

Updated Household energy bills explained

Factsheet 66

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Britain has a highly competitive domestic energy market in which prices are set by energy companies in competition with each other.

► Why are suppliers starting to increase bills?

Company decisions on whether to increase prices are based on their own reading of the market. In Britain's competitive market, if they increase bills they have to weigh up how much that increase will lead to a loss of customers.

One of their chief costs - wholesale gas - has increased significantly and that brings a knock-on increase in wholesale electricity prices because more than a third of UK power is generated by gas-fired power stations. Another important factor in electricity prices has been the rise in the price of coal which has doubled compared to 2007. In addition there

has been a significant increase in environmental costs (see back page) and energy network costs.

All suppliers reduced bills at least once in 2007 in response to falling wholesale gas prices. However, compared to January 2007, forward gas and electricity prices for winter 2008/2009 have increased by 31 per cent and 40 per cent respectively. Comparing average day-ahead prices over the past month with the same period in 2007 shows that wholesale gas prices have increased by 66 per cent and wholesale electricity prices have increased by 64 per cent.

► Why are wholesale gas prices rising?

High world oil prices (close to \$100 a barrel) are reflected in gas prices because, outside Britain, the price of gas is linked to the price of oil. This affects Britain because our North Sea reserves are declining so we now have to import a growing amount of gas from the rest of Europe via pipeline links and from elsewhere as liquefied natural gas (LNG). Liquefying gas, shipping it to Britain and converting it back into gas is more expensive than transporting it by pipeline. LNG prices have risen substantially, with pressure from Asian markets (notably Japan) paying high prices to secure LNG imports.

There have been delays in completing the construction of two major LNG terminals at Milford Haven in South Wales. The first phase of these two facilities, which have a combined capacity totalling around 16.5 billion cubic meters, was scheduled to be ready for the start of this winter (2007-2008).

Gas imports from the Norwegian Ormen Lange gas field have been less than expected due to production problems.

► Why are wholesale electricity prices rising?

Currently gas is used to generate around 36 per cent of Britain's electricity. Increases in wholesale gas costs will therefore have a knock-on effect on electricity generation costs. Prices for coal, which is used to generate around 37 per cent of our electricity, have also increased to record

levels. In addition the second phase of the European Emissions Trading Scheme (EU ETS), which began in January 2008, has increased the price of carbon which in turn increases electricity prices.

► Will all suppliers increase bills?

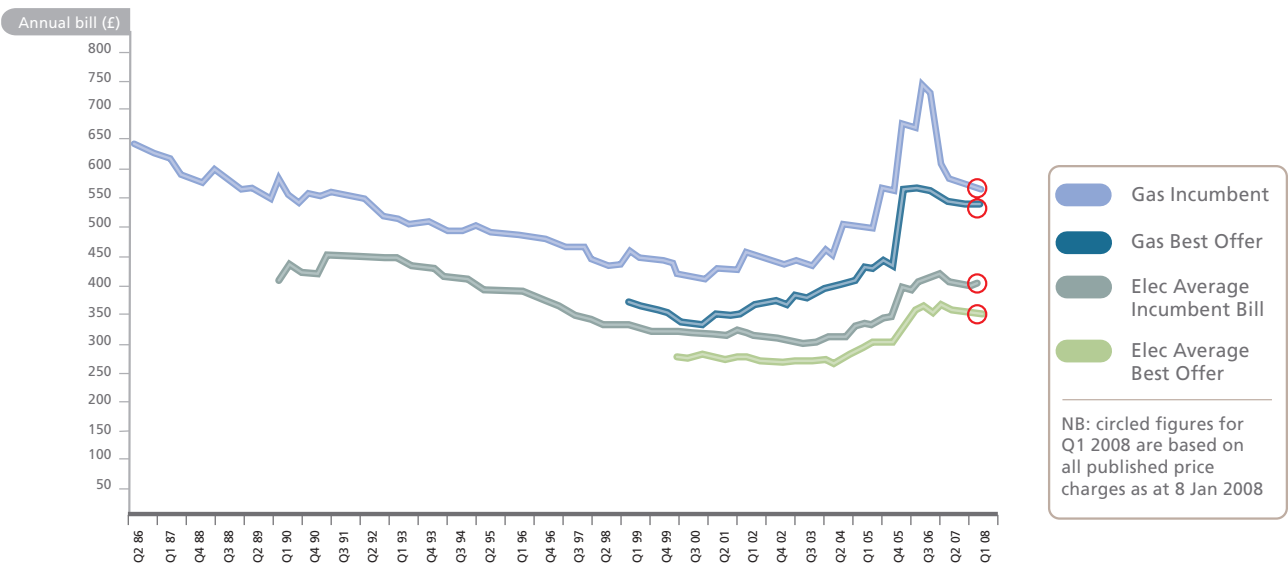
It is up to individual suppliers to decide whether or not to increase bills. In Britain's competitive market some suppliers will be smarter at buying their energy than others, meaning they will be able to keep their prices lower. If they do they will retain existing customers and attract new ones.

The supplier which has consistently offered the lowest prices and best service has doubled its number of customers to eight million over the past three years. Over the last five years we have seen the benefits of competition as companies have offered innovative deals and exploited superior wholesale buying policies to hold onto and win back customers while

others have been punished severely by customers switching away to suppliers offering better deals.

Competition has reined in price increases so standard credit customers who have never switched gas and electricity supplier can save around £90 by doing so. Customers could make even bigger savings by choosing direct debit or web-based tariffs which offer greater discounts. Customers can also sign up to fixed or capped price deals on offer which guarantee no increases for a set period. Over four million customers have done so and were shielded from the sharp price increases which happened between 2004 and 2006.

Domestic gas and electricity bills in real terms

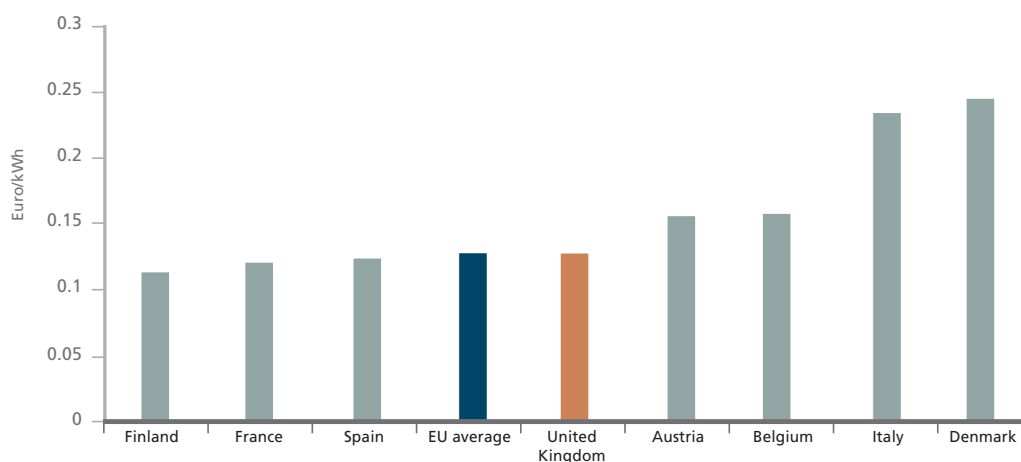


► How do our household energy prices compare with Europe?

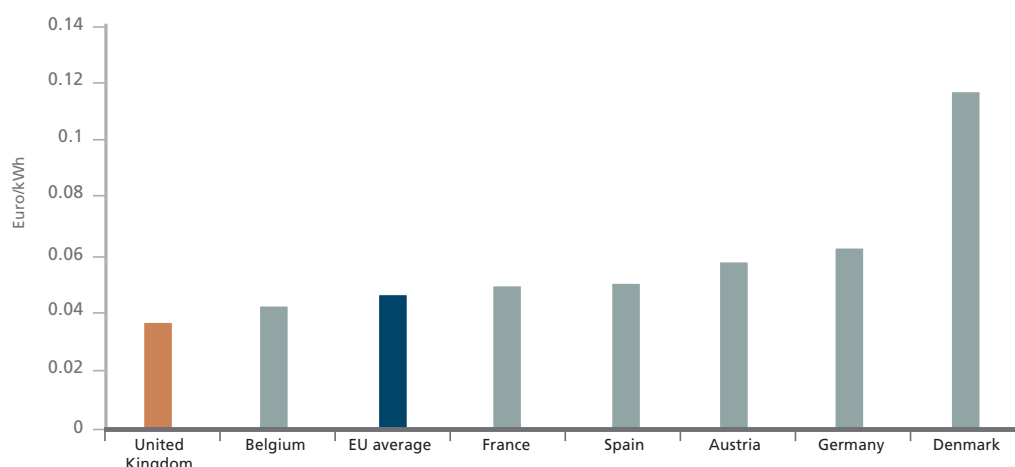
Competition in the supply market, effective regulation by Ofgem of the energy networks, and lower taxes mean Britain's electricity bills are still competitive compared with

most other European countries. Britain's gas bills are also still among the cheapest in Europe.

European electricity prices (including all taxes) in euros per kilowatt hour (kWh) based on annual consumption of 3500 kWh per year



European gas prices (including all taxes) in euros per kilowatt hour (kWh) based on annual consumption of 23250 kWh per year.



Source: Eurostat website. Graphs are based on prices in the second half of 2007

► Europe

Britain's wholesale gas markets are closely linked to European prices, due to the interconnector pipelines connecting us with the continent. **This makes the work of the European Commission to end the large multinational companies' domination of the European gas market even more important to UK consumers.** Ofgem has been instrumental in assisting in that work.

A truly competitive market in Europe akin to Britain's would reduce the cost of continental gas imports to Britain. This is why Ofgem has been working with the European Commission and other European energy regulators to remove barriers to a more competitive European energy market.

► The cost of climate change

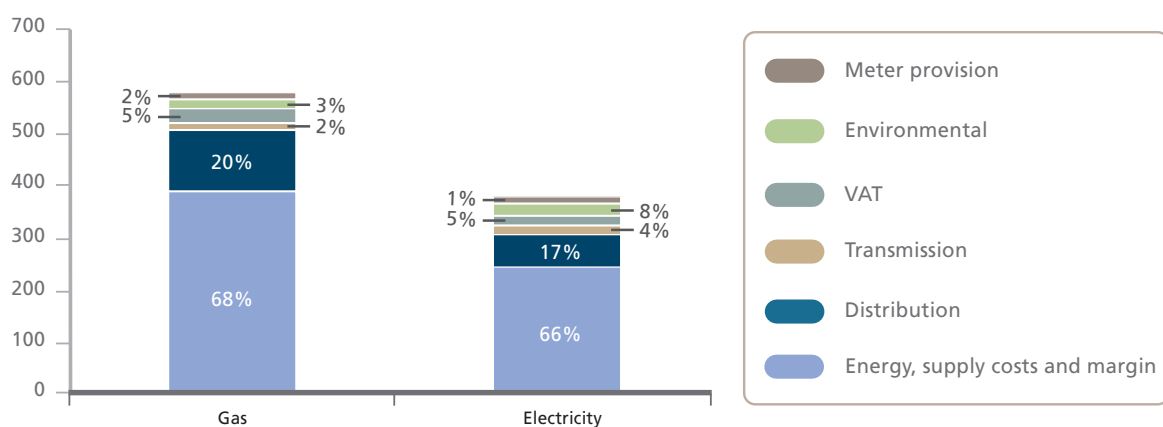
To tackle climate change Britain is increasing its renewable generation capacity and energy efficiency. Ofgem fully supports schemes like the European Emissions Trading Scheme (EU ETS) which offer a market-based solution to tackling

climate change. However, the impact of this scheme and the other environmental schemes outlined below does increase energy prices faced by customers.

► Measures to tackle climate change

- EU Emissions Trading Scheme:** The EU ETS, 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 £31 for 2008. This estimate is based on a number of assumptions and is already reflected in the wholesale electricity cost.
- The CERT (Carbon Emissions Reduction Target)** is a Government policy setting energy suppliers targets for reducing carbon emissions by providing energy efficient appliances in people's homes and increasing use of household-based electricity generation. The CERT replaces the Energy Efficiency Commitment in April 2008 and it is estimated by Defra that the costs to customers will double. Therefore in 2008 a customer using gas and electricity will pay £38 towards the programme.
- The Renewables Obligation:** Electricity suppliers are obliged by Government to source an annually increasing amount of electricity from renewable sources. This currently adds around £10 to an electricity bill per year and is set to rise to around £20 a year by 2015.
- Investment in Britain's energy networks:** 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 renewable generation. As a result, costs increased on average by around £11.37 for gas and £1.37 for electricity in 2007/2008. For 2008/2009 they will rise on average by around £2 in gas and £1 in electricity for a typical domestic customer. However, the extent of the increase varies around the country.

Breakdown of gas and electricity bills (This reflects current gas and electricity prices. However, the environmental costs have been updated to include the additional charges customers will have to pay, for example, for the CERT programme).



For further information please contact:

Mark Wiltsher, Head of Media Relations

020 7901 7006

email mark.wiltsher@ofgem.gov.uk

Chris Lock, Communications Officer

020 7901 7225

email chris.lock@ofgem.gov.uk

Rebecca Hill, Communications Officer

020 7901 7217

email rebecca.hill@ofgem.gov.uk