

To: All holders of an electricity supply licence

NOTICE UNDER SECTION 11A(2) OF THE ELECTRICITY ACT 1989

The Gas and Electricity Markets Authority (the Authority) hereby gives Notice pursuant to section 11A(2) of the Electricity Act 1989 (the Act) as follows:

1. The Authority proposes to modify all Electricity Supply Licences granted or treated as granted under section 6(1)(d) of the Act by amending Standard Condition 19A and Appendices to the Guidelines made under that condition in the manner set out in the Schedule to this Notice.
2. The reason why the Authority proposes to make this licence modification is to secure and enhance the improvements in transparency that have been developed with the large vertically-integrated energy companies over the last year. The modifications will provide greater levels of transparency, mainly on energy company revenues, costs and profits, which should help to improve consumer confidence and provide useful information for potential new entrants. Robust data also helps the Authority monitor and assess how well the market is working for consumers.
3. Further detail on the reasons behind this proposed licence modification can be found in the document 'Actions to improve the transparency of energy company profits', published on 10 October 2014.¹
4. The effect of the proposed licence modification is to ensure that the information in the Consolidated Segmental Statements (CSS) is more robust, useful and accessible for consumers, potential new entrants to the market and all other users. It aims to achieve this by requiring relevant licensees to:
 - a. prepare and publish a CSS as soon as reasonably practicable, and no later than four months after the end of the financial year
 - b. include in every CSS an explanation of how the revenues and profits can be reconciled with UK statutory accounts or Group accounts, where the former are not prepared or published
 - c. ensure that the transfer pricing methodology is appropriate and notify the Authority of any material changes to transfer pricing methodologies
 - d. include in the CSS a report from an Appropriate Auditor that gives an audited opinion as to the extent which the statements have been properly prepared in accordance with the licence condition and the Guidelines, and
 - e. provide a more detailed cost breakdown and include non-financial information that we consider helps to improve transparency on company costs and operation as outlined in the Guidelines.
5. The proposed modification to the definition of 'Relevant Licensee' also has the effect of ensuring that the licence condition only captures holders of supply licences that are part of a vertically-integrated group of companies.
6. A copy of the proposed modification and other documents referred to in this Notice have been published alongside this Notice and are available on the Ofgem website (www.ofgem.gov.uk).

¹ <https://www.ofgem.gov.uk/publications-and-updates/actions-improve-transparency-energy-company-profits-1>

7. Any representations with respect to the proposed licence modifications must be made on or before 12 December 2014 to: Robyn Daniell, Office of Gas and Electricity Markets, 9 Millbank, London, SW1P 3GE or by email to CSS@ofgem.gov.uk
8. All responses will normally be published on Ofgem's website. However, if respondents do not wish their response to be made public then they should clearly mark their response as not for publication. Ofgem prefers to receive responses in an electronic form so they can be placed easily on the Ofgem website.
9. If the Authority decides to make the proposed modification it will take effect not less than 56 days after the decision is published.

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Neil Barnes – Associate Partner, Retail Markets
For and on behalf of the Gas and Electricity Markets Authority
14 November 2014

Schedule

Condition 19A. Financial information reporting

- 19A.1. The Relevant Licensee must prepare and publish on its Website a Consolidated Segmental Statement 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 prepare and publish the Consolidated Segmental Statement referred to in paragraph 19A.1 in conjunction with any Affiliates.
- 19A.3. The Relevant Licensee must, in conjunction with any Affiliates, prepare and publish a Consolidated Segmental Statement:
- (a) as soon as reasonably practicable and no later than four 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 four 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 statement pursuant to paragraph 19A.3, prepare and compile the information according to the licensee's annual accounting procedures. The Relevant Licensee must include in every such statement an explanation of:
- (a) how it defines the terms revenues, costs and profits;
 - (b) how the revenues and profits can be reconciled with audited figures (prepared under International Financial Reporting Standards) published in Group accounts; or its UK statutory accounts;
 - (c) if Group accounts are not prepared or published, how the revenues, costs and profits can be reconciled with its UK statutory accounts; or, 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;
 - (d) its transfer pricing methodology and how this relates to the revenues, costs and profits information published; and
 - (e) where individual business functions are captured in the Consolidated Segmental Statement, as specified by Appendix 2 of the Guidelines.
- 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 its share of revenues, costs, profits and volumes of Joint Ventures and Associates.

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.7. The Relevant Licensee must, for the purposes of ensuring the transfer pricing methodology is appropriate and up to date:

(a) keep transfer pricing policies under review;

(b) ensure that the supporting information that supports the transfer pricing policies remains appropriate and up to date; and

(c) include transfer pricing policies and procedures in any appropriate annual audit.

19A.8. The Relevant Licensee must notify the Authority as soon as reasonably practicable of any material changes to transfer pricing policies.

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 Appendices 1 and 2 of the Guidelines in accordance with section 11A of the Act.

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

19A.11. 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 Statement**” means a statement as described in Appendices 1 and 2 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 the holder of an electricity supply licence granted or treated as granted under section 6(1)(d) of the Act if:

- (a) it or any of its Affiliates:
 - i. jointly supply electricity to more than 250,000 domestic customers; or
 - ii. jointly supply gas to more than 250,000 domestic customers; or
 - iii. jointly supply electricity to more than 250,000 non-domestic customers; or
 - iv. jointly supply gas to more than 250,000 non-domestic customers, respectively; and

- (b) it or any of its Affiliates is a holder of an electricity generation licence granted or treated as granted under section 6(1)(a) of the Act.

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

Guidelines

1.1 These guidelines relate to Standard Condition 19A of the Gas and Electricity Supply Licences and Standard Condition 16B of the Electricity Generation Licences (collectively referred to as 'the Conditions' for the purposes of these guidelines).

1.2. The guidelines have been prepared by the Office of Gas and Electricity Markets ('Ofgem') pursuant to paragraph 7/19A.9 of the Conditions (throughout this document the first paragraph number relates to the generation licence and the second relates to the supply licences).

Scope and Application of the Licence Condition

1.3. The Conditions only apply to those companies that are "Relevant Licensees" as defined in the Conditions. Where information required under the Conditions is held by an Affiliate the Relevant Licensee is required to obtain and publish the information. Appendix 1 provides further information on the scope of information required.

Financial Year

1.4. Under paragraph 3/19A.3 of the Condition, the financial year should be taken to mean the Relevant Licensee's current financial reporting year. For the avoidance of doubt this may differ between companies.

Interpreting the Financial Information

1.5. Under paragraph 4(a)/19A.4(a) of the Conditions a clear and full explanation of how the Relevant Licensee defines the terms revenues, costs and profits should be set out, so as to enable understanding of what the information published pursuant to paragraph 1/19A.1 does and does not represent. The licensee should:

- describe how it defines domestic and non-domestic supply business segments;
- describe how it defines conventional and renewable generation business segments;
- describe the methodology or methodologies used to allocate marketing, shared and corporate costs across generation, supply and other activities;
- report all the material individual cost items included in each of the cost categories in the template in appendix 1 and describe how each of these costs, such as Feed in Tariff costs and Renewable Obligation costs, are allocated across the segments.

Where issues pertaining to the data are unexpected or unusually complex these issues should be set out in full.

1.6 *Exceptional items*: we only expect the revenues, costs and profits to reflect company activities relating to that year of operations. Examples of financial items we would not expect to be included are, but are not limited to, mark to market adjustments, profit or losses on disposal, restructuring costs that have been identified as such in the Group's annual report and impairment charges. Where the

Relevant Licensee has included any such items for the purpose of reconciliation, or otherwise, a clear and full explanation must be provided.

1.7. **Reconciliation:** under paragraphs 4(b) & (c)/19A.4(b) & (c) and 6/19A.6 of the Conditions a clear and full explanation of the reconciliation should be provided, so as to enable an individual to understand as much as can be reasonably expected as to how revenues and profits reconcile to the Relevant Licensee's audited figures. ~~For the avoidance of doubt, the companies that published Consolidated Segmental Statements in 2009 and 2010 would fall under paragraph 4 (b)/ 19A.4(b) and not 4(c) / 19A.4 (c).~~ If a licensee separately identifies a column which it attributes to trading or portfolio optimisation, the explanatory notes should contain a detailed description of its significant component parts. An explanation of any reconciliation would be expected to take the form of a numerical table and a written statement.

1.8. Paragraph 6/19A.6 of the Conditions provide for the information required pursuant to paragraph 1/19A.1 to be presented with a clear and full explanation. This clear and full explanation should be sufficient to inform an industry stakeholder of the financial data's proper interpretation and context (eg any structural constraints the business operates within, such as tolling agreements).

Transfer Pricing Methodology

1.9. Under paragraph 4(d)/19A.4(d) of the Conditions a clear and full explanation of the Relevant Licensee's and Affiliates' transfer pricing methodology 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.

The transfer pricing methodology used to calculate weighted average cost of electricity (WACOE) and weighted average cost of gas (WACOG) should reflect how each licensee actually acquires energy. This explanation should include:

- the allocation of financial risk between group companies and / or business segments (eg treatment of internal tolling agreements or capability/capacity payments);
- ~~how the methodology related to open market prices and/or a cost plus methodology.~~
- ~~how the methodology relates to an arm's length measure, for example open market prices and/or comparable third party costs such as broker fees; and~~
- the treatment of allocated costs and corporate charges (eg head office charges).

Treatment of Joint Ventures and Associates

1.10. 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 Venture and Associates. In preparing the CSS, the Relevant Licensee should account for Joint Ventures and Associates (which hold a generation or supply licence relating to the generation or supply of gas or electricity in the UK) as follows:

- the share of revenues of Joint Ventures and Associates to be included within revenue;
- the share of the profit before tax of Joint Ventures and Associates to be included with Earnings Before Interest and Taxes (EBIT) and Earnings Before Interest, Taxes, Depreciation and Amortisation (EBITDA); and
- the share of the generation volumes of Joint Ventures and Associates to be included within the generation volumes.

1.11. For each of the items, the Relevant Licensee's share of the income and expenses of a Joint Venture or Associate should be combined line by line with similar items in the Relevant Licensee's CSS or reported as separate line items in the Relevant Licensee's CSS.

1.12. The remainder of the guidelines consist of Appendix 1 and 2.

Appendix 1

	Unit ¹	Electricity generation		Aggregate generation business ¹⁴	Electricity supply		Gas supply		Aggregate supply business ¹⁴
		Conventional	Renewable		Domestic	Non-domestic	Domestic	Non-domestic	
		20xx	20xx		20xx	20xx	20xx	20xx	
Total revenue	£M	£0	£0	£0	£0	£0	£0	£0	£0
Revenue from sales of electricity and gas ²	£M	£0	£0	£0	£0	£0	£0	£0	£0
Other revenue ³	£M	£0	£0	£0	£0	£0	£0	£0	£0
Total operating costs	£M	£0	£0	£0	£0	£0	£0	£0	£0
Direct fuel costs ⁴	£M	£0	£0	£0	£0	£0	£0	£0	£0
Transportation costs ⁵	£M	£0	£0	£0	£0	£0	£0	£0	£0
Env. & social obligation costs ⁶	£M	£0	£0	£0	£0	£0	£0	£0	£0
Other direct costs ⁷		£0	£0	£0					
Indirect costs ⁸	£M	£0	£0	£0	£0	£0	£0	£0	£0
Adjusted EBITDA⁹	£M	£0	£0	£0	£0	£0	£0	£0	£0
DA	£M	£0	£0	£0	£0	£0	£0	£0	£0
Adjusted EBIT	£M	£0	£0	£0	£0	£0	£0	£0	£0
Exceptional items	£M	£0	£0	£0	£0	£0	£0	£0	£0
EBIT	£M	£0	£0	£0	£0	£0	£0	£0	£0
Volumes									
Purchased volume ¹⁰	TWh, therms	NA	NA	NA	-	-	-	-	NA
Supplied volume ¹¹	TWh, therms	-	-	-	-	-	-	-	NA
WACO F/E/G ¹²	£/MWh, p/th	0	0	0	0	0	0	0	NA
Customer numbers ¹³	000s	NA	NA	NA	'000	'000	'000	'000	'000

Notes

Presentation of information

1. The financial data should be provided to the nearest £million to one decimal place, WACOE and WACOF to the nearest pence in £/MWh, WACOG in p/therms to one decimal place, volumes to 1 decimal place in TWh, and customer numbers rounded to the nearest 1,000. The grey shadings denote summations that can be calculated by using other information within the statement, eg adjusted EBITDA can be calculated using the total revenue and total operating cost lines in the statement.

Revenue

2. For the generation business segment this means revenue from sales of electricity output generated; or if the business operates in a tolling-agreements structure, the revenues received from the capability or capacity payments including any account of associated fuel costs (an explanation/clarification of the latter type of revenues should be provided).

For the respective supply segments this means electricity and gas sales. Revenue for domestic supply should be less dual fuel discounts where applicable; that is these discounts should be deducted from revenue, with the discount split evenly between electricity and gas. Government-mandated social tariffs and discounts, such as the Warm Home Discount (WHD), should also be deducted from domestic supply revenues directly. For the avoidance of doubt, the Government Electricity Rebate (GER) should be neutral on revenues.

3. Other revenues not covered in Note 2, eg in the generation segment may include capacity payments, other physical options and ancillary services.

Direct fuel costs

4. ~~Direct fuel costs for supply should include aggregate electricity and gas costs as outlined in Note 7.~~ Generation should include ~~an associated~~ the delivered input cost for fuel, irrespective of the business model of the Relevant Licensee or its Affiliate. If the business operates in a tolling-agreements structure the direct fuel costs for generation may be presented in the form of a footnote to the template. The footnote should include a description of the volume, total cost, and average cost. ~~It should also specify the volume of granted free carbon allowances.~~ Relevant Licensees should exclude all emission costs such as Emissions Trading System (EU ETS) and Carbon Price Floor (CPF) from this category.

Supply should include aggregate electricity and gas costs, including the wholesale energy cost, losses, the energy element of RBD costs, balancing and shaping costs. Relevant Licensees should not make any adjustments for the costs associated with emissions (eg EU ETS and CPF). It is assumed that these costs are reflected in the wholesale price of electricity.

Transportation costs

5. Transportation costs for generation should include all network costs and Balancing Services Use of System (BSUoS) charges. Supply should in addition include the transport element of Reconciliation-by-Difference (RBD) costs. For the avoidance of doubt, metering costs should not be included in the cost category.

Environmental and social obligation costs

6. Generation should include all emission costs (eg EU ETS and CPF). The licensee should specify in a footnote the volume of any granted free carbon allowances.

Supply should include the costs associated with:

- Renewable Obligation Certificates (ROCs);
- Feed-in Tariffs (FITs);
- Contracts for Difference (CfD);
- Capacity Market (CM);
- Energy Company Obligation (ECO);
- Administering the GER;
- Levy Exemption Certificates (LECs);
- Assistance for Areas with High Electricity Distribution Costs (AAHEDC).

Other direct costs

7. ~~Other direct costs for supply should include network costs BSUoS, environmental costs (including ROCs, CESP and CERTs) and the transport element of reconciliation by difference~~ Generation should include market participation costs, including Elexon/Xoserve admin costs. Supply should in addition include, brokers' costs and intermediaries' sales commissions and any 'wider' smart metering programme costs (eg Data Communications Company (DCC)-related costs).

Indirect costs

8. Indirect costs should be defined as licensees' own internal operating costs including sales and marketing costs, bad debt, costs to serve, IT, staffing costs, billing and all meter costs, **including smart meter costs (eg linked to rollout or asset rental, not DCC).**

Adjusted EBITDA

9. EBIT means earnings before interest and tax; and EBITDA means earnings before interest, tax, depreciation and amortisation. **Adjusted EBIT and EBITDA exclude exceptional items, which are defined in paragraph 1.6 of these guidelines.**

Volumes

10. For supply, purchased volumes should be volumes as purchased from the wholesale market (ie without adjustment for losses).

11. For supply, **supplied** volumes should be supplier volumes at the meter point (ie net of losses). For Generation, **supplied** volumes should be the volume of power that can actually be sold in the wholesale market, ie generation volumes after the losses up to the point where power is received under the Balancing and Settlement Code but before subsequent losses.

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

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

For generation, WACO F/E/G means the "Direct fuel costs" line divided by the "supplied volume" line, shown as £/MWh or p/th. The costs of emissions (eg EU ETS and CPF) should be added to "Direct fuel costs" before dividing by "supplied volume".

Customer numbers

13. Customer numbers should be the average number of electricity and gas, domestic and non-domestic meter points (MPANs and MPRNs) during the reporting year. This should be calculated by adding monthly customer numbers and dividing by 12.

Aggregate supply and generation business

14. The **generation and supply** aggregation columns (**aggregation of conventional and renewable generation, and** domestic and non-domestic electricity and gas supply businesses) sums the horizontal **generation and supply** figures and thereby helps facilitate reconciliation to group accounts.

Appendix 2

Business function	Generation	Supply	Not included in CSS
Operates and maintains generation assets			
Responsible for scheduling decisions			
Responsible for interactions with the Balancing Market			
Responsible for determining hedging policy			
Responsible for implementing hedging policy / makes decisions to buy/sell energy			
Interacts with wider market participants to buy/sell energy			
Holds unhedged positions (either short or long)			
Procures fuel for generation			
Procures allowances for generation			
Holds volume risk on positions sold (either internal or external)			
Matches own generation with own supply			
Forecasts total system demand			
Forecasts wholesale price			

Forecasts customer demand			
Determines retail pricing and marketing strategies			
Bears shape risk after initial hedge until market allows full hedge			
Bears short term risk for variance between demand and forecast			

Notes

1. Companies should indicate where functions reside by way of a tick in the appropriate cell of the table. If profits or losses are not recorded in the same area, then an "F" should be used to indicate where the function resides and a "P/L" should be used to indicate where the profits or losses are recorded. If a payment is made or received by either generation or supply in lieu of a profit or loss this should be referenced by way of a footnote.
2. "Not included in CSS" should include entries if neither the Generation nor Supply Segments as reported in the CSS are responsible for a particular function, but that function is undertaken by the Relevant Licensee or an Affiliate. If a function is not undertaken then no entry should be recorded.

Glossary of terms:

- "Scheduling decisions" means the decision to run individual generation units
- "Responsible for interactions with the Balancing Market" means interactions with the Balancing Mechanism in electricity.
- "Interacts with wider market participants to buy/sell energy" means the business unit responsible for interacting with wider market participants to buy/sell energy, not the entity responsible for the buy/sell decision itself, which falls under "Responsible for implementing hedging policy /makes decisions to buy/sell energy".
- "Matches own generation with own supply" means where there is some internal matching of generation and supply before either generation or supply interact with the wider market. For the avoidance of doubt, if an entry is provided in this row, a footnote explanation of the scale of volumes involved is permitted.
- "Forecasts total system demand" means forecasting total system electricity demand or total system gas demand.
- "Forecasts customer demand" means forecasting the total demand of own supply customers.
- "Bears shape risk after initial hedge until market allows full hedge" means the business unit which bears financial risk associated with hedges made before the market allows fully shaped hedging.
- "Bears short term risk for variance between demand and forecast" means the business unit which bears financial risk associated with too little or too much supply for own customer demand.