Tim Wyndham
Energy Market Research and Economics
9 Millbank
London
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27 March 2012

Dear Tim,

Consultation on Improving Reporting Transparency

EDF Energy is one of the UK's largest energy companies with activities throughout the energy chain. Our interests include nuclear, coal and gas-fired electricity generation, renewables, combined heat and power plants, and energy supply to end users. We have over five million electricity and gas customer accounts in the UK, including residential and business users.

EDF Energy welcomes the opportunity to respond to Ofgem's consultation paper on improving reporting transparency.

Our response is contained in the attachment to this letter. Should you wish to discuss any of the issues raised in our response, or have any queries, please contact my colleague David Tomblin on 0207 752 2300, or myself.

Yours sincerely,

Paul Delamare
Head of Downstream Policy and Regulation

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Attachment

Improving Reporting Transparency

EDF Energy's response to your questions

Question 1: Do stakeholders agree with, or have any comments on, BDO's findings on the transfer pricing methodologies employed by the Big 6?

EDF Energy agrees that transfer pricing is a key issue in the preparation of the segmental accounts. We are therefore pleased to see that BDO has found the suppliers' policies to be fit for purpose. We believe that, if trust in the energy market is to be restored, stakeholders must be reassured that the main vertically integrated suppliers are not hiding profits upstream, and that the limited margins available in supply are genuine. In this respect, we would expect Ofgem to use segmental accounts in preference to its own margin modelling when commenting on supplier profitability issues.

Question 2: Do stakeholders agree with, or have any comments on, BDO's findings on how the Big 6 account for long term hedges?

We agree with BDO's conclusions.

Question 3: Do stakeholders agree with, or have any comments on, BDO's findings on how each firm represents energy trading activities?

We agree with Ofgem that it is not appropriate to require suppliers to include profit on speculative trades (directional trades) or brokering/trading activities within the segmental accounts. This activity is very different in nature from generation and supply of electricity, and, is managed within EDF Group under separate risk management by a company independent from EDF Energy (EDF Trading). It is important to note that EDF Energy does not enter into trading activities. EDF Energy buys and sells commodities on the wholesale markets to optimise its assets. Any trading activities are clearly separated from EDF Energy and managed by EDF Group via EDF Trading.

Question 4: Do stakeholders agree with, or have any comments on, BDO's findings on how each company treats exceptional items?

The definition of exceptional items should simply follow the definitions set out under International Financial Reporting Standards (IFRS). Please see our response to question 13 below.

Question 5: Do stakeholders agree with, or have any comments on, BDO's findings on the consistency of treatment regarding Joint Ventures and Associates?

While we agree with the principle of ensuring consistency across all suppliers, the requirement to reconcile to IFRS income statements needs to be taken into consideration, to ensure that there are no unnecessary reconciling items to account for the difference between proportionate consolidation and equity accounting methodologies. We believe that Ofgem does not need to introduce specific rules here and that it should simply stipulate adherence to IFRS principles.

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

We agree with Ofgem's proposals not to take forward recommendation 1. While forcing a common reporting date would improve comparability of results, we believe that such an intervention would be disproportionate.

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

We have a number of concerns with this recommendation.

Firstly, we do not see how an independent auditor could "*provide assurance that the statements are accurate, complete and a fair reflection of performance*" without carrying out the same work as that of the supplier's own auditors. Furthermore, we do not see how it could be desirable for such an assessment to be carried out after the publication of the accounts, as users of them in the interim would be unsure of their final status. An independent auditor may find a statement such as 'fair reflection of performance' too judgemental/subjective to be able to provide a meaningful audit opinion.

Secondly, we do not see the value of Ofgem procuring a commentary on the accounts, as this would presumably consist of mere opinion, and would therefore be difficult for suppliers to challenge. It is important to ensure that information on accounts is reported clearly and accurately to improve transparency for consumers, independent market participants and other stakeholders, such as the media, to increase confidence in the market.

Overall, the recommendation seems to run the risk of undermining suppliers' accounts in two ways: one potentially casting doubt over accuracy and completeness, and the other potentially casting doubt over the truthfulness of reported performance. Such an approach therefore has the potential to undermine trust in suppliers' accounts at a time when trust in the market needs to be established.

There is also a potential increase in overhead cost and a reduction in operational efficiency by supporting two unrelated financial audit processes.

If Ofgem is to proceed with this recommendation, it would be sensible to allow suppliers to contribute to the development of the terms of reference for the appointment of the independent auditor and to try, as much as possible, to optimise this in line with existing statutory auditing process.

Given that all suppliers currently have their accounts independently audited for the production of their statutory accounting process, there seems to be little benefit to the consumer of providing a further audit report.

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

Yes, reconciliation of the segmental statements with an audited IFRS income statement is a sensible approach. This is in line with the recommendations made in our answer to the previous question.

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

Given that BDO found that suppliers' transfer pricing arrangements were fit for purpose, and that alternatives could not be expected to offer any clear improvements, we agree with Ofgem's proposal not to take forward recommendation 5.

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 agree with Ofgem's proposal. EDF Energy already includes all generation fuel costs within the "generation" section.

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 agree with Ofgem's proposal. EDF Energy already values in EU ETS allowances in the segmental accounts at the price paid for them (including nil for free allowances).

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

We agree that the base for reconciliation with the IFRS income statement should be EBITDA before any exceptional items. Current accounting standards severely limit the scope of exceptional items, in particular requiring them to be non-recurring. We do not believe there is any benefit in Ofgem developing its own alternative definition/list of exceptional items.

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

This will be very difficult to introduce given the wide definition of capital employed (not covered by standards such as IFRS) and the different capital structures which may exist, for good reasons, across the industry.

We understand that a Return on Capital Employed (ROCE) measure could provide additional reassurance to stakeholders that profits are not excessive and we can see what Ofgem is trying to achieve here. However, we question whether using such a measure will make the results more understandable for consumers.

There are many difficulties involved with the possible inclusion of a capital employed measure. For example, we would warn that the definition of capital employed can differ widely depending on whether we take an accounting approach (usually historical in nature) or a market value approach (more cash driven). Hence, determining a standard methodology for defining this component and ensuring it is applied consistently across the various suppliers is likely to be a challenge.

We would also note that debt may be held at the holding company, and/or companies will have invested in incomplete assets (such as partly built power stations) which are not yet creating revenues.

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

We have no additional comments.

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

We believe the licence condition should apply to all vertically integrated suppliers irrespective of size. We believe that it is helpful for stakeholders to be able to see the similar cost pressures faced by all suppliers. This would help increase consumer trust in the segmental accounts.

EDF Energy
March 2012