

## **E.ON's Comments on Ofgem's Improving Reporting Transparency Consultation**

### **Introduction**

E.ON agrees that with the completion of BDO's work Ofgem should now build on the findings to take segmental reporting forward.

A number of proposals have been put forward, which are explained in Ofgem's consultation document. However, the reasoning behind the proposed change to paragraph 2 of the licence condition, which is probably the most confusing of the changes proposed, is not explained in Ofgem's consultation. Removing the current clarity as to which Affiliates' generation and supply activities have to be included in the Consolidated Segmental Statement will be unhelpful for the reader.

The draft Guidance/Guidelines introduces seventeen "Business Functions". The Business Functions, as drafted, are very vague and the reasons for their inclusion are not always obvious. Our comments on the Business Functions are set out in the Annex of this paper. To support more consistent reporting, Ofgem needs to work with the Relevant Licensees to secure a clear set of definitions for Business Functions.

### **Ofgem's specific questions**

#### **CHAPTER: Two**

For Questions 1 to 5, which all relate to Chapter 2, we do not have any issues with BDO's comments.

#### **CHAPTER: Three**

##### **Question 6: Do stakeholders agree with, or have comments on, our proposal to not take forward recommendation 1?**

While we understand BDO's recommendation to require the companies to publish their segmental statements to the same year-end, we believe there would be large costs for those it would affect. We therefore agree with Ofgem that this recommendation should not be taken forward.

##### **Question 7: Do stakeholders agree with, or have comments on, our proposal to take forward recommendation 2?**

We question BDO's recommendation for an independent auditor to provide an opinion on the segmental statements. Because our statement is reconciled to audited accounts we do not see a need for customers to incur the additional cost of obtaining independent opinions.

##### **Question 8: Do stakeholders agree with, or have comments on, our proposal to take forward recommendation 3?**

We agree with BDO's recommendation to instruct reconciliation of the segmental statements to an audited IFRS income statement and so agree with Ofgem's decision to take this forward.

**Question 9: Do stakeholders agree with, or have comments on, our proposed way forward on recommendation 4?**

As trading functions' activities are outside of generation and supply, we disagree with BDO's recommendation to require the reporting of trading functions' results, including disclosure of the risk each trading function assumes. We also note that it is not clear what is meant by "disclosure of the risk" and that if this was to be taken forward there would need to be much greater clarity. We therefore agree with Ofgem that this recommendation should not be taken forward. However, we do have concerns with Ofgem's actual proposal.

The proposed paragraph 4(d) is ambiguous as to which companies are included within the requirement to report on Business Functions. This ambiguity could be resolved if paragraph 4(d) was amended to require that the Relevant Licensee must include in every segmental statement an explanation of:

*"where **its** individual Business Functions are captured in segmental statements, as specified by Appendix 2 of the Guidelines".*

Even with this amendment, as drafted, it is not clear how the use of the table in Appendix 2 of the Draft Guidance/Guidelines meets the requirements of the licence condition's proposed paragraph 4(d). In particular, is the intention that the table in Appendix 2 should be completed by ticking the relevant boxes, or is it a checklist against which the Relevant Licensee has to provide an explanation of its individual Business Functions captured in the segmental statement?

If the intention is for table in Appendix 2 to be completed by ticking the relevant boxes, then it must be recognised that there will usually be a number of different Relevant Licensees within a corporate group, each with potentially different operational models. Having a consolidated table covering all of the Relevant Licensees carries a significant risk of nearly all the "Generation" and "Supply" boxes being ticked for each of the Business Functions. We would suggest that there should be a separate table for each of the Relevant Licensees covered by the segmental report. Also, it should be made clear that for each Relevant Licensee's table; only the Business Functions it carries out should be included. This would remove the current problem that the table does not accommodate stating that a particular Business Function is not carried out by the Relevant Licensee.

Given our concerns, we would welcome the opportunity to explore further with Ofgem how greater clarity can be achieved for reporting on the requirements of the proposed paragraph 4(d) of the licence condition.

**Question 10: Do stakeholders agree with, or have comments on, our proposal to not take forward recommendation 5?**

We question why further work is thought to be required to assess transfer pricing policy. We therefore agree with Ofgem that this recommendation should not be taken forward.

**Question 11: Do stakeholders agree with, or have comments on, our proposal to include generation fuel costs in all the segmental statements (recommendation 6)?**

We note BDO's recommendation and Ofgem's intention to introduce uniform reporting treatments for generation fuel costs. However, it is not clear in the proposed paragraph 5 of the licence condition which generation of electricity is being referred to. We assume it is electricity generated by the Relevant Licensee. If correct, then we would recommend that paragraph 5 is clear that the information relates to the cost of fuel the Relevant Licensee uses to generate electricity.

Also, it must be recognised that there is a significant difference in the costs of fuel used for different forms of generation. The cost of fuel to a particular Relevant Licensee depends on the generation technology it is using. For example, generators who operate mainly wind generation have much lower fuel costs than those who operate gasoil open cycle gas turbine generation. Therefore, comparison of generation costs between different Consolidated Segmental Statements is of very little practical use. Requiring Relevant Licensees to add costs they have not incurred, to the segmental statements, is not going to help customers and detracts from uniform reporting. If a Relevant Licensee does not have a fuel cost it should not be required to create one.

With these two issues we recommend that the proposed paragraph 5 of the licence condition is amended to read:

*5. The Relevant Licensee must ensure that the information prepared and made public pursuant to paragraph 3 includes the cost of fuel **it incurs in generating** electricity and its share of revenues, costs, profits and volumes of Joint Ventures and Associates.*

**Question 12: Do stakeholders agree with, or have comments on, our proposal to include the revenues associated with the free EU ETS allowances in the segmental statements (recommendation 6)?**

We understand BDO's recommendation and Ofgem's intention to introduce uniform reporting treatments for free EU ETS allowances.

**Question 13: Do stakeholders agree with, or have comments on, our proposal to take forward Recommendations 7 and 8?**

We understand BDO's recommendation and Ofgem's intention for guidance on the scope and definition of exceptional items and to specify a consistent profit base for reconciliation.

**Question 14: Do stakeholders have comments on our proposal to request the provision of information on capital employed?**

We are happy to explore with the Ofgem the possibility of providing a capital employed figure for our generation and aggregate supply activities with the view of presenting the return on capital employed (ROCE).

**Question 15: Do stakeholders have any comments on, or additional evidence related to, our draft impact assessment in Appendix 6?**

We have no comments.

**Question 16: Do stakeholders have any comments on our proposed increase in the customer threshold in the draft licence condition?**

We recognise that Ofgem wishes to help small suppliers grow in size. Preparing a segmental report costs; therefore, raising the point at which this particular regulatory burden applies is logical.

## Annex

### Business Functions proposed in the Draft Guidance/Guidelines

Business Function	Comment
Operates and maintains generation assets	
Responsible for scheduling decisions	<p>We assume this is the scheduling of production by electricity generation units.</p> <p>Assignment would depend on what types of generation the Relevant Licensee operates. It could be that scheduling of wind generation would be assigned to "Generation" and CHP assigned to "Supply". The table does not accommodate presold generation capacity.</p>
Responsible for interactions with the Balancing Market	We are not sure what is meant here. Electricity has the Balancing Mechanism, but here the assignment depends on which activity is being referred to. For gas there is the On the Day Commodity Market.
Responsible for determining hedging policy	Allocation of this would depend on what is meant by hedging policy.
Responsible for implementing hedging policy	Allocation of this would depend on what is meant by hedging policy.
Interacts with wider market participants to buy/sell energy	This depends on what is meant by wider market participants and buy/sell energy.
Holds unhedged positions (either short or long)	This depends on what the hedge is referring to. Is it the procurement and sale of fuel, electricity and heat?
Procures fuel for generation	Clarity is needed as to what is meant by "procures ". Is it the securing of the provision of fuel for generation, or the purchasing of fuel for generation? Also is it fuel for the Relevant Licensee's generation or fuel for generation that will be on sold to another company?
Procures allowances for generation	This depends upon which allowances are being considered.
Holds volume risk on positions sold (either internal or external)	Greater clarity is required as to what is meant by "positions sold".
Matches own generation with own supply	This depends upon which activity is being considered. Because CHP has to match heat sales to customers' demand it can be argued that both "Generation" and "Supply" would have to be ticked on a table. However, the table does not accommodate the fact that usually E.ON does not match generation with own supply.
Forecasts total demand	We question if knowing that E.ON, let alone which Relevant Licensee, forecasts total demand helps customers or potential new entrants to the market. Also, which demand and which timeframe is being considered?
Forecasts wholesale price	We question if knowing which Relevant Licensee forecasts wholesale price helps customers or potential new entrants to the market. Again, which wholesale price and which timeframe is being considered?

Forecasts customer demand	Which customer demand and timeframe is covered here?
Determines retail pricing and marketing strategies	We assume retail pricing and marketing strategies only relate to the supply of electricity and gas.
Bears shape risk after initial hedge until market allows full hedge	For electricity and gas sales it is doubtful if the market can support full hedging, as there will always be variance between demand and forecast.
Bears short term risk for variance between demand and forecast	Which demand and forecast is being covered here?