ofgem
Making a positive difference
for energy consumers

To energy suppliers, consumer
representatives and other
interested parties

Direct Dial: 020 7901 7000
Email: css@ofgem.gov.uk

Date: 26 February 2014

Dear Colleague

Actions to improve the transparency of energy company profits

Transparency of energy company profits matters. It is important for consumer confidence, and for new firms thinking to enter the energy market. Robust data also allows us to monitor and assess how well the market is working for consumers.

Over the last four years, we have made significant improvements to the transparency of prices, costs and profits. Since 2009, we have required the energy companies to report annually on the revenues, costs and profits of their generation and supply activities separately through the Consolidated Segmental Statements (the statements). We have also published our Supply Market Indicator (SMI), which provides a forward-looking view of a representative supplier's costs and revenues. As a result, the GB energy market is among the most transparent in Europe.

We have improved the statements and the SMI year-on-year, and are committed to further improving transparency, where possible. Our aim is to help ensure that the information available on energy company revenues, costs and profits is:

- *Robust* – so it provides confidence that the reported figures are derived correctly
- *Useful* – so it is relevant, meaningful and timely for stakeholders and commentators
- *Accessible* – so it is presented in a way that can be understood by interested parties.

In October 2013 we published a consultation on steps we could take to further improve the transparency of energy company profits.[1] We received 11 responses, which are available[2] on our website, and summarised in the appendix. We welcome the engagement to date of suppliers and other stakeholders.

This letter presents the actions that we and the companies will take to make the information more robust, useful and accessible. There are a set of actions which will commence immediately. Work has commenced to ensure there is greater transparency over the 2013 statements[3] when they are published in the coming months. A further suite of improvements is required for the 2014 statements, which will be published next year. An overview of the measures is set out in the table below.

[1] Rebuilding consumer confidence: Improving the transparency of energy company profits, 31 October 2013.
[2] One response was confidential.
[3] Centrica published their 2013 statement last week. We welcome the improvements made, including earlier publication, inclusion of an audited opinion and trading results, as well as a more detailed cost breakdown.

Table: What happens when

Action / Timing	*Immediate*	*By end summer 2014*	*By end 2014*	*First half 2015*
Robustness				
Increase auditor scrutiny	Auditors scrutinising 2013 statements	2013 statements published	Enduring audit requirement in place	2014 statements are fully audited
Transfer pricing (TP) review	Ofgem kicks-off TP review	Report findings	Any additional TP requirement in place	2014 statements reflect any additional requirement
Give more insight into trading activities	Companies working to deliver	2013 statements contain more insight	Any additional trading requirement in place	2014 statements reflect any additional requirement
Usefulness				
Faster publication	Companies working to deliver	Full set of 2013 statements published two months earlier	Enduring (shorter) publication deadline in place	2014 statements published by new deadline
Develop ROCE methodology	Ofgem kicks off work	Finalise new methodology	Enduring ROCE requirement in place	2014 statements contain ROCE figures
Accessibility				
Greater cost breakdown	Implement in improved SMI	2013 statements present further cost breakdown	Updated guidance published	2014 statements contain new cost breakdown
Improved SMI	Re-launch shortly	Continuous refinement	Continuous refinement	Continuous refinement

More robust information

We want stronger assurance that the information in the statements is robust, so that there is confidence that the reported figures are derived correctly.

What we have asked the companies to do

Commission external auditors to scrutinise their Consolidated Segmental Statements

We have concluded that confidence will be best delivered by having external auditors scrutinise the companies' statements. The majority of respondents agreed.

For the 2013 statements each company has agreed that they will, at a minimum, commission their external auditors to perform a detailed series of checks on their statements. This will improve confidence that the companies have prepared their statements correctly – or highlight areas where they have not. This will also lay the groundwork to allow the companies and their auditors to develop the frameworks and processes they will need to provide a full audit from the 2014 statements onwards.

We will seek to embed the requirement for a full audit in suppliers' licences. This will require the companies to seek from their external auditors an opinion that gives positive assurance that the companies have complied with the rules and that the information in the statements represents an accurate view of company profitability. We will work with the companies and the audit community to develop this binding requirement.

What we will do

Carry out an in-depth review of the companies' transfer pricing policies

The large energy companies use transfer prices to allocate revenues, costs and profits between their generation, trading and supply business segments. There are several approaches to transfer pricing. Companies' choices on structure and operation can result in different transfer pricing policies, for example, to reflect different choices on allocating risks between segments. The transfer pricing policy on its own does not directly affect whether consumers get a fair deal. What it does mean is that segmental revenues, costs and profits will not necessarily be directly and fully comparable between companies or over time, if policies differ or change.

The Office of Gas and Electricity Markets
9 Millbank London SW1P 3GE **Tel** 020 7901 7000 **Fax** 020 7901 7066 **www.ofgem.gov.uk**

To mitigate this, we require the companies to calculate in the same way the average cost to their supply business of buying the wholesale gas and electricity they need to meet their customers' needs. This is called 'weighted average cost of electricity/gas' (WACOE/G) in the statements. There is an equivalent requirement for the weighted average cost of fuel (WACOF) on the generation segment.

The review we commissioned from BDO in 2011 concluded that the companies' transfer pricing policies were broadly "fit for purpose and transparent"[4] and would likely meet the measure of 'best practice' described in the OECD's Transfer Pricing Guidelines.[5] In response to our consultation, the majority of the large energy companies dismissed any concerns over transfer pricing, highlighting this fact.[6] However, they expressed a willingness to cooperate with any further review in this area.

There remains a public concern that companies can use their transfer pricing policies to unduly influence the profit figures they report for their supply and generation businesses. To address this, and provide the public with the confidence they need, we will build on BDO's previous review and conduct a more in-depth assessment of the transfer pricing policies that the companies use.

Our review will assess the appropriateness of the companies' individual transfer pricing policies. The review will:

- Update and enhance our understanding of the companies' current transfer pricing policies. Some of them have made changes since BDO last reviewed them
- Assess compliance with transfer pricing rules and best practice
- Identify any areas of potential concern and investigate them. This will include looking at the specific market prices used, the effect of lower liquidity in the forward markets on transfer prices, and any adjustments companies make to market prices to calculate their transfer prices
- Draw the implications for the transparency of companies' statements, and their comparability across companies.

We aim to report on the findings of this work in summer 2014. This will inform next steps in this area, including further actions to improve transparency around trading activities. We will also look at the work of the companies' external auditors in verifying whether the information in the statements results from the correct application of their policies. Auditors will need to check this each year, so the application of the transfer pricing policy will be continually scrutinised. We do not want the transfer pricing policies to cause mistrust, so we will revisit this issue if that was the case after our package is fully implemented.

Provide more insight into trading activities and results

There has been increasing interest in understanding the trading activities and results of the large energy companies. We think that greater transparency in this area should help stakeholders understand it better and this, in turn, should help rebuild confidence in the market.

The large energy companies are all active in energy trading to various degrees. Trading for the purposes of hedging is a core activity of energy generation and supply businesses and we would expect these revenues, costs and profits – but not those of speculative trades – to be reflected in the segments presented in the statements.

[4] See page 56, *Ofgem Segmental Statements Review, BDO LLP Final Report*, 16 January 2012
[5] *Transfer Pricing Guidelines for Multinational and Tax* Administrations, Organisation for Economic Co-operation and Development (OECD), 18 August 2010.
[6] One of the large energy companies suggested separation of licensed generation and licensed supply within all vertically-integrated groups. We welcome this suggestion. We would consider these types of remedies in the light of the findings of the State of the Market report we are doing with the competition authorities.

The Office of Gas and Electricity Markets
9 Millbank London SW1P 3GE **Tel** 020 7901 7000 **Fax** 020 7901 7066 **www.ofgem.gov.uk**

Transfer prices and trading results are interdependent. An appropriate transfer price should be sufficient to attribute the relevant trading function results (ie those associated with hedging activities, not speculative ones) between generation, supply and trading. The large energy companies all tend to base their transfer prices on prevailing market prices. However, there are different market prices used (eg bid/offer and at time of transaction/delivery). Also, companies may adjust the market price used for different reasons (eg to reflect risk allocation or efficiencies from vertical integration). These factors can influence the transfer price used and, with it, the revenues, costs and profits attributed to generation, supply and those that remain within the trading function.

By providing robust reference prices, our liquidity reforms should also make transfer prices more robust.[7] Furthermore, we have asked the companies to be more transparent on the factors that affect the transfer price they use, and to fully explain in their statements the consequent impact on revenues, costs and profits for the generation, supply and trading functions.

The results of the trading function are affected by companies' transfer pricing policies. Since these two issues are inseparable, we will base any enduring requirement regarding disclosure of trading results on the findings of our in-depth review of transfer pricing policies. Any such requirement would apply to the 2014 statements onwards.

For the 2013 statements, we have asked the companies to do as much as they can to shed further light on the trading function of their business and to address the perception that the trading function can be used to hide profits.

More useful information

We consider that the information on revenues, costs and profits should be relevant, meaningful and timely for stakeholders and commentators, without revealing commercially-sensitive information that could undermine competition.

What we have asked the companies to do

Accelerate publication of their statements

The companies currently have six months following the end of their financial year to publish their statements. We chose this deadline to give companies time after completing their annual report to produce the statements. We also recognised that for the first few years, the companies may need more time to develop their processes.

Having had the experience of four years' worth of statements, we consider that companies can, and should, publish their statements sooner. Most of the consultation respondents agreed that this would make the information more timely and relevant.

The involvement of external auditors will add some time into the process. Nevertheless, we consider that companies should move towards publishing their statements no later than four months after their financial year end. We intend to embed this requirement in the licence condition from the 2014 statements onwards. This would enable us to bring forward our annual summary of the statements from late autumn to the summer.

For the 2013 statements, the companies have agreed to use their best endeavours to bring forward publication as much as they can, given the time needed to engage with their auditors on the additional features of these statements. We expect the last of the 2013 statements to be published no later than July, allowing us to publish our summary no later than September 2014.

[7] Wholesale power market liquidity: decision letter

The Office of Gas and Electricity Markets
9 Millbank London SW1P 3GE **Tel** 020 7901 7000 **Fax** 020 7901 7066 **www.ofgem.gov.uk**

What we will do

Develop ROCE methodology to present profitability of generation

The return on capital employed (ROCE) is regarded as an appropriate measure of profitability in many markets. This is especially the case in capital-intensive industries, such as electricity generation. The nature of the wholesale energy market, in particular the potential for profits caused by comparatively low-cost generation and the long lead times for building new power plants, means that ROCE may not be a relevant indicator in determining whether profits are high or excessive. Nevertheless, we consider that the publication of ROCE figures for generation will provide a more meaningful picture of the level of profits over time.

The majority of respondents supported our proposal to calculate ROCE for generation and include it in the statements. However, most noted that there should be consistency in how it is calculated.

A key factor in calculating ROCE is the asset values used. There is a range of approaches used for valuing assets (eg book value, market value or modern equivalent value). These can result in very different ROCE results. We agree that it is therefore important to develop a common methodology.

We will work with stakeholders over the coming months to develop this approach. In doing so, we will build on the work being done jointly with the Office of Fair Trading and the Competition and Markets Authority as part of our State of the Market assessment. We aim to require companies to start publishing ROCE figures from their 2014 statements onwards.

<u>More accessible information</u>

We consider that information should be presented in a way that can be readily understood by interested parties, for example by providing for effective comparison across companies and over time.

What we have asked the companies to do

Presenting cost information into meaningful categories

It is important that the highly public debate about the costs of energy is based on facts, and that consumers have an accurate understanding of the cost drivers behind their bills. This is harder to achieve when companies and opinion-formers calculate and present cost information differently.

Addressing this issue requires coordination. We have worked with the companies to agree a common set of cost categories[8] for the statements and to present bill breakdown information. The focus is on showing network costs and environmental and social obligations costs separately. We sought to strike a balance between, on the one hand, having enough categories to allow people to understand the main cost drivers, while, on the other hand, keeping the breakdown simple and ensuring the greater detail does not undermine competition. We hope this will allow stakeholders to formulate coherent public narratives on costs and prices, minimising confusion.

For the 2013 statements, we will leave some flexibility around the exact allocation of every single cost item between the agreed cost categories, as we need time to work with industry to settle this. Our current guidelines[9] remain in place, but we do expect that companies

---

[8] The categories are: (1) Wholesale costs, (2) Network costs, (3) Environmental and social obligations costs, (4) Supplier operating costs.
[9] Guidelines for preparing the Consolidated Segmental Statements.

The Office of Gas and Electricity Markets
9 Millbank London SW1P 3GE **Tel** 020 7901 7000 **Fax** 020 7901 7066 **www.ofgem.gov.uk**

break up "Other direct costs" to include "Network costs" and "Environmental and social obligations costs". We will aim to amend the guidelines from the 2014 statements onwards.

What we will do

Aligning the statements with the Supply Market Indicator

The SMI adds value by providing a regular, forward-looking view of trends in costs and revenues. This complements the statements, which provide a historic view of realised revenues, costs and margins. We will re-launch the SMI shortly, once we have clarity on the impact of recent changes by government to certain environmental and social obligations on suppliers.

We have aligned the methodology and bill breakdown categories in the SMI with those of the statements. This includes using information on all tariffs instead of just standard tariffs, and presenting a consistent, more detailed breakdown of costs. To minimise overlaps and reduce the scope for misinterpretation, we also propose to publish SMI outputs as far back as the latest set of statements, together with more detail on model inputs, outputs and methodology.

Why we think these changes will help

Transparency matters. We recognise that transparency offers a route to strengthened accountability and provides important regulatory benefits. In March, we will publish a policy statement on transparency of Ofgem data that includes a commitment to ensure that information we make available about ourselves is meaningful to stakeholders and promotes the interests of consumers. We are keen that principle should also guide information made available by energy companies.

Regarding transparency of profits, we aim to provide meaningful and robust information in a way that can be clearly understood. We want to inform the debate on energy company profits and the link to the functioning of the market. There should not be disagreements over facts.

At the end of March, we will publish our State of the Market report, jointly with the Office of Fair Trading and the Competition and Markets Authority. This will place prices, costs and profits alongside broader analysis to assess how the market is working. Profitability is only one of the many indicators we track as part of our monitoring of the market. We have also published today a factsheet that explains Ofgem's monitoring work across the entire value chain.[10]

In designing our actions, we considered the recommendations of the Energy and Climate Change Select Committee.[11] One of the Committee's recommendations was that we implement, in full, the proposals that BDO made to us in 2012.[12] Our package addresses all but one of the BDO recommendations and goes further in some instances (such as calculating ROCE and requiring a further breakdown of cost information).

The one recommendation we are not implementing would involve requiring SSE to change its financial year-end[13] to align with the other companies. We do not consider that this would be a proportionate measure. The March financial year-end does not hinder comparisons significantly and would ultimately increase costs to SSE's customers in exchange for a small improvement in transparency. Instead, we have secured a commitment from SSE to publish their statements much earlier than before. This will allow stakeholders to see the full set of companies' statements sooner.

[10] "How we monitor whether the market is working properly for consumers"
[11] Report of House of Commons on Energy Prices, Profits and Poverty (July 2013)
[12] Report of BDO on Consolidated Segmental Statements (January 2012)
[13] SSE reports to a March financial year-end while the other five large companies do so to December.

The Office of Gas and Electricity Markets
9 Millbank London SW1P 3GE **Tel** 020 7901 7000 **Fax** 020 7901 7066 **www.ofgem.gov.uk**

Furthermore, some of the bigger independent suppliers are showing an interest to complete segmental statements to improve transparency and provide a point of comparison. We expect at least one of them to voluntarily publish their statement in the coming months. At least one of them operates to the same March financial year-end as SSE. Requiring a specific financial year-end would pose a disproportionate regulatory burden and risk undermining their recent success in challenging the bigger energy suppliers.

What happens next

Our actions are designed to secure improvements now, while allowing time to resolve the outstanding issues in the coming months and in time for the 2014 statements. We have agreed with the companies, on a voluntary basis, improvements to the 2013 statements as there has not been time to reflect them in licences. These licence changes will be in place ahead of the 2014 statements.

By the end of summer 2014, we expect companies to have published their 2013 statements (Centrica already has). These statements will give more insight into companies' trading activities and contain a more granular breakdown of their costs. They will have been subject to external auditors' scrutiny. This will allow us to publish our summary document in September 2014, at which point we will also report on the findings of the transfer pricing review and the methodology to calculate ROCE in a consistent way across companies.

By the end of 2014, we expect to have an amended licence condition that embeds the above improvements and provides companies with clarity on the enduring requirements.

If you have any questions on the contents of this letter, please contact Diego Villalobos, in the Retail Market Analysis team, at css@ofgem.gov.uk or on 020 7901 7000.

Yours sincerely,

Neil Barnes
Associate Partner
Retail Markets

The Office of Gas and Electricity Markets
9 Millbank London SW1P 3GE **Tel** 020 7901 7000 **Fax** 020 7901 7066 **www.ofgem.gov.uk**

Appendix: Summary of consultation responses

On 31 October 2013 we published our consultation on improving the transparency of energy company profits. We received 11 responses. These are summarised here, and available in full on our website.[14]

The consultation asked for views on ways to improve several elements of the transparency of energy company profits, notably:

- Robustness – accurate information on revenues, costs and profits and how these are allocated across companies' generation and supply businesses.
- Usefulness – relevant, meaningful and timely information for stakeholders and commentators.
- Accessibility – information presented in a way that interested parties can understand.

We have grouped responses into three types of stakeholders:

- Large energy companies: Centrica, EDF Energy, E.ON, Npower, Scottish Power.
- Consumer groups: Consumer Futures and Which?
- Other respondents: small suppliers Ecotricity, a confidential response, trade body Energy UK and consultancy firm NRG Consulting.

Robustness – increasing auditors' scrutiny of the CSS

Question 1: Would a full financial audit provide greater reassurance about the robustness of the Consolidated Segmental Statements (CSS)? How much would these audits cost?

The large energy suppliers were divided on whether the CSS should and could be formally audited. Some suppliers were supportive, generally on the condition that the audit was performed by their current auditors. Others were not supportive, as they thought there was already a transparent relationship between the CSS and their published audited accounts. They therefore said a full audit wouldn't make the CSS any more reliable. Another of the large energy suppliers said any full audit on the CSS will duplicate work already done by the external auditors for the purposes of the group annual report, and this would be inefficient and costly. The estimated cost of these audits ranged from five to six figure amounts.

Consumer groups supported auditing the CSS. Unlike some of the large energy suppliers, they thought it is difficult for a third party to reconcile the CSS with the statutory accounts of firms. They also highlighted that the Energy and Climate Change Select Committee supported a full audit.

Among other respondents, Energy UK did not support the proposal to audit the CSS. They commented that the evidence BDO presented to us in 2011 suggested that the current approach of requiring reconciliation was enough to verify that the information in the CSS was robust. Small suppliers supported an audit requirement. One small supplier called for this to go beyond UK accounts and provide a clear picture of how revenues and profits are moved around various branches of multinational energy companies.

Robustness – transfer pricing policies

Question 2: Do you have further information on the appropriateness of the companies' transfer pricing policies beyond BDO's detailed findings? Could more be done to provide reassurance in this area?

Most of the large energy suppliers did not provide further information in this area. Generally they either commented that trading operated at arm's length, so they did not

[14] One response was confidential.

The Office of Gas and Electricity Markets
9 Millbank London SW1P 3GE **Tel** 020 7901 7000 **Fax** 020 7901 7066 **www.ofgem.gov.uk**

have access to detailed information, or they said BDO had already found that their transfer pricing methodologies were fit for purpose. This notwithstanding, some suppliers expressed willingness to cooperate with any further Ofgem enquiries in this area. One suggested banning companies from being both licensed generators and licensed suppliers, in part to provide more reassurance in the area of transfer pricing.

Consumer groups called for further investigation of the large energy suppliers' transfer pricing policies. One suggested that the auditors should comment on the appropriateness of suppliers' policies as part of the audit.

Small suppliers said we should adopt BDO's recommendation to assess energy companies' transfer pricing policies. Energy UK disagreed, highlighting that the evidence BDO presented to us in 2011 concluded that the transfer pricing policies were 'fit for purpose and transparent'.

Usefulness – trading functions

Question 3: What information could the companies usefully provide on their trading functions that would improve the transparency of the profits in their generation and supply businesses? What are the costs and benefits of including the trading function in companies' statements? How possible is it to distinguish between trading for hedging and speculative purposes?

There were mixed views among the large energy suppliers. Some said it would be straightforward to separate speculative trading activity from hedging trading activity. One supplier already voluntarily provides equivalent information for its UK trading organisation alongside the generation and supply segments. Another said it was planning to follow suit (although it warned that this information would be beneficial only if all companies provided data in a consistent format. This meant guidance from us was required). However, other suppliers said it would be difficult or impossible to separate between trading for hedging and speculative purposes.

Consumer groups thought we should try to incorporate trading into existing reporting. One commented that the information made available should be relevant to understanding the dynamics and influence of the large vertically-integrated companies, not limited to profits in supply and generation. A group also suggested that other activities of the large energy suppliers – such as pan-European functions – should be included in the reporting to enable us to scrutinise the arrangements.

Small suppliers thought we should adopt BDO's recommendation to require energy companies to report on their trading activities. Energy UK welcomed our effort to increase the understanding of energy trading but highlighted that companies are likely to differ in terms of which trading information they would be able to provide. They also commented that the ability to distinguish between trading for hedging and speculative purposes varied between companies according to their business structures. They suggested that more could be done with existing data to increase understanding of energy trading.

Usefulness – deadline for publication of the CSS

Question 4: Do you agree with the proposal to reduce the deadline for companies to compile and publish their statements from six to four months? What are the costs and benefits of doing so?

All of the large energy suppliers generally supported moving the CSS publication deadline forward, as long as there were no other big changes to the requirements. Some suppliers were less committed to the four-month target than others, however. One supplier suggested five months on the basis that accuracy is more important than speed. Another suggested that the relevant licensees give a commitment to four months while keeping the licence requirement at the six-month deadline. Others said the comparability of the

The Office of Gas and Electricity Markets
9 Millbank London SW1P 3GE **Tel** 020 7901 7000 **Fax** 020 7901 7066 **www.ofgem.gov.uk**

statements and the relevance of our summary document would be improved if companies' financial accounting years were the same for all parties.

Consumer groups agreed that the deadline for publishing the statements should be tightened to make the data timelier. One consumer group argued that the deadline should be reduced further still, since the usefulness of the data is time-limited in the context of understanding the contemporary activities of the suppliers. Both groups also suggested that SSE should voluntarily align financial accounting years with the other large energy suppliers, or that Ofgem should mandate it.

Smaller suppliers were not so supportive. One commented that it would be more valuable to ask SSE to align its reporting year with the other five large energy companies. Energy UK were supportive, commenting that companies typically take three months to release their own accounts, so an earlier publication date for the statements should be achievable, depending on any new licence requirements.

Usefulness – ROCE methodology

Question 5: Is there merit in calculating a Return on Capital Employed (ROCE) for the generation business of the six large energy companies, but not for their supply businesses? Are there any specific issues with how ROCE should be calculated for generation?

The large energy suppliers generally supported our proposal to calculate ROCE. Most agreed that ROCE for generation is a widely-used metric that can be compared with the Weighted Average Cost of Capital (WACC) and is the best indicator of the return required by investors in capital-intensive industries. They also tended to agree that ROCE is not a relevant measure for supply businesses as they are not capital-intensive. However, suppliers raised methodological issues. One called for Ofgem to develop an agreed methodology to ensure the calculation is robust and consistent.

Consumer groups agreed with our proposed approach. However, one commented that this was less of a priority than the other issues. One group also suggested that ROCE should be "contextualised", as it may not be an intuitive concept to non-economists.

One small supplier agreed that calculating ROCE for the supply business would be of little value, but also questioned the value of calculating ROCE for the generation business. This was on the basis that ROCE calculations can be subjective and can mask business assumptions.

Energy UK agreed with our approach, but commented that two implementation difficulties should be dealt with. First, generation ROCE should be clearly distinguished from the ROCE companies report for their entire business in the financial statements. This could be done by calling it 'return on generation segment capital employed' (ROGSCE). Second, a consistent definition should be adopted for the generation segment capital employed.

Accessibility – other suggestions for improving transparency

Question 6: Do you have any suggestions for improvements to the format and content of our annual summary document on the statements? What more could the companies do to improve the presentation of their statements?

Four of the large energy suppliers suggested improvements to the format and content of our annual summary document on the statements. The remaining company thought the format and content of the CSS fit its purpose. The general mood was summarised by one supplier, which suggested that for future summaries, the information be presented in context and in a way that wasn't open to misinterpretation. Other suggestions included making a clearer distinction between the CSS and the Supply Market Indicators (SMI), and further breakdown the CSS results, partly so they would be more useful for potential new market entrants.

The Office of Gas and Electricity Markets
9 Millbank London SW1P 3GE **Tel** 020 7901 7000 **Fax** 020 7901 7066 **www.ofgem.gov.uk**

One consumer group agreed with our proposal to see a CSS summary document produced much earlier in the year. It added that there should be a greater examination and "contextualisation" of why trends may be emerging. One example is the convergence of domestic supply operating costs across the first four years of the CSS, which was shown in the data but not accompanied by any commentary.

Energy UK said we should provide methodological clarifications and refine the way we communicate revenues, costs and margins in the energy industry. We should clarify that the SMI is a forecast rather than an estimate of actual values. Another respondent suggested that we should provide an annual assessment of our SMI forecast against the actual values reported in the CSS.

Question 7: How else could we or the energy companies improve confidence in the energy markets?

The large energy suppliers suggested ways to improve confidence in the energy market. They thought we should explain the reasons behind price rises, as greater transparency is required around the costs that make up a consumer's bill. They also suggested that we make broad connections between the CSS, SMI and other publications about prices, costs and profits, even if this was merely an explanation of the differences between them. One supplier suggested that we should review the SMI in consultation with suppliers. This review should include a transparent analysis of the SMI model and move away from focusing on dual-fuel customers. Another supplier argued that actions to improve consumer confidence should centre on improving the ability to trade in wholesale markets and securing more robust and factually correct communication about the electricity and gas markets. This would involve us introducing new requirements for all licensees.

One consumer group argued that the scope of Ofgem's proposed transparency work should be broadened to include whether the information suggests that the markets are delivering for consumers. Another group made several suggestions to improve consumer confidence in energy markets, including an investigation into suppliers' treatment of tax and internal loans, addressing the opacity of wholesale market price changes and the hedging strategies of different suppliers, and further breaking down costs in the SMI.

Like many of the other respondents, Energy UK commented that the contribution of each cost component to price increases should be clearly explained to consumers. Another respondent also commented that certain components of the gas and electricity markets are outside the control of energy companies and Ofgem, and when these move in directions that are negative for consumers, this should be communicated better and quicker. Another respondent suggested that we should work with the industry to develop a consistent framework to assess energy companies' profits. One small supplier suggested that an agreed reference price for measuring wholesale price movements would help achieve consistency and comparability.

The Office of Gas and Electricity Markets
9 Millbank London SW1P 3GE **Tel** 020 7901 7000 **Fax** 020 7901 7066 **www.ofgem.gov.uk**