, comprising about 65% of proposed expenditure<sup>10</sup>, has been excluded from the draft plan. The proposed 2022/23 MTB costs are 15% greater compared to 2018/19<sup>11</sup>. This increase must be considered in the context of the significant decrease in Xoserve's direct costs: for example, the number of employees has reduced by about 90% since the sale of Correla<sup>12</sup>. It is clear, that a detailed explanation of MTB costs is required.

*Investment:*

The proposals for the investment focus areas are also not transparent. It is proposed that consumers will be required to provide up-front funding for some areas and a subscription model will apply to at least one other. However, the criteria for selecting a funding approach for a given investment area, a comparison of the costs associated with the various funding approaches, or a description of how the subscription model is expected to operate have been excluded from the

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<sup>7</sup> "Final Principles and Approach", page 15: [https://www.xoserve.com/media/42407/xoserve-bp22-final-principles-and-approach\\_singles.pdf](https://www.xoserve.com/media/42407/xoserve-bp22-final-principles-and-approach_singles.pdf).

<sup>8</sup> "Principles and Approach - Feedback and Responses" page 13.

<sup>9</sup> "Principles and Approach - Feedback and Responses" page 13.

<sup>10</sup> Xoserve has proposed MTB costs of £51.8m compared to total baseline expenditure of £79.8m.

<sup>11</sup> For 2018/19, MTB costs were £45.3m (£22.6m of 'People' costs and £22.7m of 'non-People' costs. See page 10 of: <https://www.xoserve.com/media/2708/bp2019-final-document.pdf>. Xoserve has proposed £51.8m of MTB costs in 2022/23.

<sup>12</sup> Up to 45 employees were retained by Xoserve and 400 were transferred to Correla. See page 6 of: <https://www.xoserve.com/media/41785/customer-handbook-frequently-asked-questions-06-april-2021.pdf>.

draft plan. These factors are critical to understanding the proposals and need to be addressed in subsequent drafts.

In summary, it needs to be demonstrated that the proposals are in consumers' interests and that consumers are not being required to provide fund expenditure above efficient levels. As explained above, the draft plan as presented does not allow us to assess whether the proposed budget is economic and efficient. Significant revision of the proposals and transparency are required to allow stakeholders to meaningfully scrutinise and provide feedback. Without significant revision that satisfactorily addresses the concerns detailed above and in our response to the *Principles and Approach* consultation, it is unlikely that the proposed budget can be considered fit for purpose.

We would welcome the opportunity to work with you to improve the proposals and will make ourselves available to do so. We remain committed to ensuring that the proposals are in consumers' interests.

Answers to the consultation questions are included in the attached appendix. I hope you find this response helpful. Please contact me if you have any questions.

Yours sincerely,

Kirsty Ingham  
Head of Industry Transformation, Governance & Forecasting  
**Centrica Regulatory Affairs & Policy**

## **Appendix: Answers to consultation questions**

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### **Do you agree with our view of the required investments detailed in the plan?**

As this transparency of information is lacking, we are unable to agree or disagree with the view of required investments.

### **Would your organisation be able to support the level of change being proposed? If you have capacity constraints, which initiatives would you prioritise and why?**

Stakeholders have already dedicated resource to inflight projects, our priority is to see the completion of current investments, including the CSS programme on time and on budget. There is an unprecedented amount of pressure on energy companies with no immediate end in sight. These are known constraints to the market as a whole and not solely a capacity issue for Centrica. We would like to ensure focus and resource is prioritised to mitigate constraints to essential gas processes and procedures.

### **Has the information issued in support of the investment areas provided you with the additional level of detail required to better understand the investments being proposed?**

No, we expect to be able to analyse granular level detail of each investment to understand the recommendations in the plan. This has not been provided and we expect to be able to review this information prior to the development of any investment area.

### **Would you prefer for the plan to include a value for contingency in the CSS programme, in case the programme is further delayed or PIS reshaped/extended?**

If funding is included in the budget it is essential that it is justified and must be returned if the funds are not required to be drawn upon. We expect to be kept informed of developments and any recommendations provided to stakeholders made on the best course of action to mitigate known risks.

### **What additional information would you need in order to identify your preferred funding option for CMS?**

It is critical that an opportunity is given to review and analyse information gathered, to understand the decision made to progress on a subscription model versus alternative funding models. As described in our cover letter, to mitigate potential conflicts of interest, it is essential that Xoserve independently conducts market-based testing rather than rely on that conducted by any third party from which it will procure services. Please provide details of how such processes have been conducted and as much transparency on results as is possible, that assures Xoserve of efficiency of the selected solution, both on price and specific service provision criteria.