

Mick Bates AM  
Chair, Sustainability Committee  
National Assembly for Wales  
Cardiff Bay  
Cardiff  
CF99 1N

2nd April 2008

Dear Mr Bates

**SUSTAINABILITY COMMITTEE MEETING OF 10 APRIL 2008: EVIDENCE AHEAD OF SESSION ON FUEL POVERTY IN WALES**

Scottish and Southern Energy (SSE) is grateful to have this opportunity to submit evidence to the Sustainability Committee's inquiry into fuel poverty in Wales. SSE is the UK's second largest supplier of electricity and gas, with around 8.5 million customers, having been the fifth largest six years ago. It supplies energy in Wales through its SWALEC brand. It is also involved in the generation, transmission and distribution of electricity and in the storage and distribution of gas. SSE is listed on the London Stock Exchange and employs over 14,000 people in the UK.

In the invitation letter to respond, it was mentioned that the Committee were deeply concerned as to the impact of increasing fuel prices on Welsh customers and on efforts to tackle fuel poverty, and it was mentioned that this session was related to the interest generated by the latest round of energy price increases and Ofgem's announcement that it intends to conduct a review of the regulatory regime for energy networks.

Given this backdrop, and the fact that there are many complex and inter-related issues involved in this policy area, SSE has provided a broader overview of how the energy market operates in Wales and the UK, in addition to the company's approach to tackling fuel poverty. SSE considers this to be highly relevant to your inquiry and looks forward to discussing these issues on 10 April.

**KEY POINTS**

This submission makes the following key points:

1. The UK energy market is competitive;
2. Price decisions are the result of many issues
3. SSE maintains a responsible and fair pricing policy; and
4. There should be meaningful support for the fuel poor.

Embedded throughout is SSE's voluntary approach to tackling fuel poverty:

- Its responsible and fair pricing strategy
- Its meaningful social tariff
- Its alignment of electricity prepayment prices with standard credit prices.
- Its tailor-made payment measures

## **1. THE UK ENERGY MARKET**

- **The UK's energy market is the most competitive in the EU and G7 – Oxera**
- **All segments of the market remain highly competitive - Ofgem**
- **Successful suppliers increase customer numbers**
- **The UK's competitive market encourages innovation**
- **There are limited barriers to entry in the market**

### **The UK's energy market is the most competitive in the EU and G7 – Oxera**

Multiple studies have been undertaken into the competitiveness of the UK Energy Market. In October 2007, Oxera, the economic consultancy, undertook an independent study examining energy market competition in the EU and G7. Its key conclusion was as follows: "On aggregating the electricity and gas markets, the UK is found to have the most competitive energy market in the EU and G7 in 2005 – a position it has held since Oxera first analysed competitiveness of energy markets in 2001". On a scale of 1 to 10, the UK's competitiveness score was 9.1, compared with 7.8 in second-placed Sweden and 6.3 in fifth-placed Germany.

As the Secretary of State for Business, Enterprise and Regulatory Reform put it: "Creating an open and competitive energy market has meant that UK consumers have consistently benefited from amongst the lowest energy prices in Europe. While it is true that wholesale energy prices are rising, greater choice and transparency are clearly the best protection against these costs being disproportionately passed onto consumers"

### **All segments of the market remain highly competitive - Ofgem**

In addition, Ofgem's Domestic Retail Market Report of June 2007 found that: "Our analysis shows that all segments of the market remain highly competitive and not just for customers who pay by direct debit or online".

Ofgem's analysis hinged upon a number of findings, including that: price competition has led to the spread between prices shrinking and the most expensive suppliers being forced to become more competitive; how innovative products are emerging as suppliers seek to win and retain customers; how customer service is improving; and how switching rates are increasing.

Consumers have a wide choice of energy suppliers and they are exercising that choice. According to Ofgem's June 2007 Report, annual rates of switching were at the highest levels in four years. On average 30,000 more switches took place per month than in the previous year. This was an 11% increase in monthly switching rates over the year.

This trend is set to continue. Statistics published by Ofgem show that, between January 2007 and July 2007, 2.8 million customers switched their electricity supplier and 2.3 million switched their gas supplier. This compares favourably to the figures for 2006 between January-July, when 2.6 million electricity customers and 2.2 million gas customers switched supplier. Energy suppliers will continue to compete heavily on price and service, strive for innovation and customers will continue to benefit from switching supplier.

In addition, Ofgem have found that of those customers who have not switched, the majority (more than 70%) say they are happy with the price and service they get from their supplier. Around 15% have not switched as they "do not see the point", while under 3% have not switched as they see it as too difficult, or were unaware of switching as an option.

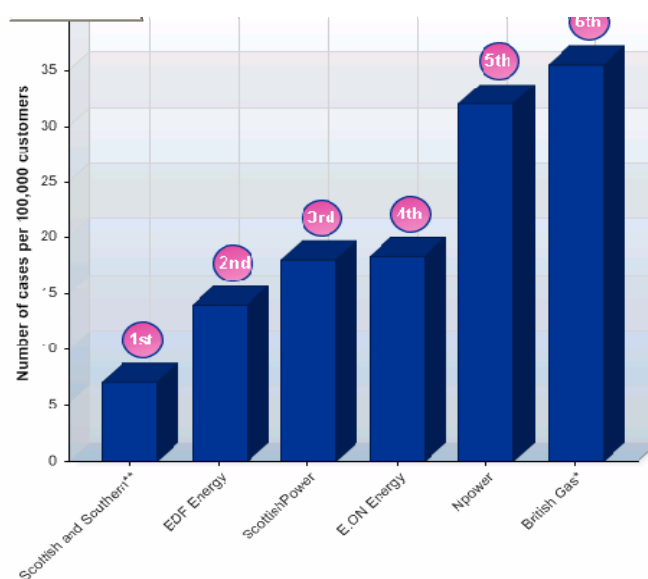
### **Successful suppliers increase customer numbers**

SSE gained one million customers during 2007 and now has well over eight million electricity and gas customers. This enabled it to overtake EON UK to become the UK's second largest energy supplier, having been fifth six years ago.

This achievement in recent years demonstrates the highly competitive nature of the market: by offering lower prices and achieving the best performance ratings for customer service SSE has outperformed its competitors in this market, and customers have voted with their feet.

While SSE attributes a significant amount of the credit for its customer growth in terms of attracting new customers upon its pricing strategy (more on this topic below), it also retains customers by leading its sector in customer service and complaint handling. Suppliers are competing on complaints and customer service performance as well as price, so SSE considers service to be a primary part of its offering to customers.

According to energywatch investigated complaints cases, SSE is consistently the best performer, with British Gas and npower performing less admirably. See graph below taken from energywatch website which shows performance across the industry for November 07 – January 08 .



**The UK’s competitive market encourages innovation**

In addition to stimulating competition in service levels, evidence also suggests that Britain’s energy supply market drives new product development: 20% of the market is now served by new products such as fixed or capped rate products, online deals or green supply products .

As a supplier SSE has responded to competition by launching a number of competitive innovative tariffs, catering for different customers’ needs. Towards the end of last year, SSE launched the ‘better plan’, a unique package which offers customers financial rewards for reducing their energy consumption. Customers receive 100% hydro-electricity at no extra cost and can earn cash credits by being helped to take a few steps to being more energy efficient. New joiners also receive a monitor displaying their energy usage.

SSE also offers an export tariff called Solar Energyplus. It offers grid-tied photovoltaic solar system owners a market leading 18 pence / kWh export tariff. It is aimed at small businesses and households and SSE pays to install export meters, obtain Renewable Obligation Certificate (ROC) accreditation, and act as ROC agent for owners of solar energy systems. At 18 pence per kWh exported, a system generating 1500kWh per year (equivalent to half the UK average for household energy consumption) will earn £135 per year if it exports 50% of power generated. It is also important to note that tariffs such as Solar Energyplus and other flexible innovative tariffs would be aided substantially by the introduction of smart meters.

### **There are limited barriers to entry in the market**

As explained above, the energy supply market is vigorously competitive, with strong evidence of customer awareness of the competitive market, a switching process that is straightforward for customers, a wide range of offers from suppliers and large numbers of customers exercising choice to switch to alternative suppliers. SSE believes that on each of these counts the competitive energy supply market would compare favourably with other competitive markets.

Nevertheless, one criticism that has been levelled at energy supply is that it is “too difficult” for new entrants to break into the market. Again, SSE does not believe that the evidence supports this. It is relatively easy for any party to obtain a supply licence and sign up to the relevant industry agreements. There are, for example, currently 150 licensed suppliers and in the last 12 months alone there have been a total of 13 applications for supply licences (six applications for gas supply licences and seven applications for electricity supply licences).

It is true that, since competition began, a number of smaller players have exited the market, notably the insolvency of Independent Energy in September 2000 and the exit of a number of electricity and gas suppliers between December 2005 and February 2006 (Zest4, Utility Link, Reephram Limited, Elador and Team Group UK Limited). There has, however, also been exit and failure by ‘incumbent’ generators and suppliers, including the Government intervention to prevent British Energy going under and the failure of the former Eastern supply business under TXU.

It is also important to note that there has been market entry by a number of high profile names, such as affinity deals with Nectar, Tesco Clubcard, Argos, British Heart Foundation, BA Airmiles and RSPB. In addition, a number of niche players have emerged in the electricity market such as Ecotricity and Good Energy, who specialise in green energy products. Good Energy has also recently been granted a gas supply licence.

However, an example of where competition is not working at a retail level is metering, where the introduction of metering competition has not produced the anticipated benefits, but has led to a fivefold increase in the amount of data that must be processed on change of supplier. Backing out metering competition and reinstating metering as a regulated product of the distribution business would not only simplify the industry change of supplier process significantly, it would also better facilitate the roll-out of new smart metering technologies (which would in turn bring competitive benefits).

## **2. PRICE DECISIONS ARE THE RESULT OF MANY ISSUES, BUT SSE MAINTAINS A FAIR PRICING POLICY**

Whenever price rises (and falls) are examined, it is very important that people understand the reasons behind the decisions. In the sections below, SSE outlines some of the contributory factors to price rises (and falls) covering wholesale gas prices, network costs, and the costs associated with tackling climate change.

### **Wholesale markets**

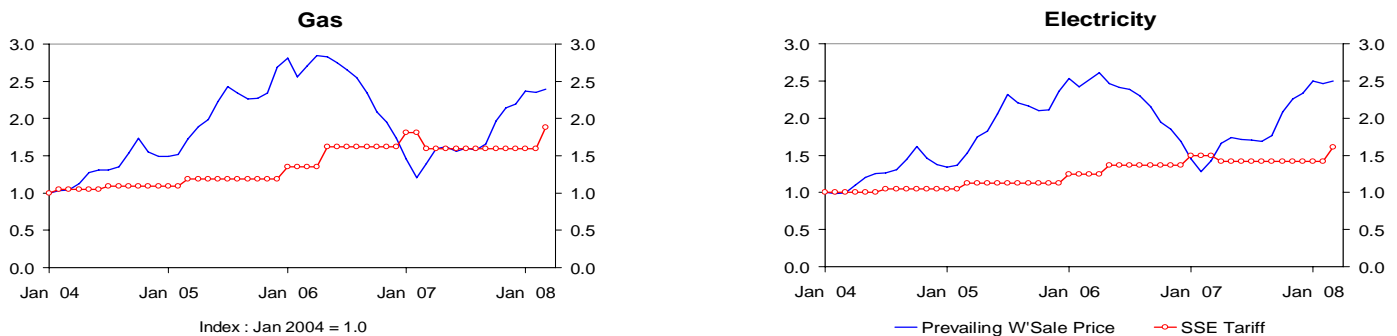
One of the key drivers for recent supplier announcements to raise prices is the recent rise in the wholesale gas price across the world. This is not caused by suppliers and the effect of this on gas prices within a country importing significant quantities of its gas is obvious. However, it must also be understood that with much of the UK’s electricity coming from gas power stations, it will clearly affect electricity prices also. Between 2003 and 2008 wholesale energy prices have increased by a factor of 2.5.

It is also important to understand that for entirely responsible reasons suppliers ‘hedge’ their requirements by buying a significant proportion of their customers’ energy needs in advance.

When wholesale prices are going up, customers benefit as there is a lag before suppliers raise retail prices; similarly, when wholesale prices fall, it takes time for suppliers to see reduced purchasing costs and pass these through to customers.

SSE's ability to work effectively and efficiently in this area has helped it to succeed in this competitive market, and not pass on the full extent of wholesale price increases to its customers. As a result, its customers have paid an average of around £433 less for their gas and electricity between April 2004 and March 2008 than have customers of British Gas. .

The graphs below illustrate the relative change in wholesale prices and SSE's domestic prices for electricity and gas since January 2004, clearly showing how SSE has prevented its customers from facing the full extent of wholesale price increases.



### Delivering climate change initiatives and the costs of network infrastructure

In addition, Government policies to tackle climate change and improve energy efficiency, which command broad support, put an upward pressure on energy prices for all customers. The Carbon Emissions Reduction Commitment (CERT) for example, will add around £38 to the average energy bill for 2008.

Network infrastructure costs have also increased to support the delivery of new renewable energy and the upgrading of energy networks to ensure they are safe and secure for another generation.

The total costs to customers in delivering network infrastructure and environmental policies have risen by almost 50% in the last 4 years, from almost £170 on electricity and gas bills in 2004 to almost £250 in 2008.

### Bill breakdown

The below table indicates how all of the above affects the breakdown of a typical bill, showing the price of SSE's tariffs, the distribution and transmission use of system costs (UoS); the costs of ROCs; the cost of EEC, now CERT; and metering and billing costs. These figures are then added up to make a 'Non Energy Cost'.

In addition, the 'Energy' costs are included, which include the cost of buying the energy (therefore wholesale costs) and include profit margins, as well as losses, which is not insignificant given that in the last few years there have been occasions where supply businesses have been making losses.

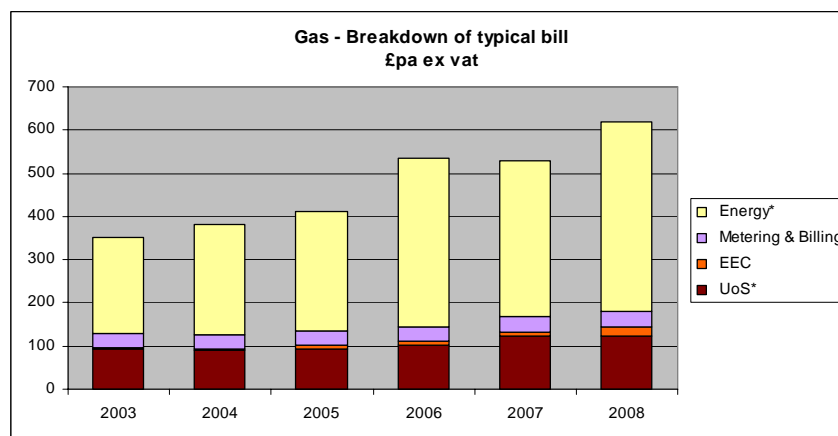
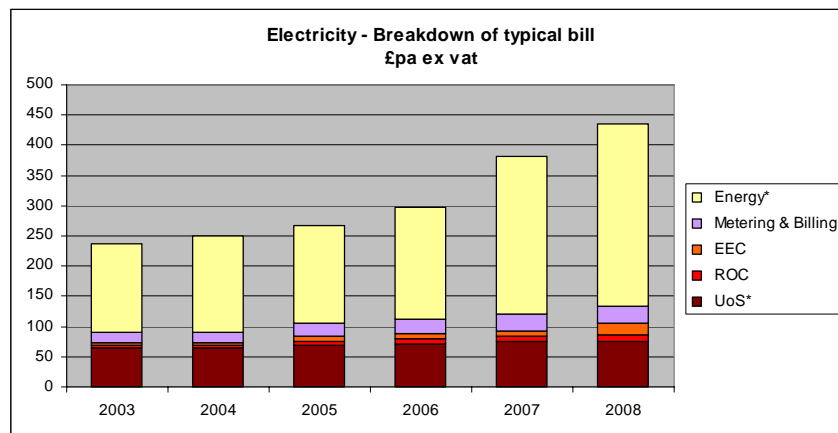
It is also useful to note the following:

- The portion of the electricity bill allocated to 'Energy' has increased by a factor of x1.9. Wholesale energy prices have increased x 2.5 in this period.
- In addition, the portion of the gas bill allocated to 'Energy' has increased by a factor of x1.7. Wholesale energy prices have increased x 2.4 in this period.

Breakdown for typical bill							
£pa	2003	2004	2005	2006	2007	2008	2008 V 2004
<b>ELECTRICITY</b>							£pa Change
<b>Tariff</b>	238	251	267	298	382	436	185 x 1.7
UoS*	64	64	70	72	75	76	12 x 1.2
ROC	4	5	6	7	9	11	6 x 2.1
EEC	4	4	9	9	9	19	15 x 5.3
Metering & Billing	18	18	22	25	27	28	10 x 1.5
Non Energy Costs	90	91	107	113	120	134	43 x 1.5
Energy*	148	160	160	185	262	302	142 x 1.9
<b>GAS</b>							
<b>Tariff</b>	319	348	380	500	495	584	236 x 1.7
UoS*	94	91	94	101	124	124	33 x 1.4
EEC	4	4	9	9	9	19	15 x 5.3
Metering & Billing	33	33	33	34	35	36	3 x 1.1
Non Energy Costs	97	94	103	110	133	143	49 x 1.5
Energy*	222	254	277	390	362	441	187 x 1.7

\* UoS refers to distribution and transmission costs. Prices generally refer to levels at April for electricity and October for gas. Gas in 2008 has been kept at 2007 level.  
\* Energy includes supply profit / loss

To make this information easier to digest, the information is also translated into graphs below.



**Other contributory factors**

The above are not all the contributory factors to price rises and falls. Issues that play their part in influencing wholesale energy prices are as diverse as Japanese nuclear plant problems, LNG supplies, Chinese coal demand, logistical and freight transport issues, Russian and Norwegian

gas, and the oil price and its effect on the global economy. Furthermore, outside Britain the price of gas is linked to the price of oil.

It is against these contributory factors that a supplier must make its price choice and suppliers, of course, have their own internal company structure and cost variations. At the same time, however, the issue of the wholesale gas market in Europe looms very large.

### **Responsible and fair pricing**

SSE adopts a 'fair pricing' policy: it seeks to be the last (or one of the last) of the major energy suppliers to increase prices if it has to, and the first (or one of the first) to lower prices if it can. At a time of sustained rises in wholesale energy prices and other upward pressures on domestic prices, SSE aims to protect its customers from the worst effects.

Household energy consumption is at its highest in the first quarter of the year, with the average household in Great Britain using around 40% of its annual gas consumption and around 30% of its annual electricity consumption in January, February and March. That is why SSE committed not to increase prices during this winter period, in contrast to the actions of all its major competitors. The company kept its electricity and gas prices for domestic customers at their pre-existing levels for the whole of the winter, when they are having to use most energy, and did not implement a price increase until after the start of British Summer Time, on 1 April.

In addition, SSE believes that the following displays further evidence of its fair pricing policy:

- During the period of rising wholesale energy prices, SSE passed on to its customers much less than the full extent of the increases in wholesale prices and environmental costs experienced in that period and it delayed any price rises for as long as possible.
- As a result, its customers have paid an average of a total of £433 less for their gas and electricity between April 2004 and March 2008 than have customers of British Gas.
- SSE was one of the first suppliers to introduce a social tariff to help its most vulnerable customers. Those qualifying for Energyplus Care are offered: a discount of at least 20% off their current tariff; a benefits health check, where appropriate; free energy efficiency measures such as loft and cavity wall insulation; and the loan of an A-rated fridge or fridge freezer if the existing one is inefficient.
- In Wales only, SWALEC created an innovative tariff called 'Easywarm'. Essentially, this tariff offers older customers (over 60s) a fixed charge to cover their household's usage of electricity and gas, providing them with certainty over time, thus meaning they do not have to compromise on comfort levels over winter. The charges are based on the number of persons & bedrooms in house, with payment by direct debit.
- SSE has aligned its electricity prepayment prices with standard credit prices. Although only around 25% of customers on PPMs are classified as fuel poor, this seemed to us to be a sensible way of helping our vulnerable customers, given that we have few ways of locating our fuel poor customers in the absence of better data sharing facilities with Government
- SSE has tailor-made payment measures, used on a daily basis by thousands of people, in order to help them to pay their bills in a manner which suits their financial situation.
- As a result of its fair pricing policy, SSE's standard direct debit tariff is actually cheaper than the tariff British Gas claims to be their social tariff – 'Essentials'. 'Essentials' is a tariff designed to help fuel poor customers pay for their energy bills. The SSE approach is to offer low prices, with a meaningful social tariff for our most vulnerable customers, while other suppliers offer higher overall prices and appear to be spending more on fuel poverty because they highlight slight reductions on their high prices as 'social' spending.

### **3. MEANINGFUL LONG TERM SUPPORT FOR THE FUEL POOR**

In Budget 2008, the UK government said that it wanted to see energy companies spend a total of £150m a year to help tackle fuel poverty. SSE has published a Code of Practice (attached as

an annexe) for helping vulnerable customers that it believes should be adopted across the energy supply industry. This Code is founded on two key points:

- the single biggest contribution which suppliers can make to preventing fuel poverty is to keep prices as low as possible for as long as possible. On this basis, those suppliers who charge most for electricity and gas should contribute most to helping vulnerable customers. At the same time, account does need to be taken of the number of customers which each supplier has. The way to combine these principles is to base suppliers' contribution on the annual turnover of their domestic energy supply businesses – a simple and fair formula which reflects suppliers' total customer numbers and the prices they charge for electricity and gas; and
- suppliers should ensure that any 'social' tariff which they offer to vulnerable customers is the lowest cost tariff that is made available by them to any type of customer, or any type of payment plan or sign-up method. This will ensure that the lowest-cost tariffs are available for the customers who have most difficulty in paying their bills. As an additional safeguard, SSE believes that suppliers should be required to ensure that their 'social' tariff for 'dual fuel' is lower than the average UK direct debit tariff.

SSE's voluntary efforts to assist its fuel poor customers have been founded on these two principles. Given the notorious difficulty there is in identifying and targeting fuel poor households, SSE firmly believes that its twin track strategy makes the greatest contribution in alleviate fuel poverty in Britain. SSE's determination to keep prices as low as possible for all its customers has prevented many thousands of families falling into the formal definition of fuel poverty.

This approach to general pricing is complemented by a deep and meaningful package of support measures through SSE's social tariff 'energyplus care'. Eligible households receive at least a 20% discount from their energy tariff in addition to other help including benefit entitlement checks, free energy efficient appliances and homes insulation, where appropriate.

At the time of writing SSE is engaged in detailed discussions with the Department for Business, Enterprise and Regulatory Reform in devising a voluntary agreement where SSE will radically increase its voluntary contribution to target even more support to its fuel poor customers.

SSE will welcome however greater support from government in the future to help identify the right customers with its programmes to assist the fuel poor. It is very simple: without improved data sharing between Government and suppliers, suppliers have very little means of actually detecting which of their customers are fuel poor, particularly if the customers pay their bills in a timely manner. Until this situation is changed, SSE cannot be sure that its voluntary programmes are reaching the right customers.

I hope the Committee finds this contribution of use.

Yours truly,

**Richard Westoby**

Head of Pricing and Forecasting  
Scottish and Southern Energy Plc