

Updated Household energy bills explained

Factsheet 81

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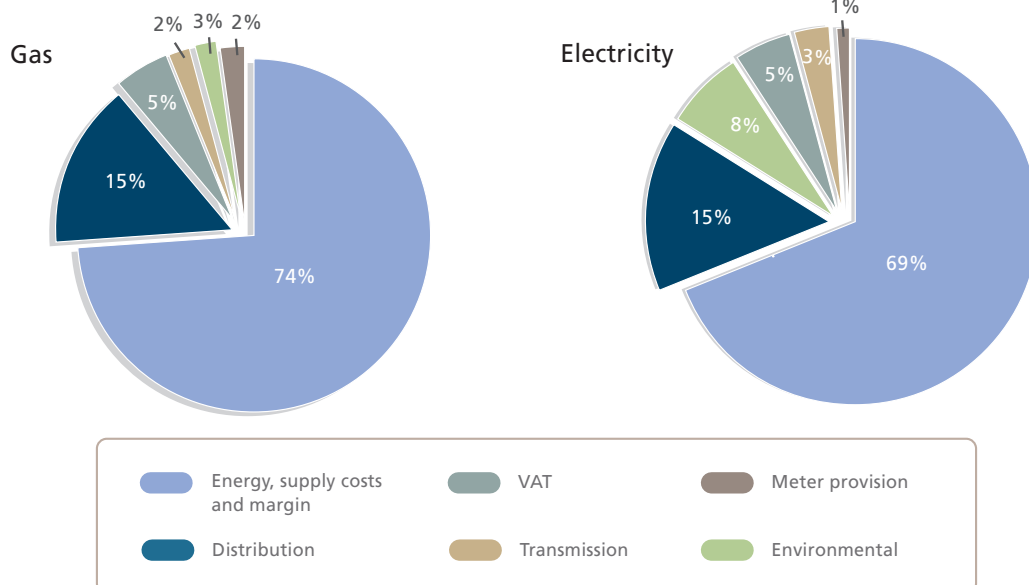
During 2008 customers experienced significant increases in their gas and electricity bills as suppliers passed on rising wholesale energy prices. Wholesale prices subsequently began to fall and since January 2009 all the major suppliers have reduced their bills.

► What makes up energy bills?

There are a number of complex factors affecting energy bills. Wholesale costs currently make up around 60 per cent of bills and if they continue to fall, suppliers will be under competitive pressure to make further price cuts. Retail energy bills are not price regulated. However, Ofgem continually monitors the market and has found no evidence that suppliers are not passing on wholesale cost savings

when they occur. But other factors are pushing bills upwards. The cost of the Government's environmental programmes is increasing and is set to rise further. Investment to renew Britain's energy infrastructure and connect more renewables are also adding to network charges, which make up 15% of the bill.

Breakdown of gas and electricity bills. This reflects current gas and electricity prices in June 2009. The current average gas bill for a quarterly credit account is £800 and for electricity it is £445.



The average bills above are based on average annual consumption figures of 3,300 kWh for electricity and 20,500 kWh for gas. They exclude any prompt payment discounts.

► What comprises the typical energy bill?

Element of bill	How have these costs shifted over time?
Wholesale energy costs (the costs of the gas, oil, coal)	Risen in recent years as international commodity price have increased and dependence on international gas markets increases
Supply costs (costs of metering, billing, and supplier margin)	No significant changes.
Network charges (costs of transporting and distributing energy to homes and businesses)	These were reduced significantly since privatisation as a result of the network companies becoming more efficient under Ofgem's regulation. But costs are now rising due to increases to renew ageing assets and help the drive to a low carbon economy
Environmental levies (costs of Government schemes to promote renewables, low carbon technologies and energy efficiency)	A decade ago these costs were not part of the bill but are now significant and are set to rise further as new Government schemes to support the move to a low carbon economy come on stream

► How do wholesale energy costs affect customers' bills?

Wholesale energy costs account for the largest share of customers' bills. In order to secure supplies and insulate consumers from volatile and frequent swings in wholesale prices, suppliers buy a large proportion of their energy requirement in advance of use. Suppliers tend to smooth the way in which the costs are passed on, spreading them over

the course of a year, or more, to keep customer prices stable and, for example, to avoid large price increases in winter months when customers are using more energy. Some energy suppliers will be smarter than others in their forward buying strategies. This will dictate how well they can compete on price and shield customers from increases.

► Ofgem keeps a watchful eye.

Ofgem examined in detail the relationship between wholesale and retail energy prices as part of its energy supply probe in 2008. We found no evidence to suggest that changes in wholesale costs have been passed through to customers to a greater extent when wholesale prices rise compared with when they fall.

But we continue to monitor this relationship closely and publish quarterly analysis. Our work and methods are transparent and have been consulted on widely. We continue this work and are determined to ensure that suppliers pass on changes in wholesale costs fairly.

► What drives wholesale costs?

The global price of oil, coal and gas drives wholesale costs and affects consumers' bills in the long term.

Movements in the prices of these commodities over the past year have been volatile. These prices are set in international markets and driven by global factors such as the availability of gas and the global demand for energy.

Gas, as well as providing a fuel to households, also drives 30 to 40 per cent of electricity generation in Britain. Many gas contracts in Europe are linked to oil contracts and therefore movements in oil prices can feed through to wholesale gas prices. Crude oil prices were at a record high of around \$145 per barrel in July 2008 subsequently falling to around \$35 per

barrel in January 2009. Between January and the end of May 2009 crude oil prices steadily rose and are currently at around \$65 - \$70 per barrel - much higher than long-term averages.

North Sea supplies provide a significant proportion of our gas but since North Sea fields began to decline Britain is now a net importer of gas during the winter. To offset the decline in North Sea production, investments have been made in facilities to import gas from a diverse range of sources. These include new pipelines to import gas from Norway, interconnectors with Europe and development of Liquefied Natural Gas (LNG) import terminals. These help to reduce the impact of any gas supply issues on mainland Europe but also make GB prices increasingly susceptible to global market prices.

(What drives wholesale costs? continued)

Coal prices also drive wholesale electricity prices as coal is used to generate 30 - 40 per cent of electricity in Britain. The price of coal delivered to North West Europe peaked in July 2008 at around \$210 per tonne but has since fallen and is currently traded around \$50 - \$70 per tonne.

Current energy policy is aiming to increase the diversity of energy supplies – eg more renewables and new nuclear. Ultimately this will help reduce dependency on international

energy markets and energy prices. Ofgem is also a strong supporter of the European Commission's work to make European energy markets more competitive. Particularly important to Britain is the on-going work to improve the transparency of the European energy market and end the anti-competitive practices of some large European utilities. A more competitive European market will help to undermine the link between oil and gas prices on the Continent.

▶ Will suppliers increase or lower bills again this year?

It is up to individual suppliers to decide whether and when they should make changes to their prices. In Britain's competitive market some suppliers will be smarter at buying their energy than others, meaning they will be able to keep

their prices lower. If they do, they stand a better chance of retaining existing customers and attracting new ones. Ofgem's research says that almost all customers cite prices as the main reason to switch supplier.

▶ How do our household energy prices compare with Europe?

EU-15 2008**Domestic electricity prices before taxes, Euro cents per kWh**

	cents/kWh
Ireland	17.9
Belgium	15.8
UK	15.3
Luxembourg	13.7
Germany	13.4
Denmark	13.2
Netherlands	13.2
Spain	12.8
Austria	12.7
Sweden	11.4
Portugal	10.7
Greece	10.1
Finland	9.6
France	9.3
Italy	NA

Source: Eurostat. Prices are for the second half of 2008, based on domestic customers consuming 2,500-5,000 kWh annually.

Domestic gas prices before taxes, Euro cents per kWh

	cents/kWh
Sweden	6.1
Portugal	6.0
Germany	5.8
Ireland	5.7
Spain	5.6
Belgium	5.0
France	4.9
Italy	4.9
Netherlands	4.8
Denmark	4.7
Austria	4.7
UK	4.6
Luxembourg	NA
Finland	NA
Greece	NA

Source: Eurostat. Prices are for the second half of 2008, based on domestic customers consuming between 5,500-55,500 kWh annually.

Competition in the supply market, effective regulation by Ofgem of the energy networks, and lower taxes mean Britain's electricity bills are still competitive compared with most other European countries. Britain's gas bills are also still among the cheapest in Europe. **Importantly - when taxes are included, the UK's electricity prices are even more competitive.**

► Cost of environmental programmes

A growing number of Government environmental programmes impact on customers' bills as suppliers pass on the cost associated with them. The current costs are set out below.

The amount customers pay towards these programmes has risen over the past few years and will continue to rise. The Government estimates that all the policies in its newly launched UK Carbon Transition Plan will increase current energy bills by 6% by 2020.

The costs of combating climate change

EU Emissions Trading Scheme

The EU ETS trading scheme, which puts a price on pollution emitted by electricity generators and heavy industry, is increasing generation costs which feeds through to customers.

For a typical domestic customer with an annual electricity consumption of 3,300 kWh, the cost of EU ETS is estimated to be around **£24** for 2009. This estimate is based on a number of factors and is already reflected in the wholesale electricity cost. Carbon prices are currently low but if they rise again the cost to customers attributed to EU ETS is likely to increase.

CERT (Carbon Emissions Reduction Target)

CERT has been the Government's main method of delivering energy efficiency since April 2008.

It obliges energy suppliers to reduce carbon dioxide emissions by promoting energy efficiency and promoting household-based electricity generation to domestic energy users. The Government is proposing to extend the scheme to 2012. From summer 2009 it is estimated that it will cost each domestic customer using gas and electricity **£45** per year.

CESP (Community Energy Saving Programme):

A new scheme that will oblige electricity suppliers and generators to promote energy efficiency in areas with high levels of low-income households.

Due to start in September 2009 and scheduled to run to 2012 it is estimated CESP will add around **£3** per year for a customer using gas and electricity.

The Renewables Obligation (RO):

Electricity suppliers are obliged by Government to source an annually increasingly amount of electricity from renewable sources.

In 2009/10 the RO adds around **£12** to annual electricity bills.

► Investment in Britain's energy networks

The costs of transporting energy are directly regulated by Ofgem. In order to maintain secure gas and electricity supplies upgrades to the networks are needed, which include replacing ageing electricity infrastructure and lower pressure gas mains so gas can be transported more safely. Electricity network companies also need to invest in their networks to connect increasing amounts of low carbon and renewable generation. As a result, average electricity bills may rise by around **£4** during 2009 (the exact amount will vary around

the country). Ofgem's five-year price controls on network companies aim to strike the right balance between allowing the companies adequate resources to invest in their networks while ensuring that customers interests are protected. However, it is likely that electricity network costs will continue to increase during the next decade and beyond. For example, Ofgem has just published initial proposals for the 2010 - 2015 electricity distribution price controls. The effect on domestic bills will be an average annual increase of less than **£4**.

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