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

Dear Diego,

Thank you for the opportunity to respond to this consultation on consolidated segmental reporting on behalf of npower and RWE Generation UK.

Broadly, we support the views of Ofgem however we do have some severe reservations regarding some of the proposed additional reporting requirements, specifically notional tax and interest numbers.

We also agree that there is the potential for significant tension between transparency and competition in the provision of this information and to whom it may or may not apply. Whilst we have no reservation in providing any of this information to the regulator it is not clear as to whether consumers themselves would benefit or indeed be further confused by what is a complex area.

We would be happy to discuss this matter further at your convenience. Full answers to all consultation questions are provided below.

Yours sincerely,

Edward Hunter



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

RWE npower notes that the independent BDO report clearly concluded that certain stakeholders concerns that profits were being distorted by transfer prices were unfounded. We trust that Ofgem will give robust due prominence to this clean bill of health in the event that such concerns continue to be repeated in the future.

We have no objection to 19A.7 to ensure that policies remain up to date, however we do not believe that anything other than a material change is necessary to be reported and the ideal vehicle for this is the CSS reporting itself.

We would suggest that the wording of 19A.8(b) needs slight clarification to reflect the process by which HMRC discharges its risk assessment role concerning the affairs of large companies. We suggest that the words "an inquiry" should be replaced by "a Compliance Check" as under CTSA (Corporation Tax Self-Assessment) this is the formal term used when HMRC wish to check something that the taxpayer has filed - it is no longer referred to as an "Enquiry."

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

In regard to the cost of an audit it is believed to be a minor cost to achieve relative transparency.

We fully support the audit requirement and have already publically committed in our 2013 CSS to a full audit of the 2014 CSS. This has been well signalled by Ofgem and we are planning on this basis.

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

RWE Npower does not prepare or publish audited consolidated accounts in the UK. It is covered by the exemption under S400 of the Companies Act 2006 not to prepare consolidated financial statements where the ultimate parent Company, RWE AG, prepares and publishes consolidated financial statements which are publically available. Therefore RWE Npower will continue to reconcile CSS to the audited segmental figures (prepared under IFRS) published in the RWE AG Annual report.

It is also worth noting that for YE 2014 (as for previous years) the audited individual legal entity accounts will be prepared under United Kingdom GAAP and not IFRS. As the Ofgem requirement is that the reconciliation is performed to audited consolidated accounts prepared under IFRS, if we did prepare consolidated UK accounts for YE 2014 these would have been prepared under UK GAAP and therefore, to be compliant with Ofgem guidelines, we would still have needed to reconcile to the segmental disclosures in the RWE AG Annual Report.

Notwithstanding the fact that RWE Npower does not prepare and publish consolidated financial statements in the UK, the following is also relevant in considering this point. Foreign owned companies (not subject to UK listing requirements that require earlier publication of annual accounts) are required to publish and file their UK statutory accounts (be it consolidated or single entity) within six or nine months (depending on the type of legal entity) after the Year End. This is later than the timing requirement for the CSS which is four months. It would require significant resource and cost investment to accelerate the UK statutory accounts process to align with the CSS date and significantly increase costs for consumers. Therefore reconciliation to audited Group consolidated accounts should be kept as an option as this provides the same level of assurance to users of the CSS.



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?

RWE nPower believes that to create a level playing field and prevent any publishing of data being deemed as contrary to competition that all Suppliers should be subject to CSS reporting but to avoid un-necessary burden suggests that a de-minimis threshold is applied potentially in line with current ECO reporting.

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?

Direct Fuel Costs

A potentially simpler solution to report direct fuel costs would be to continue to report as is but include both settlement volumes and customer metered volumes. This would enable a WACOE to be calculated using settled volumes that would more closely resemble prices observed in the wholesale market. This may provide a simpler, more transparent solution than estimating the costs associated with losses. Clearly, however, the revised classification for the YE 2014 CSS will mean that comparisons of these cost lines and WACO(G)/(E) with prior year equivalents will not be consistent. We would not suggest restating the prior year comparatives for these items as this will create confusion to users of the CSS.

Exceptional Items

Again we have no concerns with the inclusion of these items. It will aid consistency if a high level overview is provided such as Npower published in its 2013 CSS. We can see some practical issues of allocating exceptional costs across the Supply segments and would suggest that disclosure at just the generation and sub-segment level would be more sensible and avoid spurious allocations across the supply sub-segments.

Interest and Tax

At para 1.10 of the consultation document it is stated that information made available needs to be relevant and meaningful without revealing commercially-sensitive information that could harm competition, and also understandable by providing for effective comparison across companies. For the reasons mentioned below, we have significant doubt that the additional interest and tax information proposed to be captured by amending Annex 1 to the Guidelines will be relevant or meaningful and certainly not susceptible to effective comparison across companies. We therefore strongly disagree that these additional disclosures will be helpful

Our concerns are under two main headings (a) lack of meaningfulness of the data items requested, and (b) lack of comparability across groups.

We do not compute or account for tax and interest on a segmental basis, by their nature both tax and interest are entity or group level amounts.

Deriving a tax figure (impliedly being an income statement amount, therefore including deferred and corporate tax and prior year adjustments thereto) for a segment such as "domestic gas" which doesn't borrow or prepare a tax return is theoretical and therefore meaningless.

Vertically Integrated groups are very likely to have widely different balance sheet structures which will cause lack of comparability between their interest costs (with more or less debt/equity, and with debt within one or more or neither segment). Their tax charges will also depend on many factors other than the underlying CSS performance, including what tax groups



they are in, approach to accounting for group relief, changes in tax rates, timing of capital investment etc.

Many of the large energy companies, RWE included, have or are individually already taking steps to increase their tax transparency in ways which best fit with their groups activities (including those not on the CSS). Details of RWE's funding arrangements on an overall basis are also publically available. There is also an ongoing OECD initiative (BETS) which the UK Government is actively involved in with greater tax transparency as one of its main themes. We have significant concerns that including such extra data in the CSS in an artificially segmented way could create confusion and be counterproductive.

If notwithstanding the above reasoning we are ultimately compelled to provide additional interest and tax disclosures, we believe these should only be required at the total Generation and Supply segment level. There is no rational or logical basis whatsoever by which the tax and interest costs can be allocated across the supply segments (being electricity and gas split by domestic and non-domestic). Any allocation of legal entity tax and interest numbers (to fulfil OFGEM reporting requirements) would require multiple highly subjective judgements both across the supply segments and also to the out of scope activities excluded from the CSS. We are also genuinely concerned about the subjectivity of the allocations in the context of external auditors needing to opine on them.

Non Financial Information

Provided that the customer numbers conform to a standard regulatory report then all suppliers will have them to hand for year end (although not necessarily for the average of the year)

We recognise that customer numbers represent potentially useful information to customers, since aggregate figures can in some cases be meaningfully divided by customer numbers.

Whilst recognising and supporting transparency to our customers we are mindful that the CMA is considering the effects of the provision of information by suppliers to the public domain, and that this may include information about the past and which is either known accurately or can be inferred approximately from information already in the public domain.

Accordingly our thought is to delay the decision on the provision of customers numbers, until early 2015, whence provisional CMA findings may give a clearer indication on the overall benefit, or otherwise, of this reporting

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

Whilst RWEpower firmly supports the need for transparency, the level of transparency needs to be carefully assessed to ensure it is not detrimental to a competitive market or provides anyone not subject to CSS with an unfair advantage.

We are concerned that costs such as ECO would still not be comparable and may possibly be more confusing, for customers given that cost in a given year is materially impacted by volume and percentage of the obligation delivered which would not be uniform across all suppliers.

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?



In principle, RWE npower is strongly in favour of transparency, particularly in relation to customers understanding what impacts their bills. However, the intent to make costs more transparent in a competitive market place has the potential to impact competition negatively.

A balance needs to be struck between what is useful information for consumers and the possibility of sharing commercial and competitive information between Suppliers leading to an adverse effect on competition. It can be argued that consumers are mainly interested as to whether they are getting a good aggregate deal and how their supplier compares to other suppliers. It would be helpful for OFGEM to be clear what it sees the specific benefits of consumers being from this increased information.

If the information can have an adverse impact on competition, this is more likely if that information is more current. Reducing the timescales from 6 months to 4 months may therefore create a greater impact on competition. In RWE npower's view, consumers may benefit from a clearer picture of policy costs and what is driving the increases in their bills. However this does not require detailed information to be provided by each company.

We see no reason not to share any of this information with Ofgem and it may help to provide a more accurate view of the cost of obligations and policy. However we remain unconvinced that some of the data suggested would be to the benefit of the consumer. Equally, we believe it would be sensible to wait for at least the revised issues statement from the CMA to ensure that Ofgem's recommendations are in line with the CMA's thinking.