SCOTTISHPOWER

Rupert Steele OBE
Director of Regulation

Robyn Daniell
Energy Market Monitoring and Analysis
Ofgem
9 Millbank
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Dear Robyn,

Actions to Improve the Transparency of Energy Companies' Profits

Thank you for the opportunity to comment on the matters raised in this consultation.

We are broadly supportive of the proposals regarding the segmental accounts, though wish to mention a few points of detail. We do however agree with Ofgem that it will be important to consider the CMA's findings from its market investigation, relating to transparency of information in the energy market, before proposing any further material new requirements.

Our answers to the consultation questions are in Annex 1 attached. Should you wish to discuss any issues arising from our response please do not hesitate to contact me.

Yours sincerely

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Annex1

ACTIONS TO IMPROVE THE TRANSPARENCY OF ENERGY COMPANIES' PROFITS - SCOTTISHPOWER RESPONSE

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

We are comfortable with the broad thrust of Ofgem's proposals on transfer pricing methodologies. As presently drafted, the proposed SLC 19A.8 sub paragraph (a) requires the licensee to notify the Authority "of any changes to transfer pricing policies". We think it would be appropriate to include a materiality qualification to this requirement. It could be helpful if Ofgem could provide guidance on the nature and materiality of changes in policy that should be communicated to the Authority.

Should the requirements of proposed SLC 19A.7(c) be specified such that internal audit functions were required to review transfer pricing more frequently than once per year, we would not be able to implement this until the 2015 CSS. We would note that from a wider assurance perspective our external auditors cover changes in transfer pricing as part of their review during the year and we wonder whether review by internal auditors is needed in areas reviewed by external ones.

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

We support the proposals for a requirement on licensees to produce an auditor's opinion on the CSS. As noted in the consultation, ScottishPower provided an audited opinion on its 2013 CSS and we understand that Ofgem is seeking to reflect the same scope of audit in the additions it has proposed to SLC19A (paragraphs 19A.10 and 19A.11).

Our auditors confirm that the wording of an unqualified audit opinion in respect of the 2014 CSS would be expected to be in line with that provided in the report for the year ended 2013 with the additional inclusion of information regarding the audit materiality level applied. This materiality disclosure would be similar to that provided in the statutory accounts audit opinions of listed UK entities.

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

Yes, our previous segmental statements have been reconciled to UK Group statutory accounts.

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?

We agree that it is appropriate to consider which companies the CSS obligation should apply to and to provide clear criteria by which companies are included within the requirement. It is not clear to us why the obligation should currently be targeted at the 'Big 6' but not at other vertically integrated companies which are similar in size to the 'Big 6' albeit with non-domestic rather than domestic supply businesses. Equally, given that many of the benefits listed in paragraph 3.76 of the consultation would apply regardless of size, it is not clear why smaller vertically integrated companies operating in the domestic market, having over say 50,000 customers, should not also be included.

However, as Ofgem notes in the consultation, there is a tension between transparency and competition and we agree that it would be appropriate for Ofgem to await the outcome of the CMA's market investigation before making any proposals to extend the scope of the obligation.

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 agree with Ofgem's approach to await the conclusion of the CMA's market investigation before making any proposals regarding the disclosure of trading activities. Nevertheless, having disclosed information on ScottishPower's trading business on a voluntary basis in the 2013 CSS, we are happy to continue voluntarily disclosing this information.

With regards to Ofgem's proposed new detailed line item disclosures, we have the following comments:

- We do not believe that companies should be required to disclose tax and interest for every segment within the CSS. Tax and interest are not reported at this level in statutory accounts so this disclosure would require arbitrary allocations and would not necessarily be informative to stakeholders. Instead, we think it would be more useful for stakeholders for companies to disclose interest and tax for aggregate generation and aggregate supply. We would also observe that for generation, as with other asset intensive businesses, tax policy (e.g. allowance pools etc) can change from year to year causing a substantial impact on the reported tax charge (eg through the release or accrual of tax provisions). Such movements are likely to need additional commentary to avoid confusing readers of the statements.

- With regard to the proposed new disclosure of customer accounts, we note that the guidelines only provide a definition of customer numbers but not what constitutes an account. To avoid the need for further reconciliation, we would suggest that companies should apply the same definition of customer as is used in their statutory accounts. In ScottishPower's case, we use meter points (i.e. MPANs and MPRNs) as the basis for customer accounts in our statutory accounts.

- Finally we note the requirement in the CSS to split generation into "conventional" and "renewable". In ScottisPower's case, renewable and conventional generation are owned by separate companies but the conventional portfolio includes a pumped storage facility (which could be considered a mix of conventional and renewable, depending on what energy source is being used for pumping and the extent that the reservoir is filled by rainfall) and a small amount of conventional hydro (which could be considered renewable). Separating these out would seriously complicate the reconciliation to statutory accounts, with little benefit in terms of transparency. We would therefore propose to retain the hydro plant within the 'conventional' segment and to disclose this within the commentary.

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

ScottishPower voluntarily provided a detailed breakdown of its environmental and social obligation costs as an appendix to its 2013 CSS. In principle, we support Ofgem's proposals to require a disclosure in future. At present we do not see any issues that would prevent Ofgem requiring inclusion of this cost breakdown as part of the 2014 CSS instead of waiting until the 2015 statement. In this context, it would be necessary for Ofgem to be satisfied that there are no issues around obtaining an audit opinion on the breakdown.

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 agree that this is a valid question to be asking. However, it is appropriate to await the outcome of the CMA market investigation, which may consider the benefits or otherwise of transparency, before seeking to answer it.

ScottishPower
6 November 2014