

Rebuilding consumer confidence: Actions to improve the transparency of energy company profits

Energy UK response

20 October 2014

Introduction

Energy UK is the trade association for the energy industry. We represent over 80 members made up of generators and gas and electricity suppliers of all kinds and sizes as well as other businesses operating in the energy industry. Together our members generate more than 90 per cent of the UK's total electricity output, supplying more than 26 million homes and investing in 2012 more than £11 billion in the British economy.

Energy UK strongly believes in promoting competitive energy markets that produce good outcomes for consumers. In this context, we are committed to working with Government, regulators, consumer groups and our members to develop reforms which enhance consumer trust and effective engagement. At the same time, Energy UK believes in a stable and predictable regulatory regime that fosters innovation, market entry and growth, bringing benefits to consumers and helping provide the certainty that is needed to encourage investment and enhance the competitiveness of the UK economy.

These high-level principles underpin Energy UK's response to Ofgem's consultation on improving the transparency of energy company profits. This is a high-level industry view; Energy UK's members may hold different views on particular issues. We would be happy to discuss any of the points made in further detail with Ofgem or any other interested party if this is considered to be beneficial.

Executive Summary

It is important that customers and stakeholders understand the energy industry and the Consolidated Segmental Statements (CSS) are a useful tool to that end. Energy UK supports the

principle of transparency where it is proportionate and where it allows a wider discussion on the available evidence. The principles of the recent proposals from Ofgem seem appropriate to increase transparency in the market, in particular, Energy UK support the proposal to increase transparency on environmental and social costs as this is having an increasing impact on customer bills.

Given the rigour and reliability of company accounts, the CSS provides a useful tool to examine the energy industry based on facts and evidence.

Energy UK reaffirms its position that the Supply Market Indicators should be abolished as the measures are based on estimates and forecasts which have been proved incorrect and which generate inaccurate media coverage and the misinformation of the public.

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

The report by BDO has found that the six largest energy firms adhere to the rules governing transfer pricing and that none of the policies adopted by the energy companies have a material impact on the CSS. It is also stated that energy firms have limited incentive to carry out unfair transfer pricing policies. We note that HMRC is not in the process of carrying out any enquiries with respect to transfer pricing practices. The challenge now is to ensure all stakeholders recognise this situation and have faith in this conclusion. We encourage Ofgem to affirm this report and its conclusions on any future challenges regarding transfer pricing.

Re-establishing trust in the market is of fundamental importance and Energy UK agrees that there should be sufficient scrutiny to ensure this. Further work to establish trust in companies transfer pricing are supported to this end, whilst ensuring that they are proportionate given the independent research by BDO that found there is no evidence of malpractice, and that energy firms are currently adhering to the rules as recognised by established guidelines, legislation and best practice. The proposals put forward by Ofgem seem appropriate at this stage to ensure all stakeholders should have trust in the market.

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

Energy UK supports the principle of increasing the level of auditor scrutiny to ensure independent checks to ensure trust in the market is supported.

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

Energy UK will not be responding to this question on members behalf, but leave it up to relevant companies to respond.

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?

Energy UK will not be responding to this question on members behalf, but leave it up to relevant companies to respond.

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?

With regards to including customer numbers in a CSS response, Energy UK supports the principle in that it allows greater transparency within the industry and increases the relevance of the CSS to the average customer. This data will allow interested parties to consider the impact of wholesale costs, network charges, policy costs and revenue on a per capita basis. However, there are concerns that this provides too much detail to competitors and could expose firms' business practices. Ofgem should ensure that data is collected / published appropriately and at all times consideration is given as to whether this further data is needed to reach the aims of the CSS without disrupting the market.

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

Energy UK supports the recommendation to further identify the cost impacts of policy on energy firms. As the CSS are intended to increase transparency, there are advantages to displaying more clearly what has become a major contributor to energy bills. Once this data is provided, we encourage Ofgem to review the aggregate costs imposed on customers and ensure that this information is communicated to all stakeholders.

There are potential issues with some costs, such as ECO, where the time period, level of targets and commercial decisions of suppliers' will mean that this is not comparable and should be caveated / explained within the report.

We encourage Ofgem to explore the possibility of delivering amendment earlier than for the 2015 Statements.

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?

Energy UK agrees with Ofgem that there is a potential tension between transparency and competition and supports the current CMA investigation into these issues. Other industries demonstrate the risk outlined and we note the example of the Danish concrete¹ industry, where increased transparency ultimately led to a reduction in competition. This outcome is against the objectives and interests of both Ofgem and Energy UK. Some information for instance may be better withheld by Ofgem rather than published in the public domain. Individual member companies may be better placed to discuss with the regulator the relative impacts of these specific proposals.

¹ Svend Albæk, Peter Møllgaard and Per B. Overgaard, (Dec 1997), "Government-Assisted Oligopoly Coordination? A Concrete Case", The Journal of Industrial Economics. <http://www.jstor.org/stable/2950610>