

9 June 2010

## Welsh household electricity prices: Summary

### Overview

Consumer Focus Wales is the statutory voice of the energy consumer with a duty to inform, research and represent on energy matters. In this role we asked our consultants Cornwall Energy to produce a report on the cost of electricity in Wales and regional differentials<sup>1</sup>. This was prompted by continued concern among policy makers and politicians that consumers in Wales pay more for their electricity than those in the rest of Britain. The report updated similar work commissioned by Energywatch Wales in 2008<sup>2</sup>. It also provides greater clarity about electricity costs and shows what the energy consumer is paying for.

We found that the average annual price of electricity in north Wales<sup>3</sup> is **£13** more than the rest of Britain, whilst in south Wales it is **£25** more. The headline situation on price differential has improved since 2008 when the difference was £16 and £35 respectively.

Of greater consequence to consumers, the overall cost of domestic electricity in Wales has gone up significantly from £388 in 2008 to £461 today, which is a 19% rise<sup>4</sup>. This is despite the fact the cost of wholesale electricity to suppliers has fallen by half in the same period.<sup>5</sup>

### Falling profit margins in Wales since 2008

From our analysis it appears that the principal reason for the decline in the price differential between Wales and the rest of the UK is the decision by suppliers' to bring their profit margins in Wales into line with those of the rest of Britain. This follows Ofgem's introduction of an undue discrimination licence condition in September 2009 which prohibits price differentials which are not reflective of underlying costs. Excessive regional differences between electricity prices fell into this category, especially where the same supplier had different (higher) prices for consumers within its historic supply area to those elsewhere.

<sup>1</sup> Welsh Household Electricity Prices, Consumer Focus Wales, 2010, <http://www.consumerfocus.org.uk/assets/4/files/2010/06/Welsh-household-electricity-prices-June-2010.pdf>

<sup>2</sup> Welsh Household Electricity Prices, Energywatch Wales, 2008, [http://collections.europarchive.org/tna/20080922203044/http://www.energywatch.org.uk/uploads/Welsh\\_household\\_electricity\\_prices\\_April\\_2008.pdf](http://collections.europarchive.org/tna/20080922203044/http://www.energywatch.org.uk/uploads/Welsh_household_electricity_prices_April_2008.pdf)

<sup>3</sup> Customers in north Wales are part of the Merseyside and north Wales electricity region

<sup>4</sup> Consumer Focus

<sup>5</sup> Reported prices of electricity and gas on the Heren and Spectron traded power exchanges

## Distribution costs: impact on domestic consumers

The remaining difference in price can be accounted for by the higher cost of distributing electricity in Wales. It costs **£20** a year more to distribute electricity in north Wales than the rest of Britain and **£25** a year more in south Wales. In 2008 the distribution cost differentials were £4 and £20 respectively.

These distribution charges are regulated and subject to scrutiny by Ofgem. It is the regulator's view that these charges should be met by the Welsh bill payer as they accurately reflect costs incurred in service provision. The same system operates in all parts of the country. Consumers pay charges for both regulated distribution and transmission services on this basis.

Sparsity of population is the prime reason for high distribution costs in an area. The south Wales electricity distribution area includes areas of very high sparsity such as the Cambrian Mountains in mid Wales. The historic condition of the distribution network and the cost of its maintenance and improvement is also a factor.<sup>6</sup>

Other elements of electricity bills are determined differently. One, which is noteworthy, is the regulated charge for assistance for areas with high electricity distribution costs (HDCA) or 'Hydro benefit'. Levied on a volume basis, it is paid for by all consumers (business and domestic) through distribution charges across Britain to subsidise the very high cost of distributing electricity in the Scottish Hydro (north of Scotland) region. It is the current incarnation of a long-established arrangement whereby profits from depreciated hydro generation were used to keep end user power costs in northern Scotland significantly closer to the highest levels elsewhere in Great Britain than they otherwise would be. The cost to individual consumers across Britain is minimal at less than a pound year as its total value is around £40 million. Consumer Focus Wales estimates that the HDCA subsidy brings down the distribution costs in the north of Scotland by around a half (though they still remain the highest in Britain overall). The power to extend the subsidy to consumers elsewhere in Britain resides with the UK Government. The table below shows the regional distribution charges. The Scottish Hydro charges, whilst on the high end of the scale, would be almost double the level they are now without the HDCA benefit.

---

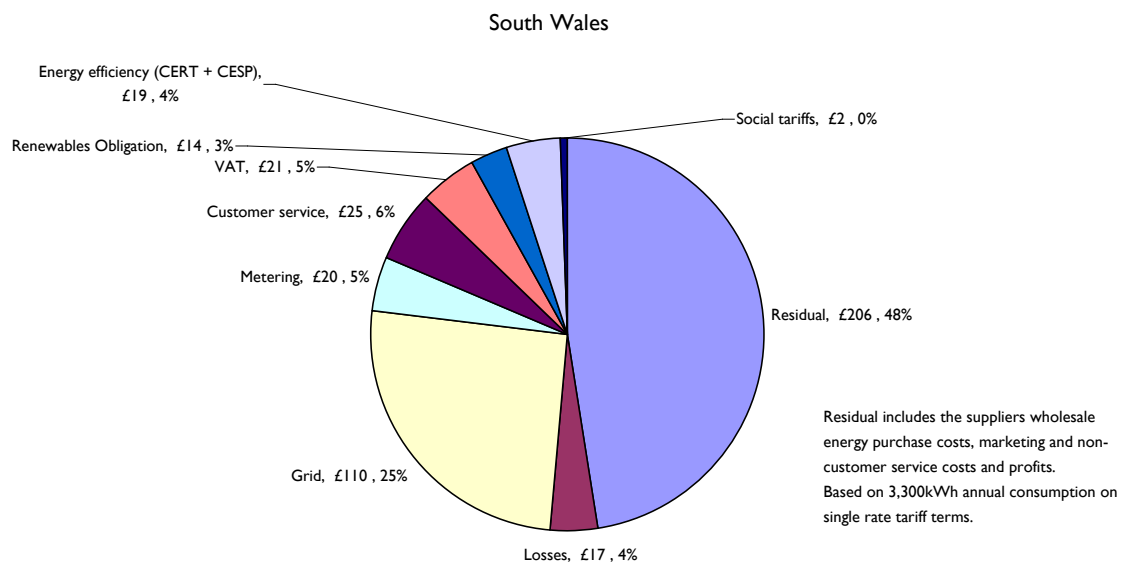
<sup>6</sup> Alison Sleightholm, Regulation and Government Affairs Manager, Western Power Distribution, meeting, 26.5.10

Supply region	Annual network charges total (£) in April 2009 (medium user single rate meter)
Swalec	101.80
ScottishHydro	101.01
SWEB	96.76
ScottishPower	94.88
Southern	86.78
ScottishPower Manweb	86.44
Northern	80.98
Yorkshire	77.22
London	75.76
Norweb	75.15
Midlands	75.08
Eastern	72.99
East Midlands	71.81
Seeboard	70.30
<b>GB average</b>	<b>83.35</b>
<b>England average</b>	<b>78.28</b>
<b>Wales average</b>	<b>94.12</b>
<b>Scotland average</b>	<b>97.95</b>

## Where your money goes

These are the costs which make up the average electricity bill in south Wales

### Components of household electricity bills



Source: Welsh household electricity prices, a paper for Consumer Focus Wales by Cornwall Energy, April 2010

## Wholesale/retail gap

Consumer Focus Wales is concerned at the significant gap which has grown between the rate at which suppliers are assumed to purchase electricity at the wholesale level and then sell it at retail level. As noted above, the wholesale cost of energy has fallen by half since 2008, whilst retail prices have risen by 19%.

The price of wholesale energy is a critical element when assessing consumer bills because it makes up the greatest proportion of the total cost and because it also regularly fluctuates in price within year, unlike other costs. It provides the greatest latitude for companies to make a profit on their supply business, particularly, as now, when wholesale prices are low. Furthermore, due to the vertically integrated structure of the Big Six when wholesale power prices go up profits switch to their generation assets from supply.

Whilst acknowledging that the price of wholesale electricity is currently low, suppliers argue that they buy their electricity in advance in order to hedge against fluctuations in the market. However, according to Ofgem's figures very little forward trading actually happens in Britain. Whereas a significant proportion of gas trades are carried out 12-18 months in advance the number of electricity trades which are carried out more than 6 months in advance is negligible. In fact, very little electricity is traded on wholesale markets. It is mostly traded bi-laterally away from the wholesale market between companies, often within the same group. In other words, this issue could be more serious as in practice the Big 6 energy companies produce much of their own electricity at below current wholesale market costs and are not exposed to the wholesale prices we have cited<sup>7</sup>.

## Next steps

In the months ahead Consumer Focus Wales will raise the issue of regional price differentials with the UK and Welsh Assembly Government, Ofgem and others, particularly with regard to the amount that suppliers charge in the areas where they are the historic supplier. We will also be taking steps to persuade Ofgem to introduce measures to improve trading activity in the wholesale power market.

---

<sup>7</sup> Ofgem is currently consulting on measures to improve liquidity in the GB power market. Please see the Consumer Focus response to the latest Ofgem consultation for more details.  
<http://www.consumerfocus.org.uk/assets/1/files/2009/06/Consumer-Focus-response-to-Liquidity-proposals-for-the-GB-wholesale-electricity-market.pdf>