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19 November 2021.

Sent by email to: stephanie.ward@xoserve.com

Dear Stephanie,

2022 Business Plan Second 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 second draft of the 2022/23 Business Plan (BP22) as presented does not allow us to assess whether the proposed budget is in consumers' interests. As we described in our response to the consultation on the first draft of BP22, engagement with the proposals was restricted by the lack of transparency and the exclusion of the necessary supporting information. The restrictions remain in the second draft and, therefore, we again provisionally conclude the proposed budget is not fit for purpose. We discuss key issues below. You will find that these points are also consistent with those raised at our meeting with Xoserve on 16 November, where your colleagues helpfully offered to review several issues and provide further clarification.

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

Xoserve states the proposed budget inherently reflects efficiency savings because efficiency savings assumed were 'liquidated' up front by way of a rebate on 2021/22 charges. This means that information about the assumed efficiency savings is a crucial input for assessing the efficiency of BP22. However, this information has been excluded from the draft. The value of the assumed efficiency savings has not been stated. Information about how the assumed efficiency savings are expected to be generated, the cost components or activities from which they can be derived and the period over which they relate has also been excluded. The exclusion of this information prevents stakeholders from meaningfully scrutinising the proposals.

There remains great difficulty reconciling the statements about the purpose of the rebate made at the time of the sale of Correla and statements now made during the BP22 planning cycle. Nevertheless, even if both sets of statements could be reconciled to support the principle of efficiency savings being 'liquidated' up front, there appear to be inconsistencies in the explanation of the rebate. For example, Xoserve states that potential future efficiency savings "...*might be*

*able to be derived from on-time and on-budget completion of current in-flight investments...*¹. It is not credible to claim efficiency savings can be derived from on-time and on-budget completion; on-time and/or on-budget delivery can only prevent overruns. Further, some investment projects, such as UK Link, were partially justified on the basis of future reduced running costs². The cost reductions will be delivered regardless of the sale of Correla and the resultant rebate.

Xoserve also explains the valuation of future efficiency savings was undertaken during the sale of Correla. However, that process occurred during the previous financial year and before the start of the current business planning process. We encourage Xoserve to explain why it believes no further efficiency gains can be made compared to the level assumed when the sale of Correla was completed in 2020/21.

Transparency of Maintaining the Business costs is needed:

As we explained previously³, the creation and sale of Correla and Xoserve's shift in focus to contract management and assurance fundamentally change the requirements of the supporting information necessary to explain the proposals. Xoserve's decision to exclude any detail relating to MTB costs prevents stakeholders from meaningfully scrutinising the proposals.

In response to concerns about the lack of transparency relating to MTB costs, Xoserve refers to the efficiency review that was conducted in 2018. The review cannot be relied upon to justify the lack of transparency because:

- The review is now approximately four years old while IT assets typically need to be replaced after five to seven years. This means the results of that review may now be outdated.
- Since 2018, Xoserve has invested in its IT estate, which was partially justified on the basis of future reduced running costs. The 2018 review is unlikely to have taken account of those future reduced running costs.
- The review was conducted before the fundamental change in Xoserve's direct cost base which has arisen because of the sale of Correla.

We continue to encourage Xoserve to be transparent about Maintaining the Business (MTB) costs, which now comprise approximately 66% of the proposed expenditure for 2022/23. MTB costs could be disaggregated into categories such as people/non-people, direct/third-party, etc. Xoserve should provide evidence of its assurance of third-party costs including a detailed description of the process by which it scrutinised and challenged third party costs and a discussion of its assessment of those costs and how concerns (if any) were addressed. In short, we need to see evidence of the impartial scrutiny that Xoserve has applied in its contract management and assurance role. Customers, and by consequence, consumers should be required to fund only efficient costs regardless of contractual arrangements between Xoserve and third-party service providers.

Xoserve should also make clear whether the MTB costs will include funding for working capital (either an absolute amount or a margin on charges or any other mechanism) as has been done

¹ "2022 Business Plan Feedback and Responses on First Draft", page 7:

<https://www.xoserve.com/media/42742/2022-business-plan-feedback-and-responses-on-first-draft.pdf>.

² For example, the UK Link investment is expected to reduce MTB costs by £0.7m per year. See page 22 of the consultation document.

³ For example, in our response to the consultation on the first draft.

in previous years. 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.

Investment proposals should be better explained:

We encourage Xoserve to set out the principles it has adopted to determine whether consumers should be required to provide up-front funding for investment projects (such as Cyber Security) or fund them over a longer period (such as Contact Management Service). The costs and benefits of each funding option should also be presented. This would better enable stakeholders to assess the consumer benefits of the proposals.

Contact Management Service investment

The information provided to stakeholders after the publication of the second draft of BP22 still does not provide sufficient clarity on the costs and benefits of each approach by which the Contact Management Service (CMS) investment could be funded and does not fully justify the subscription-based option delivers better value for consumers as Xoserve suggests. The analysis does not take full account of the fact that subscription fees would be levied over a longer period than that presented in the analysis and, so, does not take account of whole life costs. Further, we note consumers could be required to fund additional investment even if the subscription fee option is settled on⁴. The information provided also does not explain why the agile approach to delivery cannot be adopted if consumers provide up-front funding.

Cyber Security investment:

Xoserve has not explained why it proposes consumers should provide up-front funding for cyber security investment for systems which are now owned by a third party and what the consumer benefits of the proposed arrangement are. We would normally expect costs of this nature to form part of the third party's operating cost base which are then passed on to Xoserve over time. The proposed arrangement should be explained.

Xoserve needs to demonstrate 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 our response to the *Principles and Approach* consultation, it is unlikely that the proposed budget can be considered fit for purpose.

⁴ CMS rebuild options slide deck p. 8.
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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. I hope you find this response helpful. Please contact me if you have any questions.

Yours sincerely,

Kirsty Ingham
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Centrica Regulatory Affairs & Policy