ecotricity

Diego Villalobos
Energy Market Monitoring and Analysis
Ofgem
9 Millbank
London, SW1P 3GE

Ecotricity Group Ltd
Unicorn House
Russell Street
Stroud
GL5 3AX

4th December 2013
Ecotricity Reference No.: 427
holly.tomlinson@ecotricity.co.uk
01453 769301

The Renewable Energy Company Ltd (Ecotricity)
Response to Improving the Transparency of Energy Company Profits

Introduction

Ecotricity is a renewable energy generator and supplier with almost 80,000 customers and 61MW of renewable generation across the UK. As a small independent participant in the energy market, we are concerned about the effects that the lack of transparency employed by the Big Six energy companies has on competition. Equally, we think that the recent price rises announced by these companies; and the lively debate that they have stirred; demonstrate that these issues can have a significant impact on influencing consumer confidence in the market.

We believe that the current arrangements for requiring energy companies to report on their financial performance falls short of meeting Ofgem's objectives in relation to market transparency. There is a strong case for strengthening these arrangements through, for example, mandating yearly financial audits and requesting increased visibility of trading activities.

We set out our answers to the consultation questions below.

1) Would a full financial audit provide greater reassurance about the robustness of the Statements? How much would these audits cost?

We believe a full financial audit would help improve the robustness of the Statements. This would provide a greater level of assurance and understanding in relation to how the information relates back to the company's underlying financial performance. We do not believe that the current approach to simply have the statements reviewed meets these objectives. Although we realise this process would be expensive, we strongly believe it is necessary; and that the benefits it would bring by increasing trust and engagement in the market would outweigh these costs.

Moreover, we believe that an independent audit would need to go beyond UK accounts and provide a clear picture of how revenues and profits are moved around the various branches of multinational energy companies. With four out of the Big Six energy companies being foreign owned, this approach would provide British consumers and other stakeholders with the increased confidence that is needed. The Energy and Climate Change Committee (ECCC)'s July Report on *Energy Prices, Profits and Poverty* ('ECCC's report') highlighted this as a relevant issue. In one of the Big Six's own words, the complex nature of multinational companies' structure makes it difficult and misleading to draw correlations between energy prices and company profits. This should not be the case, and stakeholders should be able to understand these links. Indeed, a full, company-wide financial audit would be the most robust and transparent means of achieving this.

Finally, we strongly recommend that these audits be carried out by individuals or organisations with suitable expertise as we envisage the process being highly complex.

2) Do you have further information on the appropriateness of the companies' transfer pricing policies beyond BDO's detailed findings? Is there more that could be done to provide reassurance in this area?

We encourage Ofgem to take forward the recommendation put forward by BDO and reiterated by ECCC: to carry out an assessment of energy companies' transfer pricing policies. There is a need for more transparency around the processes and methodologies employed by vertically integrated energy companies in relation to these activities. This increased visibility is crucial as it can provide a clear picture of how profits are moved between their generation, trading and supply arms; and whether this is done in a way which is fair for the customer and enables competition.

We note that, the ECCC's report saw representatives of the Big Six energy companies describe their trading activities as a process whereby the generation arm simply sells energy into the market; whilst the supply business buys from this market; and therefore this type of trading is done at the prevailing market prices. However, we would question the validity of these claims given the widely acknowledged low level of liquidity in the energy market; and the resulting lack of robust market prices.

Unicorn House Russell Street Stroud Gloucestershire GL5 3AX
tel 01453 756111 fax 01453 756222 info@ecotricity.co.uk www.ecotricity.co.uk
The Renewable Energy Company Limited - Axiom House Station Road Stroud GL5 3AP - Registered in Cardiff No: 3043412

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?

We agree with BDO's and ECCC's recommendation to require energy companies to report on their trading activities. Companies are likely to have detailed information about their trading function and disclosing this would provide a clearer picture of their overall financial performance. For instance, information about volume and price of both internal and external trades would be beneficial. Crucially, this will allow stakeholders to determine whether reported profits and losses are accurate; and price changes justified. We believe this level of transparency would provide clear benefits, which would outweigh the costs involved in producing the necessary information.

With regard to distinguishing between hedging and speculative trading activities, we recognise that there are complexities around this. This is reflected in the existing uncertainties surrounding the European Market Infrastructure Regulation (EMIR) that mandates the reporting of speculative trades. Nevertheless, improving the transparency of the statements could act as a driver for establishing a clearer framework on how this should be approached and Ofgem's guidance on this would be most welcomed. In addition, any emerging methodologies used in the context of EMIR; and the work being carried out to clarify what is needed to define and prove hedging activities; should act as guidance for the purposes of the Statements.

4) Do you agree with the proposal of reducing the deadline for companies to compile and publish their Statements from 6 to 4 months? What are the costs and benefits of doing so?

We are agnostic in relation to the benefits that this proposal would bring. We believe it would be more valuable to request SSE to align its reporting year with the other five large energy companies; as this would make the Statements more easily comparable.

5) Do you consider that there is merit in calculating Return on Capital Employed (ROCE) for the generation businesses of the Big 6, but not for their supply business? Are there any specific issues with how ROCE should be calculated for generation?

We agree that calculating ROCE for the supply business would be of little value. However, we are also unsure about the value ROCE calculation will bring in terms of the generation business. This is because ROCE calculations can be very subjective, and can mask a number of business assumptions made. For instance, a reporting company can spread costs and profits relatively arbitrarily over the various elements of a project or site by concealing profits in labour charges or legal and administration costs. Each of the Big Six may represent ROCE quite differently, adding further to the confusion around the Statements.

ecotricity

6) Do you have any suggestions for improvements to the format and content of Ofgem's annual Summary Document on the Statements? What more could the companies do to improve the presentation of their Statements?

We do not. We welcome the publication of a brief factsheet along Ofgem's summary, which allows for a quick comparison between the reporting companies.

7) How else could Ofgem or the energy companies themselves improve confidence in the energy markets?

An agreed reference price for measuring wholesale price movements is fundamental in achieving consistency and comparability across the market. Given the large number of products being traded on the energy market, the Big Six can quote different products when assessing the impact of wholesale price movements on their company pricing strategies. We believe that average spot prices for the last year would be a relevant measure for quoting actual prices; whilst one year baseload would be best suited for forward prices.

We acknowledge the argument that different hedging strategies may lead to different wholesale price values. Nevertheless, the resulting lack of a robust reference price remains detrimental to the market; and conflicts with the Ofgem's liquidity project which seeks to address this very issue. In addition, it hinders comparability and makes it difficult to assess the fairness of the Big Six's pricing decisions; and the contribution of wholesale prices to customer energy bills.

Conclusion

We believe there is a strong case for reconsidering the level of transparency employed by large energy companies when reporting on profits. The recent round of price increases ahead of winter demonstrates the need to properly understand what drives these changes; and whether they are driven by real market conditions, or by the desire to increase company profits. We believe Ofgem should implement the recommendations put forward by BDO and ECCC, in particular in relation to financial audits and reporting of trading activities. These changes can provide a clearer picture of how revenues, costs and profits are calculated; and allow for links to be made between energy companies' financial performance and consumer's energy bills.

Ecotricity welcomes the opportunity to respond and hope you take our comments on board. We also welcome any further contact in response to this submission. Please contact Holly Tomlinson on 01453 769301 or holly.tomlinson@ecotricity.co.uk.

Yours sincerely

Holly Tomlinson
Head of Regulation, Compliance & Projects (Acting)

Unicorn House Russell Street Stroud Gloucestershire GL5 3AX
tel 01453 756111 fax 01453 756222 info@ecotricity.co.uk www.ecotricity.co.uk