

CHAPTER: Two

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

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

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

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

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

Treating all of these questions together, we would agree with Ofgem's summary that BDO have found "suppliers' financial information to be fair and appropriate and consistent with their official numbers" (Ofgem press release 31 Jan 12).

CHAPTER: Three

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

SSE supports Ofgem's recommendation. We should continue to publish our CSS consistent with our audited company accounts – to misalign the publication of the CSS would make the reconciliation to audited accounts a disproportionately onerous task.

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

SSE supports Ofgem's decision to not undertake a detailed review of the CSS on an annual basis.

An independent assessment of published statements could usefully inform Ofgem's report summarising the results (provided the process did not require excessive work and resource on the part of suppliers over and above what is required to produce the CSS).

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

SSE already reconciles the segmental statement to an audited IFRS income statement.

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

We would suggest that column 3 should be labelled "Wholesale Energy Trading" as it is likely that this label would improve the clarity of the document.

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

We support the decision to not take this forward. In light of BDO's findings it is likely that the time, cost and effort required to take this forward would be out of proportion to any benefit that could be realised.

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

SSE is strongly opposed to this measure.

We note that the summary of BDO's findings reported in the consultation document implies no criticism of differences that exist between different companies.

These differences in company structures reflect different choices by the Big 6 in how best to manage the range of different functions they undertake. (Improving Reporting Transparency, 2.6)

Ofgem takes cognisance of the implications of these legitimate differences in relation to Recommendation 4. It states that the inclusion of complete details for trading operations “would not improve transparency or comparability of the individual segments, given the differences in how companies allocate key functions” (Improving Reporting Transparency, 3.15).

Recommendation 6 does not resolve this. It is worth noting that Ofgem’s original aim when introducing the segmental statements was to “provide significant additional transparency regarding the supply and generation activities of the major vertically-integrated supply companies” (Energy Supply Probe – Proposed Retail Market Remedies, Aug 2009).

We believe that this proposal seeks to improve comparability (across the industry) at the expense of the transparency (of each of the major supply companies) which these statements currently provide. Under this proposal we would be reporting numbers in a manner which would not reflect the way that our company is structured and would not reflect the accounting treatment of our assets in our audited accounts.

More significantly, we simply do not have the data to present the accounts in a different way. The consequence is that the reconciliation to published accounts (of fundamental importance in establishing confidence in the figures contained in the CSS) would be impossible. We would therefore not be able to meet the licence obligation that this proposal would introduce.

Given that we publish the CSS on the investor relations area of our website, both industry analysts and our own shareholders refer to the statement and expect to understand how it relates to our company accounts. In order to minimise the detrimental impact of the confusion caused by reporting fuel costs under our ‘Generation’ segment we would be compelled to publish a disclaimer on our CSS, clarifying that we are obliged to represent our business in a particular way in order to comply with SLC 19.

This would be unfortunate as we believe it would risk damaging the credibility of the CSS process, but that outcome would be preferable to misleading or confusing our own shareholders, which is one of the objectives of SLC19.

Alternative proposal

We would prefer to take the more constructive approach of publishing a footnote with aggregated fuel and carbon costs for our thermal generation, and report the number and value of EU ETS allowances as follows:

Note on Fuel and Carbon Costs

SSE thermal generation plant included in this CSS (as defined in licence condition 19A.1.b) produced [---]TWh of output during the year and the delivered cost of fuel (gas including transportation, coal including freight and associated costs, delivered oil and biomass including freight and associated costs) was £[---]m (£[---]/MWh). SSE was granted [14.9]m tonnes of free carbon allowances in period 1 April 2010 to 31 March 2011. The average market price during the financial year ending 31 March 2011 for carbon tickets was €[---] per tonne. The allocation of free carbon allowances cease at 31 December 2012.

We believe that this would achieve Ofgem’s objectives, as it provides both:

- a figure that can be compared with the fuel and carbon costs of other companies; and
- transparency of SSE’s fuel and carbon costs.

In doing so, it would not in any way obscure the fact that our generation assets receive income based on providing capacity to wholesale energy trading through Power Purchase Agreements (as described in the disclosure notes on our CSS).

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 are extremely concerned that any requirement to publish our carbon position as a separate item would reveal commercially sensitive information. However we are willing to publish details of our free allowances (see question 11 above).

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

We believe that our treatment of exceptional items is transparent and appropriate.

Ofgem note that whilst “most companies carried out their reconciliation using their audited EBIT figure, one company used EBITDA” (Improving Reporting Transparency, 2.8). We would therefore question whether asking four out of six companies (one company reconciled to both EBIT and EBITDA) to change their reconciliation is the most proportionate means of achieving the stated aim of improved comparability.

Recommendation 8 would require us to reconcile against a number that does not appear anywhere in our published accounts. We are extremely concerned that trust in the CSS and in energy suppliers will be damaged if the analysis required to reconcile the data to audited accounts is either obscure or not easily accessible.

Reconciling against EBIT is completely transparent and we believe that this is a far more important consideration for the CSS.

We would therefore suggest that the reconciliation based on EBIT used by five companies should not be changed. If Ofgem is minded to improve consistency of reconciliation then requiring that one company changes their current methodology would be more consistent with the principles of better regulation.

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

SSE sees no value in this metric being employed.

Even when energy supply was price controlled, the profit calculation was % of turnover, not ROCE. Since SSE's Energy Supply business has no fixed assets on which to base the calculation, we believe that ROCE is unlikely to produce meaningful results. In addition, recent asset impairments will distort the generation calculation as it takes no account of asset life.

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

The impact assessment has not considered the issues in as much detail as we would have expected.

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

We do not understand the rationale for the proposed increase in the threshold. If part of the purpose of the CSS is to inform potential new entrants to the energy supply market of the likely margins that can be earned, then we would suggest that the smaller suppliers are of far more relevance.

We also believe that there are Vertically Integrated (VI) suppliers in the non-domestic market, particularly for gas, which would not be caught based on customer numbers but which are very significant in terms of volume supplied, as their customers are very large users. It is

inconsistent to require VI electricity companies to complete the CSS but to not impose similar conditions on VI gas companies.