



Improving Reporting Transparency of Large Energy Suppliers

Consultation

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Overview:

As part of the Retail Market Review (RMR) Ofgem appointed the accountancy firm BDO to review the way that companies provide information about the profitability of their generation and supply businesses. As a result of this work we put forward proposals in January which would change the way that companies provide this information. This was followed by a further consultation in May and an Open Letter in June.

This consultation document sets out our final proposals on our amendments to the Financial Information Reporting licence condition. Our deadline for responses is 10 August 2012.

Context

Ofgem's principal objective is to protect the interests of existing and future energy consumers. Wherever appropriate, Ofgem performs its functions in a manner which it considers would further this principal objective by promoting effective competition. However, before exercising its functions in this manner, Ofgem must consider whether the interests of consumers would be better protected by exercising its functions in other ways.

The Retail Market Review (RMR) represents Ofgem's attempt to enhance competition in the retail energy markets and make it work more effectively so that the benefits can be realised by more consumers than at present.

The proposals presented in this document are the results of one of the five workstreams initiated in the March RMR consultation. These proposals aim to improve the quality of information available to stakeholders about the profitability of different parts of the large, vertically integrated companies.

Associated documents

All documents are available at www.ofgem.gov.uk

- Improving the Reporting Transparency of Large Energy Suppliers, Open Letter June 2012
- Improving the Reporting Transparency of Large Energy Suppliers, May 2012, Reference 64/12
- Improving Reporting Transparency, January 2012, Reference 09/12
- Financial Information Reporting: 2010 Results, January 2010, Reference 10/12
- Ofgem's Retail Market Review – update and next steps (non-liquidity proposals), June 2011
- Financial Information Reporting: Amended Guidance, May 2011, Reference 69/11
- Financial Information Reporting: 2009 Results, March 2011, Reference 41/11
- The Retail Market Review – Findings and Initial Proposals, March 2011, Reference 34/11

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Executive Summary

Since 2009, the large vertically integrated energy companies have been required to publish Consolidated Segmental Statements (Statements), which separately present the profitability of generation and different supply activities. As part of the March 2011 Retail Market Review (RMR), we appointed accountancy firm BDO to review how the companies are producing the Statements.

In January 2012 we published our proposed way forward to improve the transparency and cross company comparability of the Statements. In light of responses to that consultation we revised our proposals in relation to recommendations 3, 6, 7 and 8 and issued a further consultation in May 2012 on these revisions.

Below we set out the main recommendations of the BDO review, and our final position following the informal consultations.

BDO Recommendation	Final position
1. Require the companies to publish their Statements to the same year-end	We do not intend to take forward this recommendation
2. An independent auditor to provide an opinion on the Statements	We propose obtaining an independent opinion, at least for the first year, but not necessarily from an auditor
3. Instruct reconciliation of the Statements to an audited IFRS income statement	We propose to take forward a variation of this recommendation and require companies to reconcile revenues and profits to their published Group Accounts
4. Require the reporting of trading function results, including disclosure of the risk each trading function assumes	We do not propose to take forward this recommendation, although we are proposing companies produce a checklist to identify where functions are undertaken
5. Perform further work to assess current transfer pricing policy	We do not intend to take forward this recommendation
6. Introduce uniform reporting treatments for generation fuel costs and free EU ETS allowances	We propose to take forward a variation of this recommendation and allow companies that operate toll processing arrangements to provide the fuel costs as a supplementary

	note to the main results template
7. Guidance on scope and definition of exceptional items	We are taking forward a variation of this recommendation. We provide guidance on those financial items we would not expect to be included in the Statements, but where they have, a clear and full explanation must be provided
8. Specify consistent profit base for reconciliation	As a result of our amended proposal on recommendation 3, recommendation 8 is no longer required

In order to implement these changes, we are taking the following steps:

We will amend the relevant licence conditions for holders of gas and electricity supply licences and generation licences subject to a threshold test. This document constitutes a statutory consultation on these revised obligations. Responses are requested by 10 August 2012.

Subject to the responses to consultation, we aim to introduce the amended licence conditions by mid October 2012. As stated in our Open Letter of 6 June 2012, we intend to issue a letter pursuant to the new Standard Licence Condition 19A(3)(b) of the supply licences and Standard Licence Condition 16B(3)(b) (after the formal Decision to amend and before commencement of the licence condition) specifying a the date by which the 2012 Statement should be submitted.

1. Introduction

- 1.1. In the March 2011 RMR consultation document we set out five proposals to help the energy markets in GB work in the interests of consumers:
 - Proposal 1: Improve tariff compatibility
 - Proposal 2: Enhance Liquidity
 - Proposal 3: Strengthen Probe remedies – domestic
 - Proposal 4: Strengthen Probe remedies – non-domestic
 - Proposal 5: Improve reporting transparency
- 1.2. The proposals presented in this document related to Proposal 5.
- 1.3. This document consists of 3 sections: Section 2 presents a summary of responses to our May consultation. Section 3 explains the changes we are proposing to make since the May consultation and section 4 sets out next steps.

2. BDO's review and Ofgem's informal consultations

2.1. As part of the March 2011 RMR, we appointed accountancy firm BDO to review how the companies produce the Consolidated Segmental Statements (Statements) required under SLC 19A of the gas and electricity supply licences and SLC 16B of the generation licence. Specifically, we asked BDO to analyse the following four areas:

- The transfer pricing methodology employed by the Big 6;
- How the Big 6 account for long term hedges;
- How each firm represents energy trading activities; and
- How each company treats exceptional items.

2.2. BDO's recommendations can be summarised as follows:

- Recommendation 1: Require the companies to publish their segmental statement to the same year end.
- Recommendation 2: An independent auditor to provide an opinion on the segmental statements.
- Recommendation 3: Instruct reconciliation of the segmental statements to an audited IFRS income statement.
- Recommendation 4: Require the reporting of trading function results, including disclosure of the risk each trading function assumes.
- Recommendation 5: Perform further work to assess current transfer pricing policy.
- Recommendation 6: Introduce uniform reporting treatments for generation fuel costs and free EU ETS allowances.
- Recommendation 7: Guidance on scope and definition of exceptional items.
- Recommendation 8: Specify consistent profit base for reconciliation.

2.3. Full details of BDO's findings and their recommendations can be found following this link on the RMR webpage of Ofgem's website¹.

2.4. Ofgem has issued two rounds of informal consultation: Improving the Reporting Transparency of Large Energy Suppliers in January (Reference 09/12) and in May (Reference 64/12) 2012. The reasons for our proposed way forward on each of the recommendations are explained in our January consultation document and the responses to our January consultation are summarised in the May consultation. The responses to the May consultation are summarised below.

¹

http://www.ofgem.gov.uk/Markets/RetMkts/rmr/Documents1/OFGEM%20FINAL%20REPORT_Non-Confidential%20Version.pdf

Responses to May consultation

2.5. There was continued broad agreement for the proposal not to pursue BDO's recommendation 1.

2.6. Opinions on BDO's recommendation 2 remain mixed, with one respondent questioning the additional cost of obtaining an independent opinion. The same respondent highlighted that any interaction with companies and the independent auditor ahead of publication would require additional time for the process. We understand this concern, but remain committed to obtaining an independent opinion for at least the first year following our changes to provide a view on how companies have enacted them.

2.7. There was broad support for the revised recommendation 3, which requires companies to reconcile to the UK result in their published Group accounts. However, one respondent requested that we amend the licence condition to request a reconciliation of only profits and not revenues or costs. We return to this point in the next section.

2.8. There was also broad agreement with the unchanged proposals on recommendation 4. One respondent however raised concerns that the level of interpretation required to complete the checklist of functions would lead to different treatments across companies, which could confuse the reader. We recognised this concern in January and as a result provided clearer definitions of functions in our May consultation document. Going forward we are happy to explore different formats for the completion of this table on a case-by-case basis, but in a way that makes cross company comparisons transparent.

2.9. On the unchanged recommendation not to take forward additional work on transfer pricing (recommendation 5), one respondent considered that transfer pricing policies should be subject to a periodic review. Given BDO's view that the transfer pricing methodologies were broadly fit for purpose and the different business models used by the companies, we remain unconvinced of the benefits of further work.

2.10. There was broad support for the updated recommendation 6 on the inclusion of fuel costs, although one respondent was uncomfortable with the inclusion of the Weighted Average Cost of Electricity for the generation business, on the grounds that the varying costs of input fuels limits the comparability of the measure. We understand this concern and are happy for companies to provide further breakdown of their fuel mix to support an explanation of the calculation of Weighted Average Cost of Electricity.

2.11. Responses to the proposal not to take forward work on publishing capital employed as part of the Statements were mixed, with some suggesting that the measure would be of limited value, while others argued that it would improve reporting transparency and aid comparability of generation activities. Given the difficulties in obtaining consistent information across companies on capital employed, our position on this remains unchanged.

2.12. On our unchanged proposal to increase the customer number threshold, we received mixed responses, with some responses questioning the rationale for excluding smaller suppliers. We remain of the view that increasing the customer threshold avoids costs for small suppliers and better meets the original policy intent.

2.13. No respondent thought that further separation of the non-domestic segment in future Statements would be useful.

2.14. There was broad support for providing further clarity on how third party costs are recovered across the segments, although one respondent questioned how and for whom this information would be useful and two respondents questioned the definition of 'third party costs'. We return to this point in the next section.

3. Proposed way forward

Question box

Question 1: Do respondents agree with our proposal to require reconciliation to only revenues and profits, but not costs, published in Group accounts?

Question 2: Do respondents agree that companies should describe how Feed in Tariff costs and Renewable Obligation costs are allocated across the segments?

3.1. Following the May consultation we are proposing to make two minor amendments to our licence condition amendments. We explain these two changes below and provide an explanation as to why these amendments are required.

3.2. In our May consultation we asked reporting companies to prioritise Group accounts prepared under International Financial Reporting Standards as the primary document used to reconcile revenues, costs and profits².

3.3. During the consultation we received one response asking for an amendment to this recommendation. The respondent explained that the level of segmental information presented in the company Group accounts meant that it would only be possible to complete a meaningful reconciliation to profits, but not revenues or costs. The respondent asked that we amend the wording of the licence condition to only ask that profits are reconciled.

3.4. We have considered this response carefully and discussed the proposal with BDO, the accountants who carried out our original review of the Statements. We note that while IFRS 8 does not make an explicit requirement for a revenue figure for each reportable segment³, we are minded to maintain a strong link between the segmental statements and the Group accounts. We think this is only possible if at least two of three elements of revenues, costs and profits are reconciled. We are therefore proposing to amend the requirements of the licence condition so that companies need only reconcile revenues and profits, but not cost.

3.5. The second amendment relates to the reference to 'third party costs' in paragraph 1.5 of the Guidelines. A number of respondents questioned the definition of 'third party costs'. We agree that using third party costs in the context of the Guidelines is not informative. We therefore propose to amend the Guidelines to remove reference to 'third party costs'. We will retain the requirement, however, for licensees to describe how Feed in Tariff costs and Renewable Obligation costs, are allocated across the segments.

² The wording in our May consultation also stated that companies could reconcile revenues, costs and profits to UK statutory accounts if Group accounts are not prepared or published.

³ See paragraph 8 of http://www.hm-treasury.gov.uk/d/frab89_ifrs8_operating_segments.pdf

4. Next steps

4.1. In this chapter we set out our next steps for implementing our proposed licence condition and guidelines, including an expected timeline for delivery.

4.2. Having carefully considered respondents' views, we have drafted a licence condition and guidelines document that we consider will deliver effective and proportionate arrangements that will provide greater transparency for independent market participants and other stakeholders.

4.3. These arrangements comprise:

- A revised standard licence condition 19A electricity supply licence;
- A revised standard licence condition 19A gas supply licence;
- A revised standard licence condition 16B generation licence; and
- A revised guidelines document.

4.4. This document represents the supply licence, the generation licence and the accompanying guidelines. We are seeking views on this consultation by 10 August 2012. Subject to views received, we intend to publish a statutory notice in mid August introducing the new licence conditions. Our aim is that the new standard licence condition (SLC) should take be implemented by mid October 2012.

4.5. As stated in our 6 June 2012 open letter we intend to issue a letter pursuant to the new SLC 19(3)(b) of the gas and electricity supply licences and SLC 16B(3)(b) of the generation licence shortly before the relevant conditions take effect specifying the date by which the CSS should be submitted.

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Appendix 1 - Consultation Response and Questions

1.1. Ofgem would like to hear the views of interested parties in relation to any of the issues set out in this document.

1.2. We would especially welcome responses to the specific questions which we have set out at the beginning of each chapter heading and which are replicated below.

1.3. Responses should be received by 10 August and should be sent to:

Stefan Bojanowski
Energy Market Research and Economics
Ofgem
9 Millbank
SW1P 3GE
020 7901 7068
css@ofgem.gov.uk

1.4. Unless marked confidential, all responses will be published by placing them in Ofgem's library and on its website www.ofgem.gov.uk. Respondents may request that their response is kept confidential. Ofgem shall respect this request, subject to any obligations to disclose information, for example, under the Freedom of Information Act 2000 or the Environmental Information Regulations 2004.

1.5. Respondents who wish to have their responses remain confidential should clearly mark the document/s to that effect and include the reasons for confidentiality. It would be helpful if responses could be submitted both electronically and in writing. Respondents are asked to put any confidential material in the appendices to their responses.

1.6. Any questions on this document should, in the first instance, be directed to:

Stefan Bojanowski
Energy Market Research and Economics
Ofgem
9 Millbank
SW1P 3GE
020 7901 7068
css@ofgem.gov.uk

CHAPTER: Three

Question 1: Do respondents agree with our proposal to require reconciliation to only revenues and profits, but not costs, published in Group accounts?

Question 2: Do respondents agree that companies should describe how Feed in Tariff costs and Renewable Obligation costs are allocated across the segments?

Appendix 2 – Statutory Consultation on amendment to Gas Supply Licence

NOTICE UNDER SECTION 23(2) OF THE GAS ACT 1986 CONCERNING THE PROPOSED MODIFICATION OF STANDARD LICENCE CONDITION 19A OF GAS SUPPLY LICENCES

The Gas and Electricity Markets Authority (“the Authority”) hereby gives notice pursuant to section 23(2) of the Gas Act 1986 (“the Act”) as follows:

- 1.** The Authority proposes to modify all gas supply licences granted or treated as granted under section 7A(1) of the Act by amending standard licence condition 19A.
- 2.** The reason why the Authority proposes to make this licence modification is make it easier for stakeholders to understand the profitability of the different components of the Great Britain energy market by providing greater transparency for independent market participants and other stakeholders. Further detail is set out in our document “Improving the Reporting Transparency of Large Energy Suppliers” dated 13 July 2012 (Document Reference: 95/12).
- 3.** The effect of the proposed modification is to ensure that relevant supply licensees provide information about the profitability of the different parts of their vertically integrated businesses. It aims to achieve this by requesting the relevant licensees to prepare and publish a Consolidated Segmental Statement with a break down of information relating to revenues, costs and profits of its activities in the generation and supply of electricity and the supply of gas to any premises taking account of the Guidelines prepared and published by the Authority and set out in Appendix 5.
- 4.** Relevant licence holders for the purposes of this Notice are all holders of gas supply licences with Section A of the gas supply licence in force.
- 5.** A copy of the proposed modification and other documents referred to in this notice are available (free of charge) from the Ofgem library (telephone 020 7901 7003) or on the Ofgem website (www.ofgem.gov.uk).
- 6.** Any representations on the proposed licence modifications may be made on or before 10 August 2012 to: Stefan Bojanowski, Office of Gas and Electricity Markets, 9 Millbank, London, SW1P 3GE or by email to css@ofgem.gov.uk
- 7.** All responses will normally be published on Ofgem’s website and held in the Research and Information Centre. However, if respondents do not wish their response to be made public then they should clearly mark their response as not for publication. Ofgem prefers to receive responses in an electronic form so they can be placed easily on the Ofgem website.
- 8.** If the Authority decides to make the proposed modification it will take effect 56 days after the decision is published.

Andrew Wright
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**Duly authorised on behalf of the Gas and Electricity Markets Authority
13/07/12**

Standard Licence Condition 19A

1. The Relevant Licensee must prepare and publish on its Website a Consolidated Segmental Statement in respect of information relating to the revenues, costs and profits of its activities in the generation and supply of electricity and the supply of gas to any premises taking account of the Guidelines.
2. Where applicable, the Relevant Licensee must prepare and publish the Consolidated Segmental Statement referred to in paragraph 1 in conjunction with any Affiliates.
3. The Relevant Licensee must, in conjunction with any Affiliates, prepare and publish a Consolidated Segmental Statement
 - (a) no later than six months after the end of the Relevant Licensee's financial year; or
 - (b) no later than a date specified by the Authority, which can be no earlier than six months after the end of the Relevant Licensee's financial year.
4. Subject to complying with this paragraph the Relevant Licensee may, for the purpose of preparing the statement pursuant to paragraph 3, prepare and compile the information according to the licensee's annual accounting procedures. The Relevant Licensee must include in every such statement an explanation of:
 - (a) how it defines the terms revenues, costs and profits;
 - (b) how the revenues and profits can be reconciled with audited figures (prepared under International Financial Reporting Standards) published in Group accounts; or
 - (c) if Group accounts are not prepared or published, how the revenues, costs and profits can be reconciled with its UK statutory accounts;
 - (d) its transfer pricing methodology and how this relates to the revenues, costs and profits information published; and
 - (e) where individual business functions are captured in the Consolidated Segmental Statement, as specified by Appendix 2 of the Guidelines.
5. The Relevant Licensee must ensure that the information prepared and made public pursuant to paragraph 3 includes the cost of fuel used to generate electricity and its share of revenues, costs, profits and volumes of Joint Ventures and Associates.

6. Subject to complying with Paragraph 5 the Relevant Licensee must ensure that all the information prepared and made public pursuant to paragraph 3 is in all material respects consistent with the information prepared pursuant to paragraph 4 and the information is presented with a clear and full explanation.

7. (a) The Authority shall prepare Guidelines in relation to the requirements of this condition and may modify, in whole or in part, the Guidelines following consultation with the Relevant Licensees.

(b) The Authority shall modify the definition of Consolidated Segmental Statement as described in Appendices 1 and 2 of the Guidelines in accordance with section 23 of the Act.

8. For the purposes of this condition:

“Affiliate” means any holding company or subsidiary of a holding company of the Relevant Licensee, in each case within the meaning of sections 1159 and 1160 of the Companies Act 2006.

“Associate” means an entity, including an unincorporated entity such as a partnership, over which the Relevant Licensee has significant influence and that is neither a subsidiary nor an interest in a joint venture.

“Consolidated Segmental Statement” means a statement as described in Appendices 1 and 2 of the Guidelines.

“Joint Venture” means a contractual arrangement whereby the Relevant Licensees and one or more parties undertake an economic activity that is subject to joint control.

“Relevant Licensee” means the holder of a supply licence granted or treated as granted under section 7A(1) of the Act if it or any of its Affiliates:

- i. jointly supply electricity to more than 250,000 domestic customers; or
- ii. jointly supply gas to more than 250,000 domestic customers; or
- iii. jointly supply electricity to more than 250,000 non-domestic customers; or
- iv. jointly supply gas to more than 250,000 non-domestic customers, respectively.

“Website” means a website controlled and used by the Relevant Licensee or an Affiliate for the purposes of providing information and communication.

Appendix 3 – Statutory Consultation on amendment to Electricity Supply licence

NOTICE UNDER SECTION 11A(2) OF THE ELECTRICITY ACT 1989 CONCERNING THE PROPOSED MODIFICATION OF STANDARD LICENCE CONDITION 19A OF THE ELECTRICITY SUPPLY LICENCE

The Gas and Electricity Markets Authority (“the Authority”) hereby gives notice pursuant to section 11A(2) of the Electricity Act 1989 (“the Act”) as follows:

1. The Authority proposes to modify all electricity supply licences granted or treated as granted under section 6(1)(d) of the Act by amending standard licence condition 19A.
2. The reason why the Authority proposes to make this licence modification is to make it easier for stakeholders to understand the profitability of the different components of the Great Britain energy market by providing greater transparency for independent market participants and other stakeholders. Further detail is set out in our document “Improving the Reporting Transparency of Large Energy Suppliers” dated 13 July 2012 (Document Reference: 95/12).
3. The effect of the proposed modification is to ensure that relevant supply licensees provide information about the profitability of the different parts of their vertically integrated businesses. It aims to achieve this by requesting the relevant licensees to prepare and publish a Consolidated Segmental Statement with a break down of information relating to revenues, costs and profits of its activities in the generation and supply of electricity and the supply of gas to any premises taking account of the Guidelines prepared and published by the Authority and set out in Appendix 5.
4. Relevant licence holders for the purposes of this Notice are all holders of electricity supply licences with Section A of the electricity supply licence in force.
5. A copy of the proposed modification and other documents referred to in this notice are available (free of charge) from the Ofgem library (telephone 020 7901 7003) or on the Ofgem website (www.ofgem.gov.uk).
6. Any representations on the proposed licence modifications may be made on or before 10 August 2012 to: Stefan Bojanowski, Office of Gas and Electricity Markets, 9 Millbank, London, SW1P 3GE or by email to css@ofgem.gov.uk
7. All responses will normally be published on Ofgem’s website and held in the Research and Information Centre. However, if respondents do not wish their response to be made public then they should clearly mark their response as not for publication. Ofgem prefers to receive responses in an electronic form so they can be placed easily on the Ofgem website.

8. If the Authority decides to make the proposed modification it will take effect 56 days after the decision is published.

Andrew Wright

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**Duly authorised on behalf of the Gas and Electricity Markets Authority
13/07/12**

Standard Licence Condition 19A

1. The Relevant Licensee must prepare and publish on its Website a Consolidated Segmental Statement in respect of information relating to the revenues, costs and profits of its activities in the generation and supply of electricity and the supply of gas to any premises taking account of the Guidelines.
2. Where applicable, the Relevant Licensee must prepare and publish the Consolidated Segmental Statement referred to in paragraph 1 in conjunction with any Affiliates.
3. The Relevant Licensee must, in conjunction with any Affiliates, prepare and publish a Consolidated Segmental Statement
 - (a) no later than six months after the end of the Relevant Licensee's financial year;
 - or
 - (b) no later than a date specified by the Authority, which can be no earlier than six months after the end of the Relevant Licensee's financial year.
4. Subject to complying with this paragraph the Relevant Licensee may, for the purpose of preparing the statement pursuant to paragraph 3, prepare and compile the information according to the licensee's annual accounting procedures. The Relevant Licensee must include in every such statement an explanation of:
 - (a) how it defines the terms revenues, costs and profits;
 - (b) how the revenues and profits can be reconciled with audited figures (prepared under International Financial Reporting Standards) published in Group accounts;
 - (c) or, if Group accounts are not prepared or published, how the revenues, costs and profits can be reconciled with its UK statutory accounts;
 - (d) its transfer pricing methodology and how this relates to the revenues, costs and profits information published; and
 - (e) where individual business functions are captured in the Consolidated Segmental Statement, as specified by Appendix 2 of the Guidelines.
5. The Relevant Licensee must ensure that the information prepared and made public pursuant to paragraph 3 includes the cost of fuel used to generate electricity and its share of revenues, costs, profits and volumes of Joint Ventures and Associates.

6. Subject to complying with Paragraph 5 the Relevant Licensee must ensure that all the information prepared and made public pursuant to paragraph 3 is in all material respects consistent with the information prepared pursuant to paragraph 4 and the information is presented with a clear and full explanation.

7. (a) The Authority shall prepare Guidelines in relation to the requirements of this condition and may modify, in whole or in part, the Guidelines following consultation with the Relevant Licensees.

(b) The Authority shall modify the definition of Consolidated Segmental Statement as described in Appendices 1 and 2 of the Guidelines in accordance with section 11A of the Act.

8. For the purposes of this condition:

“Affiliate” means any holding company or subsidiary of a holding company of the Relevant Licensee, in each case within the meaning of sections 1159 and 1160 of the Companies Act 2006.

“Associate” means an entity, including an unincorporated entity such as a partnership, over which the Relevant Licensee has significant influence and that is neither a subsidiary nor an interest in a joint venture.

“Consolidated Segmental Statement” means a statement as described in Appendices 1 and 2 of the Guidelines.

“Joint Venture” means a contractual arrangement whereby the Relevant Licensees and one or more parties undertake an economic activity that is subject to joint control.

“Relevant Licensee” means the holder of an electricity supply licence granted or treated as granted under section 6(1)(d) of the Act if it or any of its Affiliates:

- i. jointly supply electricity to more than 250,000 domestic customers; or
- ii. jointly supply gas to more than 250,000 domestic customers; or
- iii. jointly supply electricity to more than 250,000 non-domestic customers; or
- iv. jointly supply gas to more than 250,000 non-domestic customers, respectively.

“Website” means a website controlled and used by the Relevant Licensee or an Affiliate for the purposes of providing information and communication.

Appendix 4 – Statutory Consultation on amendment to the Generation licence

NOTICE UNDER SECTION 11A(2) OF THE ELECTRICITY ACT 1989 CONCERNING THE PROPOSED MODIFICATION OF STANDARD LICENCE CONDITION 16B OF THE ELECTRICITY GENERATION LICENCE

The Gas and Electricity Markets Authority (“the Authority”) hereby gives notice pursuant to section 11A(2) of the Electricity Act 1989 (“the Act”) as follows:

- 1.** The Authority proposes to modify all electricity generation licences granted or treated as granted under section 6(1)(a) of the Act by amending standard licence condition 16B.
- 2.** The reason why the Authority proposes to make this licence modification is to make it easier for stakeholders to understand the profitability of the different parts of the Great Britain energy market by providing greater transparency for independent market participants and other stakeholders. Further detail is set out in our document “Improving the Reporting Transparency of Large Energy Suppliers” dated 13 July 2012 (Document Reference 95/12).
- 3.** The effect of the proposed modification is to ensure that relevant supply licensees provide information about the profitability of the different parts of their vertically integrated businesses. It aims to achieve this by requesting the relevant licensees to prepare and publish a Consolidated Segmental Statement with a break down of information relating to revenues, costs and profits of its activities in the generation and supply of electricity and the supply of gas to any premises taking into account the Guidelines prepared and published by the Authority and set out in Appendix 5.
- 4.** Relevant licence holders for the purposes of this Notice are all holders of electricity generation licence with Section A in force.
- 5.** A copy of the proposed modification and other documents referred to in this notice are available (free of charge) from the Ofgem library (telephone 020 7901 7003) or on the Ofgem website (www.ofgem.gov.uk).
- 6.** Any representations on the proposed licence modifications may be made on or before 10 August 2012 to: Stefan Bojanowski, Office of Gas and Electricity Markets, 9 Millbank, London, SW1P 3GE or by email to css@ofgem.gov.uk.
- 7.** All responses will normally be published on Ofgem’s website and held in the Research and Information Centre. However, if respondents do not wish their response to be made public then they should clearly mark their response as not for publication. Ofgem prefers to receive responses in an electronic form so they can be placed easily on the Ofgem website.

8. If the Authority decides to make the proposed modification it will take effect 56 days after the decision is published.

Andrew Wright

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**Duly authorised on behalf of the Gas and Electricity Markets Authority
13/07/12**

Standard Licence Condition 16B

1. The Relevant Licensee must prepare and publish on its Website a Consolidated Segmental Statement in respect of information relating to the revenues, costs and profits of its activities in the generation and supply of electricity and the supply of gas to any premises taking account of the Guidelines.
2. Where applicable, the Relevant Licensee must prepare and publish the Consolidated Segmental Statement referred to in paragraph 1 in conjunction with any Affiliates.
3. The Relevant Licensee must, in conjunction with any Affiliates, prepare and publish a Consolidated Segmental Statement
 - (a) no later than six months after the end of the Relevant Licensee's financial year; or
 - (b) no later than a date specified by the Authority, which can be no earlier than six months after the end of the Relevant Licensee's financial year.
4. Subject to complying with this paragraph the Relevant Licensee may, for the purpose of preparing the statement pursuant to paragraph 3, prepare and compile the information according to the licensee's annual accounting procedures. The Relevant Licensee must include in every such statement an explanation of:
 - (a) how it defines the terms revenues, costs and profits;
 - (b) how the revenues and profits can be reconciled with audited figures (prepared under International Financial Reporting Standards) published in Group accounts;
 - (c) or, if Group accounts are not prepared or published, how the revenues, costs and profits can be reconciled with its UK statutory accounts
 - (d) its transfer pricing methodology and how this relates to the revenues, costs and profits information published; and
 - (e) where individual business functions are captured in the Consolidated Segmental Statement, as specified by Appendix 2 of the Guidelines.
5. The Relevant Licensee must ensure that the information prepared and made public pursuant to paragraph 3 includes the cost of fuel used to generate electricity and its share of revenues, costs, profits and volumes of Joint Ventures and Associates.

6. Subject to complying with Paragraph 5 the Relevant Licensee must ensure that all the information prepared and made public pursuant to paragraph 3 is in all material respects consistent with the information prepared pursuant to paragraph 4 and the information is presented with a clear and full explanation.

7. (a) The Authority shall prepare Guidelines in relation to the requirements of this condition and may modify, in whole or in part, the Guidelines following consultation with the Relevant Licensees.

(b) The Authority shall modify the definition of Consolidated Segmental Statement as described in Appendices 1 and 2 of the Guidelines in accordance with section 11A of the Act.

8. For the purposes of this condition:

“Affiliate” means any holding company or subsidiary of a holding company of the Relevant Licensee, in each case within the meaning of sections 1159 and 1160 of the Companies Act 2006.

“Associate” means an entity, including an unincorporated entity such as a partnership, over which the Relevant Licensee has significant influence and that is neither a subsidiary nor an interest in a joint venture.

“Consolidated Segmental Statement” means a statement as described in Appendices 1 and 2 of the Guidelines.

“Joint Venture” means a contractual arrangement whereby the Relevant Licensees and one or more parties undertake an economic activity that is subject to joint control.

“Relevant Licensee” means the holder of an electricity generation licence granted or treated as granted under section 6(1)(a) of the Act if it or any of its Affiliates:

- i. jointly supply electricity to more than 250,000 domestic customers; or
- ii. jointly supply gas to more than 250,000 domestic customers; or
- iii. jointly supply electricity to more than 250,000 non-domestic customers; or
- iv. jointly supply gas to more than 250,000 non-domestic customers, respectively.

“Website” means a website controlled and used by the Relevant Licensee or an Affiliate for the purposes of providing information and communication.

Appendix 5 - Consultation on the amendments to the Guidelines

1.1. These guidelines relate to Standard Condition 19A of the Gas and Electricity Supply Licences and Standard Condition 16B of the Electricity Generation Licences (collectively referred to as 'the Conditions' for the purposes of these guidelines).

1.2. The guidelines have been prepared by the Office of Gas and Electricity Markets ('Ofgem') pursuant to paragraph 8/19A.8 of the Conditions (throughout this document the first paragraph number relates to the generation licence and the second relates to the supply licences).

Scope and Application of the Licence Condition

1.3. The Conditions only apply to those companies that are "Relevant Licensees" as defined in the Conditions. Where information required under the Conditions is held by an Affiliate the Relevant Licensee is required to obtain and publish the information. Annex 1 provides further information on the scope of information required (eg the requirement for which generation volumes should be included in note 9).

Financial Year

1.4. Under paragraph 3/19A.3 of the Condition, the financial year should be taken to mean the Relevant Licensee's current financial reporting year. For the avoidance of doubt this may differ between companies.

Interpreting the Financial Information

1.5. Under paragraph 4(a)/19A.4(a) of the Conditions a clear and full explanation of how the Relevant Licensee defines the terms revenues, costs and profits should be set out, so as to enable understanding of what the information published pursuant to paragraph 1/19A.1 does and does not represent. The licensee should describe the methodology or methodologies used to allocate marketing, shared and corporate costs across generation, supply and other activities. The licensee should also describe how individual costs such as Feed in Tariff costs and Renewable Obligation costs, are allocated across the segments. Where issues pertaining to the data are unexpected or unusually complex these issues should be set out in full.

1.6 We would only expect the revenues, costs and profits to reflect company activities relating to that year of operations. Examples of financial items we would not expect to be included are, but are not limited to, mark to market adjustments, profit or losses on disposal, restructuring costs that have been identified as such in the Group's annual report and impairment charges. Where the Relevant Licensee has included any such items for the purpose of reconciliation, or otherwise, a clear and full explanation must be provided.

1.7. Under paragraphs 4(b) & (c) /19A.4(b) & (c) and 6/19A.6 of the Conditions a clear and full explanation of the reconciliation should be provided, so as to enable an individual to understand as much as can be reasonably expected as to how revenues and profits reconcile to the Relevant Licensee's audited figures. For the avoidance of doubt, the companies that published Consolidated Segmental Statements in 2009 and 2010 would fall under paragraph 4(b) / 19A.4(b) and not 4(c) / 19A.4(c) If a licensee separately identifies a column which it attributes to trading or portfolio optimisation, the explanatory notes should contain a detailed description of its significant component parts. An explanation of any reconciliation would be expected to take the form of a numerical table and a written statement.

1.8. Paragraph 6/19A.6 of the Conditions provide for the information required pursuant to paragraph 1/19A.1 to be presented with a clear and full explanation. This clear and full explanation should be sufficient to inform an industry stakeholder of the financial data's proper interpretation and context (eg any structural constraints the business operates within, such as tolling agreements).

Transfer Pricing Methodology

1.9. Under paragraph 4(d)/19A.4(d) of the Conditions a clear and full explanation of the Relevant Licensee's and Affiliates' transfer pricing methodology should be provided, so as to enable an industry stakeholder to understand as much as can be reasonably expected about the transfer pricing methodology adopted. The transfer pricing methodology used to calculate WACOE and WACOG should reflect how each licensee actually acquires energy. This explanation should include:

- how the methodology relates to open market prices and/or a cost plus methodology;
- the treatment of allocated costs and corporate charges (eg head office charges); and
- the allocation of financial risk between group companies and / or business segments (eg treatment of internal tolling agreements/capability payments).

Treatment of Joint Ventures and Associates

1.10. Under paragraph 5 of the Conditions the Relevant Licensee must ensure that the information provided in the CSS includes its share of revenues, costs, profits and volumes of any Joint Venture and Associates. In preparing the CSS, the Relevant Licensee should account for Joint Ventures and Associates (which hold a generation or supply licence relating to the generation or supply of gas or electricity in the UK) as follows:

- the share of revenues of Joint Ventures and Associates to be included within revenue;
- the share of the profit before tax of Joint Ventures and Associates to be included with EBIT and EBITDA; and
- the share of the generation volumes of Joint Ventures and Associates to be included within the generation volumes.

1.11. For each of the items, the Relevant Licensee's share of the income and expenses of a Joint Venture or Associate should be combined line by line with similar items in the Relevant Licensee's CSS or reported as separate line items in the Relevant Licensee's CSS.

1.12. The remainder of the guidelines consist of Annex 1 and 2.

Annex 1

	Unit ¹	Generation	Electricity supply		Gas supply		Aggregate supply business ¹⁰
			Domestic	Non-domestic	Domestic	Non-domestic	
		20xx	20xx	20xx	20xx	20xx	20xx
Total revenue	£M	£0	£0	£0	£0	£0	£0
Revenue from sales of electricity and gas ²	£M	£0	£0	£0	£0	£0	£0
Other revenue ³	£M	£0	£0	£0	£0	£0	£0
Total operating costs	£M	£0	£0	£0	£0	£0	£0
Direct fuel costs ⁴	£M	£0	£0	£0	£0	£0	£0
Other direct costs ⁵	£M	£0	£0	£0	£0	£0	£0
Indirect costs ⁶	£M	£0	£0	£0	£0	£0	£0
WACO F/E/G ⁷	£/MWh, p/th	0	0	0	0	0	NA
EBITDA ⁸	£M	£0	£0	£0	£0	£0	£0
DA	£M	£0	£0	£0	£0	£0	£0
EBIT	£M	£0	£0	£0	£0	£0	£0
Volume ⁹	TWh, therms	-	-	-	-	-	NA

Notes

1. The financial data should be provided to the nearest £million, WACOE and WACOF to the nearest pence in £/MWh, WACOG in p/therms to 1 decimal place and volumes to 1 decimal place in TWh. The grey shadings denote summations that can be calculated by using other information within the statement, eg EBITDA can be calculated using the total revenue and total operating cost lines in the statement.

2. For the generation business segment this means revenue from sales of electricity output generated; or if the business operates in a tolling-agreements structure, the revenues received from the capability or capacity payments including any account of associated fuel costs (an explanation/clarification of the latter type of revenues should be provided). For the respective supply segments this means electricity and gas sales. Revenue for domestic supply should be less dual fuel discounts where applicable; that is these discounts should be deducted from revenue, with the discount split evenly between electricity and gas. Social tariff costs should also be deducted from domestic supply revenue directly.

3. Other respective segmental revenues not covered in Note 2, eg in the generation segment may include capacity payments, other physical options and ancillary services.

4. Direct fuel costs for supply should include aggregate electricity and gas costs as outlined in Note 7. Direct fuel costs for generation should include an associated input cost for fuel, irrespective of the business model of the Relevant Licensee or its Affiliate. If the business operates in a tolling-agreements structure the direct fuel costs for generation may be presented in the form of a footnote to the template. The footnote should include a description of the volume, total cost, and average cost. It should also specify the volume of granted free carbon allowances.

5. Other direct costs for supply should include network costs, BSUOS, environmental costs (including ROCs, CESP and CERTs) and the transport element of Reconciliation-by-Difference (RBD) costs.

6. Indirect costs should be defined as licensees' own internal operating costs including sales and marketing costs, bad debt, costs to serve, IT, staffing costs, billing and all meter costs.

7. For generation this means the weighted average input cost of fuel (eg gas, coal, uranium, etc) used by the generation business, shown as £/MWh. This should reflect the delivered cost of fuel. For the supply businesses, WACOE/G should cover the wholesale energy cost, losses, the energy element of RBD costs, balancing and shaping costs incurred by supply licensees.

8. EBIT means earnings before interest and tax; and EBITDA means earnings before interest, tax, depreciation and amortisation.

9. Volumes should be supplier volumes at the meter point (ie net of losses). Generation volumes should be the volume of power that can actually be sold in the wholesale market, ie generation volumes after the losses up to the point where power is received under the Balancing and Settlement Code but before subsequent losses.

10. The supply aggregation column (aggregation of domestic and non-domestic electricity and gas supply businesses) sums the horizontal supply figures and thereby helps facilitate reconciliation to group accounts.

Annex 2

Business function	Generation	Supply	Not included in CSS
Operates and maintains generation assets			
Responsible for scheduling decisions			
Responsible for interactions with the Balancing Market			
Responsible for determining hedging policy			
Responsible for implementing hedging policy / makes decisions to buy/sell energy			
Interacts with wider market participants to buy/sell energy			
Holds unhedged positions (either short or long)			
Procures fuel for generation			
Procures allowances for generation			
Holds volume risk on positions sold (either internal or external)			
Matches own generation with own supply			
Forecasts total system demand			
Forecasts wholesale price			
Forecasts customer demand			
Determines retail pricing and marketing strategies			
Bears shape risk after initial hedge until market allows full hedge			
Bears short term risk for variance between demand and forecast			

Notes

1. Companies should indicate where functions reside by way of a tick in the appropriate cell of the table. If profits or losses are not recorded in the same area, then an "F" should be used to indicate where the function resides and a "P/L" should be used to indicate where the profits or losses are recorded. If a payment is made or received by either generation or supply in lieu of a profit or loss this should be referenced by way of a footnote.



Improving Reporting Transparency of Large Energy Suppliers

2. "Not included in CSS" should include entries if neither the Generation nor Supply Segments as reported in the CSS are responsible for a particular function, but that function is undertaken by the Relevant Licensee or an Affiliate. If a function is not undertaken then no entry should be recorded.

Glossary of terms:

- "Scheduling decisions" means the decision to run individual generation units
- "Responsible for interactions with the Balancing Market" means interactions with the Balancing Mechanism in electricity.
- "Interacts with wider market participants to buy/sell energy" means the business unit responsible for interacting with wider market participants to buy/sell energy, not the entity responsible for the buy/sell decision itself, which falls under "Responsible for implementing hedging policy /makes decisions to buy/sell energy".
- "Matches own generation with own supply" means where there is some internal matching of generation and supply before either generation or supply interact with the wider market. For the avoidance of doubt, if an entry is provided in this row, a footnote explanation of the scale of volumes involved is permitted.
- "Forecasts total system demand" means forecasting total system electricity demand or total system gas demand.
- "Forecasts customer demand" means forecasting the total demand of own supply customers.
- "Bears shape risk after initial hedge until market allows full hedge" means the business unit which bears financial risk associated with hedges made before the market allows fully shaped hedging.
- "Bears short term risk for variance between demand and forecast" means the business unit which bears financial risk associated with too little or too much supply for own customer demand.

Appendix 6 - Glossary

E

EBIT

Earnings before Interest and Tax: Operating Profit, in Profit & Loss account.

EBITDA

Earnings before Interest, Tax, Depreciation & Amortisation: Operating profit excluding non-cash items, in Profit & Loss account.

EU ETS

European Union Emission Trading Scheme: The EU-wide greenhouse gas emissions trading scheme, under which governments must set emission limits for all large emitters of carbon dioxide in their country.

H

Hedging

Buying or selling energy ahead of the time the energy is actually delivered to reduce the risks associated with price movement.

I

International Financial Reporting Standards (IFRS)

A set of international accounting standards stating how particular types of transactions and other events should be reported in financial statements.

M

Mark-to-market

Mark-to-market gains and losses refer to unrealised profits and losses associated with open positions at the end of the financial year.

N

Non-speculative trading

In this report non-speculative trading is taken to mean trading for the purpose of cost-effective management supply for customers.

R

Return on Capital Employed (ROCE)

A measure of the returns that a company is realising from its invested capital. It represents the efficiency with which capital is being utilised to generate revenue.

S

Speculative trading

In this report speculative trading is taken to mean trading for the purpose of profit and not for the cost-effective management supply for customers.

T

Transfer pricing

Transfer pricing refers to the attribution of a price to transactions between related parties.

U

UK GAAP

UK Generally Accepted Accounting Principles. The basis under which all UK companies operated before 2005. Companies listed on the stock exchange must now use International Financial Reporting Standards.

Upstream

In this document when we refer to upstream we mean the electricity generation sector.

V

Vertically integrated businesses

Where one supply group owns two or more parts of the energy supply chain. For example, where the same supply group owns generation capacity and also supplies energy to the retail market.

Appendix 7 - Feedback Questionnaire

1.1. Ofgem considers that consultation is at the heart of good policy development. We are keen to consider any comments or complaints about the manner in which this consultation has been conducted. In any case we would be keen to get your answers to the following questions:

1. Do you have any comments about the overall process, which was adopted for this consultation?
2. Do you have any comments about the overall tone and content of the report?
3. Was the report easy to read and understand, could it have been better written?
4. To what extent did the report's conclusions provide a balanced view?
5. To what extent did the report make reasoned recommendations for improvement?
6. Please add any further comments?

1.2. Please send your comments to:

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