

**E.ON's UK Consolidated Segmental Report
for the year ended 31 December 2013**

E.ON's UK Consolidated Segmental Report for the year ended 31 December 2013

Introduction

In accordance with the Electricity Generation Licence Condition 16 - Financial Information Reporting, and the Electricity Supply and Gas Supply Licence Conditions 19A - Financial Information Reporting, the E.ON companies (Relevant Licensees) listed below on page 3 have prepared this Consolidated Segmental Report for the year ended 31 December 2013. This Consolidated Segmental Report and supporting information is prepared in accordance with the Licence Conditions' Guidelines issued by Ofgem. This report comprises:

1. Details of the Relevant Licensees;
2. An explanation of how Joint Ventures and Associates of the Relevant Licensees are reported in this report;
3. An explanation of how any electricity and gas trading carried out within the E.ON SE Group (the group containing the ultimate parent company, E.ON SE and its subsidiary companies) is reported in this report;
4. **E.ON's UK Consolidated Segmental Statement** for the year ended 31 December 2013, which provides information relating to the revenues, costs and profits of the Relevant **Licensees' activities in the generation** of electricity and the supply of electricity and gas to any premises (Table 1);
5. An explanation of how the Relevant Licensees define the terms: revenues, costs and profits used in the Consolidated Segmental Statement (Notes to Table 1);
6. A reconciliation of the Revenues and EBITDA contained within the Consolidated Segmental Statement to the audited data published in the Annual Report of E.ON SE for the year ended 31 December 2013 (Table 2);
7. An explanation of the definitions used and reconciling items (Notes to Table 2);
8. An explanation of the transfer pricing methodology used by the Relevant Licensees and how this relates to the revenues, costs and profit information in the Consolidated Segmental Statement; and
9. A table that forms an explanation of where individual business functions are captured in the Consolidated Segmental Statement, as specified by Appendix 2 of the Guidelines to the Licence Conditions (Table 3).

The Relevant Licensees published this report on the website www.eonenergy.com/About-eon/our-company/at-a-glance/company-reporting.

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Relevant Licensees

- 1, Electricity supply licensees
 - E.ON Energy Solutions Limited
 - E.ON UK plc
 - Economy Power Limited

- 2, Gas supply licensees
 - E.ON Energy Gas (Eastern) Limited
 - E.ON Energy Gas (North West) Limited
 - E.ON Energy Solutions Limited
 - E.ON UK Gas Limited
 - E.ON UK plc
 - TXU Europe (AHG) Limited

- 3, Generation licensees
 - Citigen (London) Limited
 - Enfield Energy Centre Limited
 - E.ON Climate & Renewables UK Humber Wind Limited
 - E.ON Climate & Renewables UK Rampion Offshore Wind Limited
 - E.ON UK plc

- 4, All the Relevant Licensees are wholly owned subsidiaries of E.ON SE.

For this report:

- the combined electricity generation activities of the Relevant Licensees are "Generation", which forms the Generation segment in the Consolidated Segmental Statement (Table 1), and comprises the Relevant Licensees' generation activities managed by the E.ON Management Units E.ON Climate and Renewables, E.ON Global Generation and E.ON Regional Unit UK; and

- the combined supply (electricity and gas) activities of the Relevant Licensees are "Supply", which forms the Supply segment in the Consolidated Segmental Statement (Table 1), and comprises the Relevant Licensees' supply activities managed by the E.ON Management Unit E.ON Regional Unit UK.

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Major operational generation plant of the Relevant Licensees in 2013

- Citigen (London) Limited - Citigen CHP (natural gas fired combined heat and power plant)
- E.ON Climate & Renewables UK Humber Wind Limited - Out Newton (wind farm)
- E.ON UK plc - Cottam Development Centre (natural gas fired combined cycle gas turbine plant)
Connah's Quay (natural gas fired combined cycle gas turbine plant)
Enfield (natural gas fired combined cycle gas turbine plant)
Grain (natural gas fired combined cycle gas turbine plant and gasoil open cycle gas turbine plant)
Ironbridge (biomass fired steam plant)
Killingholme (natural gas fired combined cycle gas turbine plant)
Ratcliffe (coal fired steam plant and gasoil open cycle gas turbine plant)
Steven's Croft (biomass fired steam plant)
Taylor's Lane (gas oil open cycle gas turbine plant)

Joint Ventures and Associates

Under the Guidelines to Licence Conditions, in preparing the Consolidated Segmental Statement (Table 1), the Relevant Licensee should account for Joint Ventures and Associates (which hold a generation or electricity/gas supply licence in the UK). The E.ON UK plc Group has one such company, London Array Limited. This company has a generation licence and is 30% owned by the E.ON UK plc Group. Consequently, the Consolidated Segmental Statement (Table 1) includes:

- The revenues arising from E.ON UK plc Group's 30% interest in the London Array wind farm;
- The EBITDA arising from E.ON UK plc Group's 30% interest in the London Array wind farm; and
- **30% of London Array's** generation volume.

London Array **Limited's** activities do not form part of the transfer pricing methodology used by the Relevant Licensees and are not covered in Table 3.

The Relevant Licensees also have Affiliates, Associates and Joint Ventures that are not licensees, but carry out generation and supply activities in Great Britain. As these companies are not licensees their activities are not included in the Consolidated Segmental Statement (Table 1).

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Trading

E.ON Global Commodities SE (EGC) was established to centralise all of the E.ON SE Group's European trading operations. While a wholly owned subsidiary of E.ON SE, EGC is not a Relevant Licensee. As such, EGC's activities are not included in the Consolidated Segmental Statement (Table 1). EGC's activities include purchasing generation from the Relevant Licensees and providing electricity and gas for supply activities by the Relevant Licensees. These arrangements are covered by cross border contracts, which are prepared on an arm's length basis (meaning that although the transactions are between two related or affiliated parties, they are conducted as if the two parties were unrelated) and are subject to examination by the tax authorities in Germany and the UK. These arrangements are described in the explanation of the transfer pricing methodology used by the Relevant Licensees on pages 13 to 15 of this Report.

The Relevant Licensees' generation activities do not engage in the trading of electricity or gas, other than in contracting with EGC to sell electricity and procure gas. These contracts have prices based on the wholesale prices at the time of contracting of capability and at the time of generation for energy. The arrangement means that income of conventional plant, for the Generation segment in the Consolidated Segmental Statement (Table 1), is based directly on wholesale market prices. Any profit or loss from trading, including balancing activities, by EGC does not affect Generation's income and therefore, if there was an entry for trading in the Generation segment of the Consolidated Segmental Statement (Table 1), it would be zero.

Electricity and gas supply activities forming Supply do not engage in the trading of electricity or gas, other than in contracting to procure electricity and gas for supply. Nearly all these contracts are with EGC. The contracts with EGC use prices based on the wholesale prices at the time of contracting for the energy and at the time of supply for any reconciliation. These arrangements mean that the cost of energy purchased from EGC by Supply is based on wholesale market prices. Any profit or loss from trading by EGC, or any other companies in the E.ON organisation, does not affect costs for Supply and therefore if there was an entry for trading in the Supply segment of the Consolidated Segmental Statement (Table 1), it would be zero.

There are differences between the income rate for the Generation segment and the electricity expenditure rate of the Supply segment in the Consolidated Segmental Statement (Table 1), but none of these are due to trading activities of EGC or any other E.ON businesses. The differences are because the electricity volumes generated and supplied by activities forming Generation and Supply respectively, are different, as are their respective load profiles and the times at which they contract. These factors, together with the effects of transaction costs and the activities forming Supply not purchasing all their volumes from EGC, mean that although activities of Generation and Supply are contracting at wholesale market prices, **Generation's average income rate per KWh generated will be different to Supply's average expenditure rate per KWh of electricity supplied.** Also, in the Consolidated Segmental Statement (Table 1), the weighted average input cost of all fuel shown in the Generation segment is different to the weighted average input cost of gas shown in the Supply segment. This is because the generation plants of the Relevant Licensees use a mixture of fuels and use different volumes, load profiles and contracting times to that of their supply activities.

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Table 1	Note	Unit	Generation	Supply				Aggregate supply business (see Note 13)
				Electricity supply		Gas supply		
				Domestic	Non-domestic	Domestic	Non-domestic	
				2013	2013	2013	2013	
Revenue from sales of electricity and gas	1	£m	1,192	2,573	2,883	1,964	622	8,042
Other revenue	2	£m	62	-	-	-	-	-
Total revenue		£m	1,254	2,573	2,883	1,964	622	8,042
Direct fuel costs	3	£m	-827	-1,125	-1,735	-1,186	-472	-4,518
Network costs	4	£m	-35	-610	-638	-423	-90	-1,761
Environmental and social obligations costs	5	£m	-52	-328	-358	-96	-	-782
Other direct costs	6	£m	-97	-4	-1	-2	-1	-8
Indirect costs*	7	£m	-82	-321	-76	-250	-30	-677
Total operating costs		£m	-1,093	-2,388	-2,808	-1,957	-593	-7,746
EBITDA	8	£m	161	185	75	7	29	296
DA*	9	£m	-326	-6	-1	-4	-	-11
EBIT	10	£m	-165	179	74	3	29	285
WACO F/E/G	11	£/MWh p/th	38.38 -	59.84 -	55.97 -	- 75.21	- 68.80	- -
Volume	12	TWh Million Therms	22.9 -	18.8 -	31.0 -	- 1,577	- 686	- -

*Indirect costs and DA include restructuring costs and impairments respectively as described in notes 7 and 9 on page 8.

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Notes to Table 1

1. **Revenue from sales of electricity and gas** - for the Generation segment, this means revenue received from EGC for sales of the Relevant Licensees' net generation and includes revenues received from capacity payments and remuneration for fuel and EU emissions trading system (EU-ETS) allowances used. For the respective Supply segments, this means electricity and gas sales by the Relevant Licensees. Revenue for domestic supply is less dual fuel discounts where applicable; with the discount allocated according to billed value. Electricity and gas social tariff costs are deducted directly from the respective electricity or gas domestic supply revenue.
2. **Other revenue** - this means other segmental revenues of the Relevant Licensees not covered in revenues from sales of electricity and gas. For the Generation segment this includes any ancillary services, ash sales and Renewables Obligation Certificates (ROCs). For Citigen (London) Limited, this includes heat and cooling. For the Supply segment, the Consolidated Segmental Statement only includes licensed supply activity, as all other activities have been adjusted on the reconciliation in Table 2.
3. **Direct fuel costs** - for the Generation segment, this is just the cost of fuel (e.g. gas, coal, etc.), including carbon price floor related taxes, consumed by the Relevant Licensees during the financial year. For the Supply segment, this is just the cost of electricity and gas used by the Relevant Licensees' Supply activities. This covers the wholesale energy cost, losses, the energy element of Reconciliation-by-Difference (RBD), and balancing and shaping costs incurred by the Relevant Licensees.
4. **Network costs** - for the Generation segment, this includes use of system charges. For the Supply segment, this includes use of system charges, transportation costs, Balancing Services Use of System (BSUoS), Residual Cashflow Reallocation Cashflow (RCRC), Elexon administration charges, Assistance for Areas with High Electricity Distribution Costs (AAHEDC), the transport element of RBD and other network costs. Costs are as recorded in the company's books of accounts and supporting documents.
5. **Environmental and social obligations costs** - For the Generation segment, this is the cost of EU-ETS allowances. The volume of granted free carbon allowances for the Relevant Licensees under the National Allocation Plan, as reported in this Consolidated Segmental Statement, was 7kTe. For the Supply segment the costs directly attributable to it were Renewable Obligation Certificates (ROCs), Levy Exempt Certificates (LECs), Feed In Tariffs (FIT), the Energy Companies Obligation (ECO), the Community Energy Saving Programme (CESP), the Carbon Emission Reduction Target (CERT) and SMART programme costs to set-up the Data Communications Company (DCC) and technology. FIT costs are **allocated between electricity's domestic and non-domestic** customers on the basis of electricity volume. ROCs and LECs are included as recorded in the company's books of accounts and supporting documents for domestic and non-domestic supply. ECO, CESP & CERT costs are as recorded in the company's books of accounts and supporting documents for the domestic supply customer group. For both the domestic and non-domestic supply customer groups there is a further split to allocate to electricity and gas using the number of customer accounts. Using an allocation based on the number of customer accounts provides a consistent approach for allocating such costs across all customer accounts.
6. **Other direct costs** - for the Generation segment, this includes cost of electricity imported to the sites and ash disposal costs. For the Supply segment, this includes residual costs.

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7. **Indirect costs** – For the Generation segment, this includes general office costs and repairs and maintenance offset by a £15m gain on the disposal of the London Array onshore sub-station. For the Supply segment this means **the Relevant Licensees' own internal operating costs** including sales and marketing costs, bad debt, costs to serve, IT, staffing costs, head office costs that are attributable to Supply, billing and all meter costs, including smart meters. Also included are restructuring costs, which are resources engaged on a business process review that management consider relate to the reporting period in full and relate directly to the operation of the Supply segment, thus they form part of the total cost of resources employed in the business; they are not capital in nature. Costs are as recorded in the company's books of accounts and are allocated where possible as a direct allocation to a particular customer group, i.e. there is an allocation between domestic and non-domestic, and then, within each of those two customer groups, between electricity and gas. Unless stated otherwise, where a direct allocation cannot be made to a particular customer group, the allocation between domestic and non-domestic and then electricity and gas has been made on a reasonable endeavours basis using the number of customer accounts in each category. Using an allocation based on the number of customer accounts provides a consistent approach for allocating such costs across all customer accounts.
 8. **EBITDA** – this means earnings before interest, tax, depreciation, amortisation and impairments.
 9. **DA** – this means depreciation and amortisation. The Generation segment also includes relevant impairments that relate directly to the operation of the Generation businesses. This includes £122m written off Tangible Fixed Assets in respect of the Ratcliffe power station during the year.
 10. **EBIT** – this means earnings before interest and tax. In accordance with the Guidelines to Licence Conditions, the Consolidated Segmental Statement does not include the mark to market adjustment of derivatives. This is the notional profit/loss incurred through changes in valuation of contracts with future delivery dates, due to changes in market price. As these contracts have not been realised in cash terms, they do not form part of the performance measures used by management to make strategic decisions and have therefore been excluded. In addition, EBIT excludes any other exceptional items unless disclosed within the Consolidated Segmental Statement.
 11. **WACO F/E/G** –
 - a. For the Generation segment, this is **the "Direct fuel costs"** and **"Environmental and social obligations costs"**, as described in Notes 3 and 5 above, and means the weighted average input cost of all fuel (e.g. gas and coal) used by the Relevant Licensees and the cost of EU-ETS allowances. This is shown as £/MWh and is for the volume described in Note 12 below.
 - b. For the Supply segment, **this is solely the "Direct fuel costs"**, as described in Note 3 above, and means the weighted average cost of electricity (shown as £/MWh), or gas (shown as p/therm) used by the Relevant **Licensee's Supply activities**. It covers the total wholesale energy cost, which includes costs associated the EU-ETS and the Carbon Price Floor, all transactions for sales recorded at the meter point, and any losses incurred by the Relevant Licensees.
 - c. The energy volumes, used for calculating WACO F/E/G (TWh and Million Therms), are solely the **Volumes** shown in Table 1 and described in Note 12 below.

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12. **Volume** – for the Generation segment, this is the volume of electricity that can actually be sold in the wholesale market, i.e. generation volumes after the losses up to the point where electricity is received under the Balancing and Settlement Code, but before subsequent losses. It includes generation by the Relevant Licensees that do not have “*Direct fuel costs*”, e.g. wind generation. For the Supply segment, this is the volume as recorded at the meter point (i.e. net of losses).
13. **Aggregate supply business** – this column sums the horizontal supply figures of the Electricity Supply and Gas Supply columns. Both the Electricity Supply and Gas Supply columns are each further divided into two columns to provide a domestic and non domestic supply market breakdown. Where possible a direct allocation has been made to a particular customer group, i.e. there is an allocation between electricity and gas, and then, within each of those two groups, between domestic and non-domestic sales. Unless stated otherwise, where a direct allocation cannot be made to a particular customer group, the allocation between electricity and gas and then between domestic and non-domestic sales has been made on a reasonable endeavours basis using the number of customer accounts in each category. Using an allocation based on the number of customer accounts provides a consistent approach for allocating such costs across all customer accounts.

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Table 2 Reconciliation

	External Sales in €m	Inter-segment Sales in €m	Revenue		Note	EBITDA			
			€m	€m		€m	€m		
E.ON SE Group	122,450	-	122,450		1		9,315		
less: Global Commodities	57,228	32,823	90,051				352		
Region Germany	35,778	999	36,777				2,413		
Non EU Countries	1,865	-	1,865				533		
Generation (E.ON Global Generation)	2,703	8,288	10,991		2		1,882		
Exploration & Production	1,630	421	2,051				1,070		
Renewables (E.ON Climate and Renewables)	688	1,748	2,436		3		1,431		
Group Management	190	- 45,184	- 44,994				- 539		
Other EU Regions	12,719	840	13,559				1,795		
	112,801	-65	112,736				8,937		
Region UK (E.ON Regional Unit UK)	9,649	65	9,714	=	8,250	4	321	=	378
Other Region UK activities					- 118	5	- 26		
Reallocation of other Retail business					-90	6	13		
Restructuring costs					-	7	-12		
Adjusted EBITDA per Table 1							296		
Depreciation & Amortisation					-	8	- 11		
Consolidated Segmental Statement (Aggregate supply business)					8,042	9	285		
Total Generation above			10,991			2			1,882
Less Non UK components			-9,635			10			-1,806
UK Generation			1,356	=	1,152	11	64	=	76
Reallocation of generation activities					102	12	104		
Restructuring costs					-	7	-7		
Adjusted EBITDA per Table 1							161		
Depreciation & Amortisation					-	8	-204		
Generation impairments					-	13	-122		
Consolidated Segmental Statement (Generation)			1,254			14	-165		

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Notes to Table 2

- 1 *E.ON SE Group* figures are taken from pages 190 and 191 of the [2013 E.ON SE Group Annual Report](#), which show the Financial Information by Business Segment disclosed in €m.
- 2 *Generation* segment is also taken from pages 190 and 191 of the [2013 E.ON SE Group Annual Report](#) and covers the E.ON SE Group's worldwide generation activities, including the **Relevant Licensees'** component, in €m. This segment result has been further adjusted lower down the reconciliation for the **Relevant Licensees'** generation component of these figures.
- 3 *Renewables* segment is also taken from pages 190 and 191 of the [2013 E.ON SE Group Annual Report](#), and covers the E.ON SE Group's worldwide renewables activities, including the **Relevant Licensees'** component, in €m. The **Relevant Licensees'** component is then included lower down the reconciliation as part of Note 13.
- 4 *Region UK* figures have been extracted from the Financial Information by Business Segment – Presentation of Other EU Countries, disclosed in €m, on pages 190 and 191 of the [2013 E.ON SE Group Annual Report](#). This has been translated into £m using an average exchange rate of £1 = €1.177.
- 5 *Other Region UK activities* are the other activities carried out by E.ON Regional Unit UK, including the Corporate Centre functions, which do not form part of the **Relevant Licensee's Supply activities**.
- 6 *Reallocation of other Retail business* are E.ON Regional Unit UK's supply activities that do not form part of the Supply segment in the Consolidated Segmental Statement (Table 1), e.g. licence exempt supply by Affiliates of the Relevant Licensees.
- 7 *Restructuring costs* are the resources engaged in restructuring E.ON Regional Unit UK's supply activities (£12m) and the **Relevant Licensee's** Generation activities (£7m). The costs relate directly to the operation of the Supply and Generation segments.
- 8 *Depreciation & Amortisation* is the required adjustment from the EBITDA measure, used in the Financial Information by Business Segment on pages 190 and 191 of the [2013 E.ON SE Group Annual Report](#), to the EBIT presentation in **E.ON's UK Consolidated Segmental Statement** for the year ended 31 December 2013 (Table 1) of this report.
- 9 *Consolidated Segmental Statement (Aggregate supply business)* figures are the Aggregate supply business figures presented in **E.ON's UK Consolidated Segmental Statement** for the year ended 31 December 2013 (Table 1) of this report.
- 10 *Non UK components* are **E.ON's** other worldwide generation activities.
- 11 *UK Generation* represents the activities associated with generation plant accounted for within the E.ON UK plc Group.

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- 12 *Reallocation of generation activities* include the generation activities of Citigen (London) Limited and those accounted for within E.ON Climate and Renewables.
- 13 *Generation impairments* are the amounts written off Tangible Fixed Assets in respect of the Ratcliffe power station during the year.
- 14 *Consolidated Segmental Statement (Generation)* figures are the Generation segment figures presented in **E.ON's UK Consolidated Segmental Statement** for the year ended 31 December 2013 (Table 1) of this report.

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The transfer pricing methodology used by the Relevant Licensees

All of the Relevant Licensees operate within E.ON's transfer pricing methodology as described below.

E.ON's transfer pricing methodology for the Relevant Licensee's Generation activities

Following the disposal by E.ON UK plc of the Energy Trading business to EET (now EGC) on 1 January 2009, the Relevant Licensees are no longer exposed to short term commodity price risks on fuel (other than for any fuel held in stock), EU-ETS allowances purchased and electricity sold. For the **Relevant Licensees'** Generation activities, this explanation of the transfer pricing methodology reflects how they actually acquire energy.

Arrangements between the Relevant Licensees and EGC for generation plant scheduled by EGC

The Relevant Licensee (E.ON UK plc) has contracts with EGC for the production capacity for some of its generation plant. These contracts allow EGC the right to schedule that generation plant and to take all the electricity produced by it. EGC undertakes to provide all the fuel and EU-ETS allowances required for the plant to operate. EGC can then trade this production capacity on the market. The contracts mean that the key risk for the licensee is the potential for unscheduled power station outages, for which it would incur financial penalties.

Under these contracts, E.ON UK plc sells its forecast economic electricity generation capability (capacity) to EGC ahead of time. The corresponding forward prices of electricity, fuel and EU-ETS allowances, at the time of the sale, determine the value of the availability performance related capacity payment that E.ON UK plc receives from EGC. **These payments form part of the "Revenue from sales of electricity and gas" for the Generation segment** within the Consolidated Segmental Statement (Table 1). These Generation segment activities do not receive any revenue from external sales of electricity.

In addition to the availability performance related capacity payment, E.ON UK plc also receives payment from EGC for the fuel and the value of emission allowances used in generating the volumes scheduled by EGC. The price paid by EGC for the fuel used by E.ON UK plc is the corresponding market price for the fuel at the time the fuel is used. These payments also **form part of the "Revenue from sales of electricity and gas" for the Generation segment** within the Consolidated Segmental Statement (Table 1). Ancillary services are also covered by the contracts and form part of the Generation segment within **"Other revenue"** in the Consolidated Segmental Statement (Table 1).

The price paid by E.ON UK plc for the fuel it receives is the corresponding market price at the time the fuel is delivered to the power station. This payment forms part of the **"Direct fuel costs"** for the Generation segment within the Consolidated Segmental Statement (Table 1). These direct fuel costs, together with the EU-ETS allowances shown in the **"Environmental and social obligations costs"** Generation segment of the Consolidated Segmental Statement (Table 1) are included in the costs used for the **"WACO F/E/G"** for the Generation segment within the Consolidated Segmental Statement (Table 1).

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Arrangements between the Relevant Licensees and EGC for renewables generation plant

Relevant Licensees' renewables generation plant is plant fuelled by biomass and wind powered generation.

The Relevant Licensees have contracts to receive payment from EGC for the output from the licensees' renewables generation plant. These arrangements are primarily for delivery of electricity, with EGC not scheduling the generation. The prices are market based with imbalances between contracted and outturn covered by a balancing fee. **These payments form part of the "Revenue from sales of electricity and gas" for the Generation segment within the Consolidated Segmental Statement (Table 1).**

Any payment for fuel by the licensee is direct to the fuel supplier and does not form part of the transfer pricing methodology. These payments are the **"Direct fuel costs" within the Consolidated Segmental Statement (Table 1)**; they only cover the cost of the fuel used in generation and do not cover any fuel delivered to site that has not been used. These costs are included in the **"WACO F/E/G" for the Generation segment within the Consolidated Segmental Statement (Table 1).**

Arrangements for the Relevant Licensees' other generation plant

Arrangements are in place with EGC for the Relevant Licensees' other plant. These arrangements are primarily for delivery of electricity. Here EGC does not schedule the generation but it does provide the fuel. The combined generation output of plant subject to these arrangements is less than 5% of the total volume forming the Generation segment in the Consolidated Segmental Statement (Table 1).

E.ON's transfer pricing methodology for the Relevant Licensees' Supply activities

The revenues from Supply sales of electricity and gas do not form part of the contracts between the Relevant Licensees and EGC.

The Relevant Licensees buy nearly all of their required supply of electricity and gas from EGC **on an arm's length contracts** using traded market instruments, including derivative financial instruments. **The arm's length arrangements** are secured through the instruments using a price that is directly derived from visible wholesale market prices at the time when the transaction takes place. This means that prices paid for the electricity and gas corresponds to the current open market price for the particular product. A small volume is also purchased from embedded generation and industry mechanisms. Variations between final contract commitments and outturn customer demand are settled using the corresponding short term prices in the electricity and gas markets. There are no other costs relating to the contracts with EGC. Thus, to the extent that a Relevant Licensee procures energy from other E.ON companies, the transfer pricing methodology reflects how they actually acquire energy. The total price paid by the Relevant Licensees for electricity or gas, used for supply, is the **"Direct fuel costs" for the Supply segment in the Consolidated Segmental Statement (Table 1).** This is the cost used for the **"WACO F/E/G" for the Supply segment within the Consolidated Segmental Statement (Table 1).**

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The required supply is based on forecast demand and the timing of purchases. These are determined by an assessment of competitive market dynamics and represent the key commodity risks for **the Relevant Licensees' Supply activities**. As explained above, the full costs of these purchases are included in "*Direct fuel costs*" in the Consolidated Segmental Statement (Table 1). However, any notional profit or loss, through changes in valuation due to changes in market price, of contracts with future delivery dates, is excluded. The exclusion of this notional profit or loss reflects the fact that these contracts have not been realised in cash terms and do not form part of the performance measures used by management to make strategic decisions. Excluding such notional profit or loss in the Consolidated Segmental Statement (Table 1) **supports Ofgem's requirements for consistency in reporting and so support meaningful comparison of statements.**

A number of purchasing strategies are operated to address the various characteristics and requirements of our customers and reflect the competitive market conditions. These strategies range from flexible purchase arrangements for some large corporate customers, to longer term hedges for most tariff customers. This can produce different WACO E/G for the different electricity and gas Supply segments of the Consolidated Segmental Statement (Table 1).

Arrangements between the Relevant Licensees and other parts of E.ON

The treatment of services taken from other parts of E.ON by the **Relevant Licensees'** Generation and Supply activities are covered by service level agreements. These Generation and Supply costs are included in "*Indirect costs*" within the Consolidated Segmental Statement (Table 1).

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Table 3 Business function	Generation	Supply	Another part of the business¹
Operates and maintains generation assets	√		
Responsible for scheduling decisions	√ ²		√ ³
Responsible for interactions with the Balancing Market			√
Responsible for determining hedging policy	P/L ⁴	√ ⁵	F ⁶
Responsible for implementing hedging policy/makes decisions to buy/sell energy		√	√
Interacts with wider market participants to buy/sell energy ⁷			√
Holds unhedged positions (either short or long) ⁸	√	√	√
Procures fuel for generation	√ ⁹		√ ¹⁰
Procures allowances for generation			√
Holds volume risk on positions sold (either internal or external)	√	√	
Matches own generation with own supply ¹¹			
Forecasts total system demand ¹²			
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		√	

Key

√ Indicates that the business function and the profits or losses reside in the same business.

F Indicates where the business function resides in cases where it is not in the same business as where the profit or loss is recorded.

P/L Indicates where the profit and loss is recorded in cases where the business function does not reside in the same business.

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Notes to Table 3

1. Excluding generation and supply by E.ON companies that are not Relevant Licensees.
2. Electricity generation from Relevant Licensees' plant not scheduled by EGC.
3. Electricity generation **from Relevant Licensees' plant** that is scheduled by EGC.
4. Relevant Licensees' Generation activities are not responsible for determining hedging policy. **However, the impact of the E.ON Group's overall hedging policy on the Relevant Licensees' Generation activities is reflected in any profit or loss recorded in Generation segment of the Consolidated Segmental Statement (Table 1).**
5. **The impact of the E.ON Group's overall hedging policy is also reflected in any profit or loss recorded by the Supply segment of the Consolidated Segmental Statement (Table 1).** In addition, the **Relevant Licensees' Supply activities are responsible for determining their hedging policies within E.ON Group's overall hedging policy.**
6. **While E.ON Group's overall hedging policy is determined by another part of the business to the Relevant Licensees' Generation and Supply activities, the impact of the strategy on the Generation and Supply segments in the Consolidated Segmental Statement (Table 1) is reflected in any profit or loss recorded by them.** This excludes the small volume purchased from embedded generation and industry mechanisms by the **Relevant Licensees' Supply activities.**
7. **The Relevant Licensees' Supply activities do purchase small volumes from embedded generation and industry mechanisms.** As this accounts for less than 5% of the total electricity supply volume reported in the Supply segment of the Consolidated Segmental Statement (Table 1), to avoid overcomplicating this Table 3, it is not shown. If it was included there would be a tick in the Supply column for this business function.
8. The **Relevant Licensees' Generation capacity that is not, or has not yet been, contracted with EGC.** **The Relevant Licensees' Supply activities forecast sales, the energy for which has not yet been contracted and their residual exposure to volume changes.**
9. The **Relevant Licensees' Generation** activities responsible for procuring fuel for operational renewable plant.
10. Other than procuring fuel for operational renewable plant, EGC is responsible for procuring fuel for generation.
11. **E.ON's transfer pricing arrangements mean that there is no matching of the Group's, or Relevant Licensees', own generation with own supply.**
12. The Transmission System Operator forecasts the total system demand.