

SSE



Scottish and Southern
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Our Reference:
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Dear Alistair

HOUSEHOLD ENERGY BILLS

Thank you for your letter of 4 August about the outlook for the energy prices being paid by customers of SSE. The importance of good communication between energy suppliers and customers cannot be over-stated. During 2008/09, people in SSE's service centres in Basingstoke, Cardiff, Cumbernauld, Perth and Portsmouth had 18 million conversations with customers and, on the specific issue of prices, I sent a letter to all of our customers last autumn. I would certainly consider doing something similar as and when the position on prices becomes clearer.

SSE's stated aim in energy supply is to offer consistently competitive prices and maintain best-in-sector service, over the medium term. As you know, the electricity and gas bills paid by customers cover six separate costs: securing the energy which customers actually use; distributing that energy to customers' homes; providing meters in those homes; delivering associated services to help customers; environment and social costs under the various government schemes; and VAT at 5% levied by the government.

Of these, the principal costs are the energy itself, distribution of that energy and implementing environment and social policies.

Environment and social costs: the EU Emissions Trading Scheme, the Renewables Obligation and the Carbon Emissions Reduction Target currently cost the typical household around £83 a year. In spite of a reduction in the price of carbon dioxide emissions allowances, this is up from around £64 in 2007/08 and is set to increase further in 2010/11 and beyond as a result of the various public policy proposals set out in The UK Low Carbon Transition Plan and The UK Renewable Energy Strategy in July to "make the necessary transition to low carbon, right for climate change, energy security and jobs".

Distribution costs: electricity and gas network costs are set within five-year Price Controls and in 2009/10 they amount to around £213 for a typical household, compared with £154 in 2004/05. A further increase of £11 on electricity distribution charges in April 2010 is expected, reflecting Ofgem-initiated changes to the methodology for allocating these costs between household and other customers. In addition, a further £11 can be expected to be added to bills in April 2010 as a consequence of the proposals announced by Ofgem on 3 August "to boost customer service and cut carbon from regional electricity networks".

Energy costs: energy costs typically account for around two thirds of the electricity and gas bills paid by customers. Suppliers' first responsibility to their customers is to secure the energy they need and to do this they source energy two years or more in advance of it actually being used by customers. This means there is a lag between rises and falls in wholesale prices and rises and falls in the prices charged to customers. This is particularly significant at the moment because the marked fall in demand for energy experienced in recent months means that it is taking customers longer to consume the energy that was purchased in advance to secure their supply, at wholesale prices which were much higher than is currently the case. As a consequence, on occasion, suppliers have to sell surplus energy above customer demand at a loss on the wholesale markets.

In terms of how wholesale costs are likely to bear on future energy bills, therefore, SSE's aim remains as stated in May; to avoid an increase in 2009 and 2010, despite the fact that wholesale energy prices remain volatile. Forward annual wholesale prices for electricity and gas are currently around 10% to 20% respectively higher for the year starting April 2010 than for the year starting October 2009. Looking forward to the year starting April 2011, the increases are 20% and 40% respectively. With forward annual wholesale prices significantly higher, and with upward pressures in terms of distribution, environment and social costs, seeking to avoid an increase between now and the end of 2010 is an important goal.

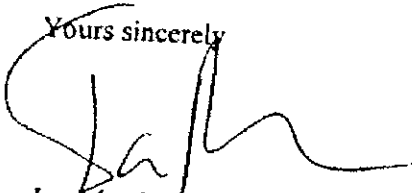
More broadly, SSE's policy on prices is to seek to implement as quickly as possible any price decreases and delay for as long as possible any increases. In all of this, suppliers (like all other businesses) clearly have to secure, over the medium term, a reasonable level of profit which, as the all-party Business and Enterprise Committee of the House of Commons said last December, is a "precondition" of the necessary investment in new electricity generating capacity taking place. From time to time, SSE has sustained significant losses within its energy supply business in order to protect its customers from the worst effects of high wholesale energy prices and it is able to do this during such periods as long as the reasonable level of profit to which the Committee referred can be secured at other times.

As the Committee reported, "once the global economy begins to recover, in the long term 'the era of cheap energy is surely over'". This makes it all the more important that the use of energy is as efficient as possible, and it is clear that the co-operation seen in recent years between government, energy suppliers, Ofgem, consumer organisations and others is delivering a sustained reduction in the amount of gas being consumed in Britain's homes. This makes households less exposed to the impact of high prices than they otherwise would be, because they are using less energy, and this must be a top priority in the future.

In summary, higher forward annual wholesale prices and higher distribution, environment and social costs all counter the recent falls in wholesale prices. Nevertheless, SSE would like to follow the reduction in energy prices it implemented in March with a further reduction or rebate if it were possible. In practice, however, it is not yet able to commit to such a reduction, although it remains committed to ensuring its prices are as low as possible over the medium term as part of its strategy to increase further the number of customers to which it supplies electricity and gas.

Moreover, SSE is particularly mindful of the impact on vulnerable customers of energy bills during the winter months of higher consumption, and will actively monitor this in the coming months, especially if the weather is colder than normal. We remain committed to good communication with customers on this key issue and have a number of ideas as to what we will do in the coming months. I will be writing in similar terms to Ed Miliband and Ed Mayo.

Yours sincerely



Ian Marchant
Chief Executive