



**E.ON's response to Ofgem's October 2014 consultation
Rebuilding consumer confidence: Actions to improve the transparency of energy
company profits**

Ofgem's consultation "Rebuilding consumer confidence: Actions to improve the transparency of energy company profits" ("Ofgem's Consultation") provides an ideal opportunity to build on the findings of BDO's report "Improving Transparency of Energy Company Profits Review of Big Six Transfer Pricing policies October 2012" ("BDO's Report"). E.ON therefore welcomes the consultation as a means of addressing the known issues with the Standard Generation and Supply Licence Conditions "Financial Information Reporting" ("the Licence Conditions"). Our hope is that through Ofgem's Consultation the known issues with the Licence Conditions are addressed, so that their requirements can better contribute to the continued development of competition in electricity and gas for the benefit of customers.

BDO's Report confirmed that the transfer pricing arrangements of the sample group of generation and supply licensees, which BDO examined, operate in accordance with recognised standards in the UK. Such findings show that a regulatory intervention by the Authority, through introducing additional transfer pricing regulations for generation and supply licensees, with the inherent risks of such intervention, is not required.

For some time we have had concerns that the Licence Conditions are not clear on their purpose, as to their requirements, the aim of the requirements and in the use of terminology.

Within Ofgem's Consultation, Ofgem has helpfully explained that;

"The format of the statements is primarily aimed at market participants, particularly smaller suppliers, and potential new entrants. However, the information they contain is important for all of our stakeholders."¹

Based on the clarity provided, first by BDO's Report, the conclusion from which is that there should be no regulatory intervention to introduce additional transfer pricing regulations for generation and supply licensees, and by Ofgem as to the target audience of the statements within the Licence Conditions, below we answer Ofgem's questions, provide suggested wording to help improve the revising the Licence Conditions and also provide suggestions for enhancing the Licence Conditions' Guidelines. In doing this our hope is to secure revisions to the Licence Conditions and the Guidelines that:

- better support smaller suppliers and potential new entrants;
- provide more consistency between Consolidated Segmental Reports of corporate groups;
- provide greater clarity of the requirements placed on licensees; and
- most importantly, within the Licence Conditions' limits, support greater competition in electricity generation and electricity and gas supply to the benefit of end customers.

¹ Ofgem's Consultation Rebuilding consumer confidence: Actions to improve the transparency of energy company profits, 10 October 2014 paragraph 2.9.



Ofgem's Questions

Question 1: Do you agree with the proposal to tighten the scrutiny of companies' transfer pricing policies?

BDO's Report has shown that a regulatory intervention by the Authority, with the inherent risks of such intervention, to introduce additional transfer pricing regulations for generation and supply licensees is not required. We therefore believe that there should be no tightening of the scrutiny of companies' transfer pricing policies through the Licence Conditions.

This year, Ofgem commissioned BDO to conduct an independent assessment of the transfer pricing policies used by the Relevant Licensees. This built on their previous 2012 review, which also covered transfer pricing, among other things. From BDO's Report Ofgem has concluded that;

"The review found the large energy companies' transfer pricing policies to be appropriate. This gives us even greater assurance that the statements present an accurate picture of generation and supply profitability."²

"It confirmed that the large energy companies, like any other business with internal transactions at different segments of the value chain, are constrained by transfer pricing rules. The use of transfer pricing is widespread in the economy, and is governed by an established set of legislation, guidelines and best practice.

Different jurisdictions implement and give force to transfer pricing rules through tax legislation. In the UK, the relevant legislation is the Taxation (International and Other Provisions) Act 2010, and HM Revenue & Customs is the tax authority responsible for enforcing it.

The key finding is that the business models used by the large energy companies, and their current transfer pricing policies, reflect the arm's length standard. This means that they adhere to the key requirement of transfer pricing rules.

Furthermore, there appears to be no material tax, commercial or managerial incentive to shift profit from reported to unreported segments through transfer pricing.

Therefore, we are more confident that the profits companies declare are the ones they actually make, from their activities in generation and supply, and there is no undue allocation of profits into companies' trading arms. As a result, the statements present an accurate picture of segmental profitability."³

Such conclusions do not present any suggestion that there is a case for regulatory intervention, through tightening the scrutiny of companies' transfer pricing policies, but rather find that there is not an issue with Relevant Licensee's transfer pricing arrangements.

² Ofgem's Consultation Rebuilding consumer confidence: Actions to improve the transparency of energy company profits, 10 October 2014 paragraph 3.12.

³ Ofgem's Consultation Rebuilding consumer confidence: Actions to improve the transparency of energy company profits, 10 October 2014 paragraphs 3.13 to 3.17.



We recognise that the report highlighted the importance of keeping transfer pricing policies under review as the market, and businesses themselves, change. We agree with this, but it is for the companies to do this, as part of operating transfer pricing compliantly within the normal constraints of the rules. As part of this, it is also for the companies to decide if they should have transfer pricing-specific internal audit procedures, not the Authority.

The actual proposed requirements for the Licence Conditions, in relation to transfer pricing, amount to a significant regulatory intervention of introducing the regulation of Licensees' transfer pricing arrangements and thus the way they manage their companies. The proposals also introduce increased regulatory risk, with the risk of fines if companies fail to:

1. ensure the transfer pricing methodology is appropriate and up to date, where "appropriate and up to date" is not defined;
2. keep transfer pricing policies under review, where "keep under review" is not defined;
3. ensure that the supporting information that supports the transfer pricing policies remains appropriate and up to date, where what constitutes "appropriate supporting information and pricing policies remaining appropriate and up to date" is not defined;
4. include transfer pricing policies and procedures in their internal audit process, even if the company believes such internal audit processes are not required;
5. notify the Authority as soon as reasonably practicable of any changes to transfer pricing policies, despite no justification having been given by Ofgem as to why all changes have to be notified as soon as reasonably practicable; and
6. notify the Authority as soon as reasonably practicable if the Relevant Licensee's transfer pricing is the subject of an inquiry by HM Revenue & Customs, despite such inquiries being on years where the Consolidated Segmental Report has already been published, no justification having been given by Ofgem as to why such notification has to be given and no assurance that Ofgem would treat such notification as confidential.

Therefore, the Licence Condition's requirement needs to be limited to;

"That the Relevant Licensee must include in every such statement an explanation of:

1. *how it defines the terms revenues, costs and profits; and*
2. *its transfer pricing methodology and how this relates to the revenues, costs and profits information published."*

We are aware that the current licence condition also includes the requirement:

"That the Relevant Licensee must include in every such statement an explanation of where individual business functions are captured in the Consolidated Segmental Statement, as specified by Appendix 2 of the Guidelines."

As we have pointed out before, the purpose of the table Appendix 2 of the Guidelines is not clear, is confusing for those preparing it and risks misinforming the reader. The



opportunity should now be taken to provide a more robust Consolidated Segmental Report by taking this particular requirement out of the Licence Condition.

A further point on having a regulatory intervention to tighten the scrutiny of companies' transfer pricing policies is that, in Ofgem's Consultation, Ofgem has not shown any cost benefit analysis for introducing further regulatory requirements and costs to the industry, and therefore customers, for providing further scrutiny.

In conclusion, given BDO's Report's findings, while Ofgem has clearly addressed;

"public concern that, even after successive rounds of improvements to the statements, the companies could use their transfer pricing policies to unduly influence the profit figures they report for their supply and generation businesses"⁴,

Ofgem has also presented clear evidence as to why incurring further cost, though tighten scrutiny of companies' transfer pricing policies, is not necessary.

Question 2: Do you agree with the proposed audit requirement? Do you have any views on the detail of the requirement?

The Consolidated Segmental Reports currently demonstrate adequate reassurance through presenting reconciliations of the Consolidated Segmental Statements to published audited accounts. We question if there is sufficient benefit to customers from the Consolidated Segmental Reports, and the Consolidated Segmental Statements within them, being subject an audit requirement and the additional cost that would impose.

We note that based on the evidence it has, Ofgem believes;

"an audit opinion costs the companies between £30,000 and £150,000 per company per year, depending on individual company circumstances."⁵

We believe that the cost of securing an audit opinion, rather than commissioning external auditors to perform a detailed series of checks on the statements, as used for the 2013 Consolidated Segmental Reports, will be much greater than the range of £30,000 to £150,000. We suggest that the basis for Ofgem's range of £30,000 and £150,000 is for commissioning external auditors to perform a detailed series of checks on the Consolidated Segmental Statements within the Consolidated Segmental Reports. Ofgem needs to publish a cost benefit analysis for customers to justify the additional cost of moving from commissioning external auditors to perform a detailed series of checks on the statements, to securing an audit opinion.

Ofgem's Consultation states that;

"Companies will need to commission an external auditor to provide an audit opinion that the statements have been prepared, in all material respects, in accordance with the licence condition and associated guidelines (we have published drafts of

⁴ Ofgem's Consultation Rebuilding consumer confidence: Actions to improve the transparency of energy company profits, 10 October 2014 paragraph 3.9.

⁵ Ofgem's Consultation Rebuilding consumer confidence: Actions to improve the transparency of energy company profits, 10 October 2014 paragraph 3.29.



the proposed amended licence condition and guidelines in the appendices). The audits must conform to International Financial Reporting Standards (IFRS).⁶

Ofgem needs to be clearer as to what it means by “statement”. Is it only the Consolidated Segmental Statement, i.e. just Annex 1 in the Guidelines, or the whole of the Consolidated Segmental Report?

We believe that the audits should conform to “International Standards on Auditing (UK and Ireland)”, not to International Financial Reporting Standards (IFRS). Therefore the requirement should be to conform to International Standards on Auditing (UK and Ireland).

We note that Ofgem is proposing a Licence Condition requirement for the licensee to deliver the audit and publish the Consolidated Segmental Statement within four months after the financial year closes. Four months is very tight for a licence requirement. At four months there is the real risk of the Consolidated Segmental Statement having to be published before the statutory accounts have been published. While we are comfortable to have a licence requirement to use best endeavours to publish the Consolidated Segmental Report within four months after the Relevant Licensees’ financial years have closed, the firm licence requirement end date for publishing the Consolidated Segmental Statement must remain at six months. Even at six months this deadline is still three months shorter than the statutory nine months for filing and publishing company accounts.

Question 3: Do you agree that the proposed change to the reconciliation requirement?

The presence of an audit opinion provides the reassurance of the Consolidated Segmental Statement’s alignment with published audited accounts, which is what the reconciliation currently provides. Therefore, to avoid duplication of effort, if audit opinions are to be introduced, then the current requirements for reconciliations should be withdrawn. This would mean the removal from the Licence Conditions of the requirement for an explanation of:

- 1. how the revenues and profits can be reconciled with its UK statutory accounts; or*
- 2. if UK statutory accounts are not prepared or published, how the revenues and profits can be reconciled with audited figures (prepared under International Financial Reporting Standards) published in Group accounts.*

To have a Licence Condition requirement to provide both audit opinions and reconciliations, Ofgem would need to provide a cost benefit analysis as to the benefit to customers from the extra cost incurred by requiring such duplication.

⁶ Ofgem’s Consultation Rebuilding consumer confidence: Actions to improve the transparency of energy company profits, 10 October 2014 paragraph 3.32.



Question 4: Do you think the obligation to produce Consolidated Segmental Statements should continue to be targeted to large vertically integrated companies? If not, who do you think the obligation should apply to and why?

If Ofgem believes there is a net value to customers in licensees incurring the cost of preparing Consolidated Segmental Reports containing Consolidated Segmental Statements, then all generation, electricity supply and gas supply licensees should prepare and publish such reports.

Ofgem states that;

*"Transparency of energy company profitability matters. It is important for consumer confidence, and for new firms thinking to enter the energy market. We recognise that transparency offers a route to strengthened accountability and provides important regulatory benefits."*⁷

Clearly the most relevant Consolidated Segmental Reports for a firm thinking to entering the energy market will be of those licensees who have themselves recently entered the energy market and therefore are most similar to the potential new entrant's likely position. The least useful Consolidated Segmental Reports, for a firm thinking of entering the energy market, will be of those of the large licensees. The large licensees' performances are likely to be significantly different to those of a new entrant, as the large licensees have benefits from economies of scale, which are not initially accessible to a small player, but are subject to regulatory costs that are not imposed on small players.

Large volumes are now being supplied by some licensees with less than 250,000 customers and also generated by some licensees who do not supply more than 250,000 customers. For Ofgem to have robust data on company profitability, which helps it and others to monitor and assess how well the market is working for consumers, it needs complete data. Without all licensees providing Consolidated Segmental Reports, the data is incomplete and less robust than it could have been.

To provide better information for firms thinking of entering the energy market and more robust information for Ofgem and others to monitor and assess how well the market is working for consumers, the definition of a Relevant Licensee should just be;

"means a holder of an electricity generation licence granted or treated as granted under section 6(1)(a) of the Electricity Act, the holder of an electricity supply licence granted or treated as granted under section 6(1)(d) of the Electricity Act, or the holder of an gas supply licence granted or treated as granted under section 7A(1) of the Gas Act."

⁷ Ofgem's Consultation Rebuilding consumer confidence: Actions to improve the transparency of energy company profits, 10 October 2014 paragraph 1.1.



Question 5: Do you agree with the proposed cost categories, and the detailed allocation of cost items between these categories? Do you agree with the additional financial and non-financial information to be disclosed?

We support the proposed cost categories for the Consolidated Segmental Statement (Annex 1 of the Guidelines). We do however believe that the proposed detailed allocation of cost items between these categories would not present as accurate picture as could be achieved, with some different allocations. We disagree with the additional financial information to be disclosed, but are comfortable with non-financial information, in the form of customer account numbers, forming a row in the Consolidated Segmental Statement.

Having the proposed cost categories, particularly "Environmental and social obligation costs" will help to give transparency to how these costs are contributing to customers' bills, and is therefore welcome. Also, the introduction of "Adjusted EBITDA", "Adjusted EBIT" and "Exceptional items" is welcome and again should provide greater transparency.

The proposed changes to the ordering of the Consolidated Segmental Statement's rows will make the table difficult for the reader to follow. In support of wider readership understanding, the more logical order, which is currently used, should be retained. Our suggested form of the Consolidated Segmental Statement is set out in Table 1 below.

It is not logical, and therefore unhelpful to the reader, to allocate tax and interest to the different segments of the Consolidated Segmental Statement. Using E.ON UK plc. as an example, its UK tax liabilities are agreed annually with HMRC based on its UK GAAP statutory accounts, rather than reported IFRS values. These computations are never agreed within the timeframe of four months as proposed by OFGEM. It would be meaningless to allocate part of the tax charge for E.ON UK plc. to the Generation activities contained within it, given the other activities that are also conducted within it. The only other approach would be to apply a standard rate of Corporation Tax to the EBIT total in the Consolidated Segmental Statement, but that would also be meaningless and fundamentally wrong, as a company's tax liability is not directly derived from its accounting EBIT number. Therefore to retain robustness of the Consolidated Segmental Statement and avoid misleading the reader, we would argue that tax should not form a row of the Consolidated Segmental Statement.

For net interest costs, as with tax, the same argument applies, in that a company's finance costs will be driven by the financing structure of its balance sheet, which will have no relevance to its operating results, and may contain inter-group funding at zero effective rates. To make such arbitrary allocations would devalue the robustness of both the Consolidated Segmental Statements themselves and any comparison between statements of different corporate groups. Therefore to retain robustness of the Consolidated Segmental Statement and avoid misleading the reader, we would argue that interest should not form a row of the Consolidated Segmental Statement.

Balancing costs are incurred when purchasing energy through the balancing mechanism. This makes them a direct fuel cost and as such should be included in "Direct fuel costs"; they should not be part of "Other direct costs".



The Guidelines are not clear where derivative hedging instruments used for managing energy costs, such as weather hedges, should be reported. We believe that such non-physical hedges are a direct fuel cost and therefore the Guidelines need to be clearer that they should be reported as "Direct fuel costs".

We support allocating Carbon Price Floor costs for fuel delivered to generation plant to "Environmental and social obligation costs". However, the Guidelines are not clear that "Direct fuel costs", for Generation, should not include Carbon Price Floor costs.

The Guidelines suggest that all Contracts for Difference (CfD) should be classed in "Environmental and social obligation costs". We are surprised at this, as we would have expected only CfDs associated with support for renewable energy and possibly nuclear to be included. The Guidelines need to have a definitive list of which CfDs should be included in the "Environmental and social obligation costs".

We would have expected to see landfill tax costs for generation being included in the "Environmental and social obligation costs". To just limit Generation to emission costs for "Environmental and social obligation costs" will not give a complete picture of the environmental and social obligation costs the Generation businesses are incurring.

With the proposed splitting of Generation into "Conventional" and "Renewable" in the Consolidated Segmental Statement, if consistency between statements of different corporate groups is to be achieved, the Guidelines need to set out clearly which forms of generation should fall into each of the two categories.

Question 6: Do you agree with our proposal to require further breakdown of environmental and social obligation costs from the 2015 statements onwards?

We do agree with Ofgem's proposal to require further breakdown of environmental and social obligation costs. However, we ask that it is for the 2014 statements onwards. If a breakdown of environmental and social obligation costs in the Consolidated Segmental Statement is believed to provide a net benefit to customers, then a delay until 2016 to start with the 2015 statements should be avoided.

In our answer to Question 5 above, we have explained how some changes to the detail allocations proposed for the "Environmental and social obligation costs" could provide a more accurate picture for the reader.

Question 7: There is a potential tension between transparency and competition. Do the benefits in improved transparency this package aims to deliver outweigh the risks of an adverse impact on competition?

We believe that supporting the continued development of competition is the best way of supporting the end customer. Therefore, any regulatory intervention, including increasing levels of transparency, must show a net benefit to competition and thus customers, having first taken into account the risks of unintended consequences.



The risk to competition, particularly in supply, was a concern that E.ON raised with Ofgem when the idea of consolidated segmental reports was first floated. In addition to considering if the benefits, in improved transparency this package aims to deliver, outweigh the risks of an adverse impact on competition, Ofgem should also be considering if the identified benefits in improved transparency that the current Consolidated Segmental Reports deliver, are already being outweighed by any unintended adverse effects they may be having on competition.

Given there cannot be a clear level of transparency beyond which the adverse effect on competition is greater than the benefit secured from transparency, Ofgem needs to be cautious when encouraging more transparency. It also needs to be very clear that the publishing of information in a form required to comply with the Licence Conditions does not constitute a breach of competition law.

The licence conditions

Below we set out proposals for a revised Licence Condition 19A, taking into account our answers to Ofgem's questions above. This proposal assumes that audit opinions will be required. The aim of this proposal is to secure a revised licence condition that can better support smaller suppliers and potential new entrants, provide more consistency between Consolidated Segmental Reports of different corporate groups, provide greater clarity of the requirements placed on licensees and, most importantly, within the Licence Conditions' limits, support greater competition in electricity generation and electricity and gas supply to the benefit of end customers.

Proposed Condition 19A Financial information reporting

19A.1. The Relevant Licensee must secure the preparation and publishing on the Website a Consolidated Segmental Report in respect of information relating to the revenues, costs and profits of its activities in the generation and supply of electricity and the supply of gas to any premises taking account of the Guidelines.

19A.2. Where applicable, the Relevant Licensee must secure the preparation and publishing of the Consolidated Segmental Report referred to in paragraph 19A.1 in conjunction with any Affiliates that are Relevant Licensees.

19A.3. The Relevant Licensee must, in conjunction with any Affiliates that are Relevant Licensees, secure the preparation and publishing of a Consolidated Segmental Report:

- a) as soon as reasonably practicable before four months, but no later than six months, after the end of the Relevant Licensee's financial year; or
- b) no later than a date specified by the Authority, which can be no earlier than six months after the end of the Relevant Licensee's financial year.



19A.4. Subject to complying with this paragraph the Relevant Licensee may, for the purpose of preparing the report pursuant to paragraph 19A.3, secure the preparing and compiling of the information according to the licensee's annual accounting procedures. The Relevant Licensee must secure the inclusion in every such report an explanation of:

- a) how it defines the terms revenues, costs and profits; and
- b) its transfer pricing methodology, how this relates to the revenues, costs and profits information published and of any changes from the methodology described in the previous year.

19A.5. The Relevant Licensee must ensure that the information prepared and made public pursuant to paragraph 19A.3 includes the cost of fuel used to generate electricity and the Relevant Licensees' shares of revenues, costs, profits and volumes of Joint Ventures and Associates that are Relevant Licensees.

19A.6. Subject to complying with Paragraph 19A.5 the Relevant Licensee must ensure that all the information prepared and made public pursuant to paragraph 19A.3 is in all material respects consistent with the information prepared pursuant to paragraph 19A.4 and the information is presented with a clear and full explanation.

19A.9. (a) The Authority shall prepare Guidelines in relation to the requirements of this condition and may modify, in whole or in part, the Guidelines following consultation with the Relevant Licensees.

- (b) The Authority shall modify the definition of Consolidated Segmental Statement as described in Annex 1 of the Guidelines in accordance with section 11A of the Electricity Act and section 23 of the Gas Act.

19A.10. Except and to the extent that the Authority otherwise consents, the Relevant Licensee must secure the inclusion in the Consolidated Segmental Report a report from an Appropriate Auditor that gives an audited opinion as to the extent to which the Relevant Licensees have properly prepared the Consolidated Segmental Report in accordance with this licence condition and the Guidelines.

19A.11. The audited opinion prepared pursuant to paragraph 19A.10 must conform to the International Standards on Auditing (UK and Ireland).

19A.12. For the purposes of this condition:

"Affiliate" means any holding company or subsidiary of a holding company of the Relevant Licensee, in each case within the meaning of sections 1159 and 1160 of the Companies Act 2006.



“Appropriate Auditors” means

- (a) in the case of a licensee which is a company within the meaning of section 1 of the Companies Act 2006, a person appointed as auditor under Chapter 2 of Part 16 of that Act;
- (b) in the case of any other licensee which is required by the law of a country or territory within the European Economic Area to appoint an auditor under provisions analogous to Chapter 2 of Part 16 of the Companies Act 2006, a person so appointed;
- (c) in any other case, a person who is eligible for appointment as a company auditor under sections 1212 and 1216 of the Companies Act 2006, or in relation to auditors appointed for financial years beginning before 6 April 2008, a person who is eligible for appointment as a company auditor under sections 25 and 26 of the Companies Act 1989.

“Associate” means an entity, including an unincorporated entity such as a partnership, over which the Relevant Licensee has significant influence and that is neither a subsidiary nor an interest in a joint venture.

“Consolidated Segmental Report” means a report as described in the Guidelines.

“Consolidated Segmental Statement” means a statement as described in Annex1 of the Guidelines.

“Joint Venture” means a contractual arrangement whereby the Relevant Licensees and one or more parties undertake an economic activity that is subject to joint control.

“Relevant Licensee” means a holder of an electricity generation licence granted or treated as granted under section 6(1)(a) of the Electricity Act, the holder of an electricity supply licence granted or treated as granted under section 6(1)(d) of the Electricity Act, or the holder of an gas supply licence granted or treated as granted under section 7A(1) of the Gas Act.

“Website” means a website controlled and used by the Relevant Licensee or an Affiliate for the purposes of providing information and communication.

The Guidelines

The Guidelines have an essential role in ensuring consistency across the different corporate groups’ Consolidated Segmental Reports and in helping the readers of the reports secure maximum understanding. In support of this and reflecting our suggestions for the Licence Condition, below we set out suggested amendments to the Draft of the proposed amended Guidelines presented in Appendix 3 of Ofgem’s Consultation.



Interpreting the Financial Information

Paragraph 1.5 second sentence – we would suggest this sentence should start as;

"The Relevant Licensee should"

Paragraph 1.7 – we would suggest this paragraph is removed as it is referring to reconciliations, which are not required if an audit opinion is required.

Transfer Pricing Methodology

Paragraph 1.9 first sentence – we would suggest this sentence should be;

"Under paragraph 4(d)/19A.4(d) of the Conditions a clear and full explanation of the Relevant Licensee's and its Affiliates', which are also Relevant Licensees, transfer pricing methodologies for generation and supply should be provided, so as to enable an industry stakeholder to understand as much as can be reasonably expected about the transfer pricing methodology adopted."

These suggested changes are to introduce greater clarity that the only Affiliates, Joint Ventures and Associates to be reported on in the Consolidated Segmental Report are those that are licensees and therefore Relevant Licensees.

Treatment of Joint Ventures and Associates

Paragraph 1.10 first two sentences – we would suggest these two sentences should be;

"Under paragraph 5 of the Conditions the Relevant Licensee must ensure that the information provided in the CSS includes its share of revenues, costs, profits and volumes of any Joint Ventures and Associates that are Relevant Licensees. In preparing the CSS, the Relevant Licensee should account for Joint Ventures and Associates that are Relevant Licensees as follows:"

These suggested changes are to introduce greater clarity that the only Affiliates, Joint Ventures and Associates to be reported on in the Consolidated Segmental Report are those that are Relevant Licensees.

Paragraph 1.12– we would suggest this should be;

"The remainder of the guidelines consist of Annex 1, the Consolidated Segmental Statement."

Here we are suggesting that Annex 2 is removed from the licence condition and the Guidelines. Also, that it is made clearer that the actual Consolidated Segmental Statement is only Annex 1 of the Guidelines.



Annex 1 (the Consolidated Segmental Statement)

To help the reader, it is important that the Consolidated Segmental Statement is set out in a logical sequence of rows. The proposed changes to the ordering of the Consolidated Segmental Statement's rows will make the table difficult for the reader to follow. In support of wider readership understanding, the more logical order that is currently used should be retained. Our suggested form of the Consolidated Segmental Statement is set out in Table 1 below.

Table 1 Proposed Consolidated Segmental Statement Template

Annex 1	Note	Unit	Electricity generation		Aggregate generation business (see Note 13)	Electricity Supply		Gas Supply		Aggregate supply business (see Note 13)
			Conventional	Renewable		Domestic	Non-domestic	Domestic	Non-domestic	
			20xx	20xx	20xx	20xx	20xx	20xx	20xx	20xx
Revenue from sales of electricity and gas	1	£'m	0	0	0	0	0	0	0	0
Other revenue	2	£'m	0	0	0	0	0	0	0	0
Total revenue		£'m	0	0	0	0	0	0	0	0
Direct fuel costs	3	£'m	0	0	0	0	0	0	0	0
Transportation costs	4	£'m	0	0	0	0	0	0	0	0
Environmental and social obligation costs	5	£'m	0	0	0	0	0	0	0	0
Other direct costs	6	£'m	0	0	0	0	0	0	0	0
Indirect costs	7	£'m	0	0	0	0	0	0	0	0
Total operating costs		£'m	0	0	0	0	0	0	0	0
Adjusted EBITDA		£'m	0	0	0	0	0	0	0	0
DA	8	£'m	0	0	0	0	0	0	0	0
Adjusted EBIT		£'m	0	0	0	0	0	0	0	0
Exceptional items	9	£'m	0	0	0	0	0	0	0	0
EBIT	10	£'m	0	0	0	0	0	0	0	0
WACOF/E/G	11	£/MWh p/th	0.00 -	0.00 -	0.00 -	0.00 -	0.00 -	- 0.00	- 0.00	- -
Volume	12	TWh therms (m)	0.0 -	0.0 -	0.0 -	0.0 -	0.0 -	- 0	- 0	- -
Customer accounts	13	Thousands accounts	-	-	-	0	0	0	0	0

Notes (to the Consolidated Segmental Statement)

Direct fuel costs

(Note 3 in the Proposed Consolidated Segmental Statement Template)

We would suggest the first sentence of the first paragraph should be;

"Generation should include the delivered input cost for fuel, irrespective of the business models of the Relevant Licensee or its Affiliates that are Relevant Licensees."

This suggested change is to support greater clarity that the only Affiliates, Joint Ventures and Associates to be reported on in the Consolidated Segmental Report are those that are licensees.



We would suggest the first sentence of the second paragraph should be;

"Supply should include aggregate electricity and gas costs, including the wholesale energy cost, imbalance (i.e. cash out) costs and other shaping costs."

Cash out should be included in direct fuel costs for supply, as it is a legitimate method of procuring energy.

Environmental and social obligation costs

(Note 5 in the Proposed Consolidated Segmental Statement Template)

We would suggest the first sentence of the first paragraph should be;

"Generation should include all emission costs (e.g. EU ETS and CPF) and disposal costs (e.g. landfill tax)."

We would also suggest that greater clarity is required as to which Contracts for Differences (CfD) should be included in Environmental and social obligation costs.

Other direct costs

(Note 6 in the Proposed Consolidated Segmental Statement Template)

We suggest this should be;

"Other direct costs for generation should include market participation costs, including losses, Elexon/Xoserve admin costs. Supply should in addition include, brokers' costs and intermediaries' sales commissions, the energy element of RBD costs, and any 'wider' smart programme costs (e.g. Data Communications Company (DCC)-related costs)."

This removes imbalance costs from other direct costs and places them in Direct fuel costs.

Weighted average cost of fuel/electricity/gas (WACO F/E/G)

(Note 11 in the Proposed Consolidated Segmental Statement Template)

To aid understanding we suggest this should be;

"For generation, WACO F/E/G means the "Direct fuel costs" and "Environmental and social obligation costs" lines added together and divided by the "Volume" line, shown as £/MWh.

For supply, WACO F/E/G means the "Direct fuel costs" line divided by the "Volume" line, shown as £/MWh or p/th."

Volumes

(Note 12 in the Proposed Consolidated Segmental Statement Template)

To aid presentation we would suggest that the volumes of gas are shown as millions of therms, rather than therms.



Annex 2

As we have pointed out before, the purpose of the table in Annex 2 of the Guidelines is not clear, is confusing for those preparing it and risks misinforming the reader. The opportunity should now be taken to provide a more robust Consolidated Segmental Report by taking this particular requirement out of the Licence Condition and the Guidelines.