Decision

Decision on the potential impact of COVID-19 on the default tariff cap: cap period seven			
Publication date:	5 August 2021	**Contact:**	Karen Mayor, Deputy Director Retail Monitoring, Compliance and Price Cap Policy (interim)
		Team:	Retail Price Regulation
		Email:	retailpriceregulation@ofgem.gov.uk

We consulted in March and again in May 2021 on whether to adjust the default tariff cap in cap period seven to account for the impact of COVID-19 on the efficient costs of supplying domestic default tariff customers. This document describes our decision to not include an additional allowance in cap period seven (October 2021 – March 2022) for costs arising from COVID-19. We do not consider that there is significant and clear evidence that suppliers are likely to incur material additional debt-related costs due to COVID-19 for serving domestic default tariff customers.

Contents

Executive summary

The default tariff cap ('cap') protects default tariff customers, ensuring that they pay a fair price for their energy, reflecting its underlying costs. In our February 2021 decision,[1] we concluded that the COVID-19 pandemic had resulted in additional costs – specifically debt-related costs for credit meter default tariff customers - that were material in cap periods four to six (April 2020 to September 2021) and not allowed for through the existing cap methodology. We therefore included an additional allowance in the cap level for cap period six (which started on 1 April 2021) and cap period seven (from 1 October 2021). We set this as a float (which was conservative in favour of consumers), which we would "true-up" later using final costs.

Scope of our assessment

We have assessed whether there is clear and significant evidence that suppliers are likely to incur material additional debt-related costs, in particular:

- bad debt costs[2] for credit customers in cap period seven (October 2021 to March 2022);
- bad debt costs for prepayment meter (PPM) customers for cap periods four to seven (April 2020 to March 2022);
- working capital costs for both credit and PPM customers in cap period seven; and
- debt-related administrative costs for both credit and PPM customers in cap period seven.

Our methodology

We have based our methodology on the one we used in our February 2021 decision. However, we have decided to amend it to include additional filters to assess whether a supplier's forecast should form a part of our sample. We have also decided to include an

---

[1] Ofgem (2021), Decision on the potential impact of COVID-19 on the default tariff cap, executive summary.
https://www.ofgem.gov.uk/publications-and-updates/decision-potential-impact-covid-19-default-tariff-cap

[2] We define bad debt as the unrecoverable debt that suppliers write off. We define working capital as current assets minus current liabilities for the domestic supply business, in line with the definition we used in our November 2020 consultation. The debt-related administrative costs are the costs of chasing debt before it is written off.

assessment of leading institutions' expectations on the impact of COVID-19 on the economy to assess the fundamental need for a float.

Whether a float is necessary

We only consider that a further float is necessary if there is significant and clear evidence that suppliers are likely to incur material additional costs due to COVID-19 in cap period seven. Following our review of suppliers' forecast debt-related costs and the forecasts of key economic metrics, we have not found this to be the case.

Therefore, we have decided to not introduce an additional float for debt-related costs in cap period seven for either credit or PPM.

Sharing factor

Given that we have decided that a further float in cap period seven is not necessary, we currently do not need to decide whether to introduce a sharing factor for it. As such there is no decision set out in this document relating to a 50:50 sharing factor as proposed in our May 2021 consultation.[3]

Going forward

As a result of our decision, there will not be any further adjustment for additional costs related to COVID-19 to either credit or PPM customers in cap period seven. The remaining float of £8.86 per customer[4] will be applied in cap period seven in line with our February 2021 decision.[5]

We will consider as part of our true-up exercise whether it is appropriate to review costs from COVID-19 for cap period seven, though this will be subject to when suitable data becomes available.

---

[3] Ofgem (2021), Reviewing the potential impact of COVID-19 on the default tariff cap: cap period seven, paragraph 3.3.
https://www.ofgem.gov.uk/publications-and-updates/price-cap-consultation-reviewing-potential-impact-covid-19-default-tariff-cap-cap-period-seven

[4] Dual fuel, at the typical consumption values used to set the cap (3,100kWh for single-rate electricity and 12,000kWh for gas).

[5] Ofgem (2021), Decision on the potential impact of COVID-19 on the default tariff cap, Table 4.
https://www.ofgem.gov.uk/publications-and-updates/decision-potential-impact-covid-19-default-tariff-cap

1. Decision process

Our decision-making process

March 2021 working paper

1.1. We published a working paper in March 2021 that set out our initial thinking on reviewing the potential impact of COVID-19 on the default tariff cap ('cap'), and whether an additional allowance (a 'float') for cap period seven (October 2021 – March 2022) was necessary. Stakeholders provided responses in April 2021.

May 2021 consultation

1.2. We published a consultation in May 2021 with our revised proposals. We consulted on whether to update the methodology that we used to set the initial float for cap periods four to six (April 2020 to September 2021), to account for the impact of COVID-19 on the efficient costs of supplying domestic default tariff customers in cap period seven. Stakeholders provided responses in June 2021.

August decision and future process

1.3. This decision is for cap period seven, starting on 1 October 2021. We have decided to not introduce a float[6] in cap period seven for costs arising from COVID-19.

1.4. We will consider as part of our true-up exercise whether it is appropriate to review costs from COVID-19 for cap period seven, though this will be subject to when suitable data becomes available.

[6] In our February 2021 decision for cap periods four to six, we had spread part of the float for credit customers into the additional allowance of £8.86 for cap period seven. We have published the updated Annex 8 alongside this decision.

Related publications

1.5. The main documents relating to the cap are:

- Domestic Gas and Electricity (Tariff Cap) Act 2018: http://www.legislation.gov.uk/ukpga/2018/21/contents/enacted;

- Default Tariff Cap Decision: https://www.ofgem.gov.uk/publications-and-updates/default-tariff-cap-decision-overview.

1.6. The main documents relating to reviewing the potential impact of COVID-19 on the default tariff cap are:

- May 2021 consultation on reviewing the potential impact of COVID-19 on the default tariff cap ('May 2021 consultation'): https://www.ofgem.gov.uk/publications-and-updates/price-cap-consultation-reviewing-potential-impact-covid-19-default-tariff-cap-cap-period-seven;

- March 2021 working paper on reviewing the potential impact of COVID-19 on the default tariff cap ('March 2021 working paper'): https://www.ofgem.gov.uk/publications-and-updates/price-cap-working-paper-reviewing-potential-impact-covid-19-default-tariff-cap-cap-period-seven;

- February 2021 decision on the potential impact of COVID-19 on the default tariff cap ('February 2021 decision'): https://www.ofgem.gov.uk/publications-and-updates/decision-potential-impact-covid-19-default-tariff-cap;

- November 2020 consultation on reviewing the potential impact of COVID-19 on the default tariff cap: ('November 2020 consultation'): https://www.ofgem.gov.uk/publications-and-updates/reviewing-potential-impact-covid-19-default-tariff-cap-november-2020-consultation;

- September 2020 policy consultation on reviewing the potential impact of COVID-19 on the default tariff cap: ('September 2020 consultation'): https://www.ofgem.gov.uk/publications-and-updates/reviewing-potential-impact-covid-19-default-tariff-cap-september-2020-policy-consultation;

- Impact of COVID-19 on retail energy supply companies – regulatory expectations from 1 July 2020: https://www.ofgem.gov.uk/publications-and-updates/impact-covid-19-retail-energy-supply-companies-regulatory-expectations-1-july-2020.

General feedback

1.7. We are keen to receive your comments on the clarity of this report. We would also like to get your answers to these questions:

1. Do you have any comments about the overall quality of this document?
2. Do you have any comments about its tone and content?
3. Was it easy to read and understand? Or could it have been better written?
4. Are its conclusions balanced?
5. Did it make reasoned recommendations?
6. Any further comments?

Please send any general feedback comments to retailpriceregulation@ofgem.gov.uk.

2. Introduction

What are our decisions?

2.1. This document sets out our decision to not introduce a further float to account for the potential impacts of COVID-19 in cap period seven for domestic default tariff customers.

2.2. We do not consider there is significant and clear evidence that suppliers are likely to incur material additional debt-related costs due to COVID-19 for serving domestic default tariff customers in the periods assessed. Therefore, we have decided that a float for cap period seven is not needed for:

- bad debt costs for credit customers in cap period seven (October 2021 to March 2022);
- bad debt costs for prepayment meter (PPM) customers for cap periods four to seven (April 2020 to March 2022);
- working capital costs for both credit and PPM customers in cap period seven; and
- debt-related administrative costs for both credit and PPM customers in cap period seven.

2.3. We have decided to broadly maintain the methodology we have used for the COVID-19 adjustment in our February 2021 decision.[7] However, we have decided to amend our methodology to include additional filters to assess whether a supplier's forecast should form part of our sample. Given the underlying uncertainty on the need for a float for cap period seven, we have sought to avoid using forecasts when we had concerns that they may not represent reasonable estimates of the likely additional COVID-19 costs that suppliers will incur. As a result, we have decided to remove unreasonable forecasts or inconsistent data from the sample that we use to

[7] Ofgem (2021), Decision on the potential impact of COVID-19 on the default tariff cap. https://www.ofgem.gov.uk/publications-and-updates/decision-potential-impact-covid-19-default-tariff-cap

benchmark costs. This will ensure that our float estimate is conservative and that we err on the side of customers to protect customers' interests. We have also decided to include an additional assessment of external forecasts of key economic metrics to form a view on the fundamental need for a float.

2.4. Given that we have decided that a further float in cap period seven is not necessary, we currently do not need to decide whether to introduce a sharing factor for it. As such there is no decision set out in this document relating to a 50:50 sharing factor as proposed in our May 2021 consultation.[8]

Structure of this decision document

2.5. This decision document has the following structure:

- Chapter 1 outlines our decision-making process.
- Chapter 2 summarises our decisions and the structure of this document. It also provides a general introduction to the cap.
- Chapter 3 sets out the scope of our assessment and our decisions to amend the existing methodology to assess the need for a float for credit and PPM customers.
- Chapter 4 sets out our decision to not have an additional float for debt-related costs due to COVID-19 in cap period seven. It also outlines our views on key economic metrics and Request for Information (RFI) results.
- Appendices 1 to 4 contain details on stakeholders' comments on our approach, as well as the data we collected through our RFI and the calculations which led to our decision. Appendices 5 to 7 contain some details on how we addressed the stakeholders' comments on additional filters, sharing factor and customer

[8] Ofgem (2021), Reviewing the potential impact of COVID-19 on the default tariff cap: cap period seven, paragraph 3.3.
https://www.ofgem.gov.uk/publications-and-updates/price-cap-consultation-reviewing-potential-impact-covid-19-default-tariff-cap-cap-period-seven

mix in responding to our March 2021 working paper and May 2021 consultation.

The default tariff cap

2.6. We set the cap with reference to the Domestic Gas and Electricity (Tariff Cap) Act 2018 ('Act'). The objective of the Act is to protect current and future default tariff customers. We consider protecting customers to mean that prices reflect underlying efficient costs. In doing so, we must have regard to four matters:[9]

- the need to create incentives for holders of supply licences to improve their efficiency;
- the need to set the cap at a level that enables holders of supply licences to compete effectively for domestic supply contracts;
- the need to maintain incentives for domestic customers to switch to different domestic supply contracts; and
- the need to ensure that holders of supply licences who operate efficiently are able to finance activities authorised by the licence.

2.7. The requirement to have regard to the four matters identified in section 1(6) of the Act does not mean that we must achieve all of these. In setting the cap, our primary consideration is the protection of existing and future consumers who pay standard variable and default rates. In reaching decisions on particular aspects of the cap, the weight to be given to each of these considerations is a matter of judgment. Often, a balance must be struck between competing considerations.

2.8. In setting the cap, we may not make different provisions for different holders of supply licences.[10] This means that we must set one cap level for all suppliers.

[9] Domestic Gas and Electricity (Tariff Cap) Act 2018, Section 1(6).
https://www.legislation.gov.uk/ukpga/2018/21/section/1/enacted
[10] Domestic Gas and Electricity (Tariff Cap) Act 2018, Section 2(2).
http://www.legislation.gov.uk/ukpga/2018/21/section/2/enacted

3. Scope and methodology

Chapter summary

This chapter sets out the scope of our assessment on whether there is significant and clear evidence that suppliers are likely to incur material additional costs due to COVID-19 for serving domestic default tariff customers. It also sets out our decision on the methodology we use to assess the need for a float for both credit and PPM customers.

Summary

3.1. In line with our February 2021 decision,[11] we have decided to only assess suppliers' additional debt-related COVID-19 costs for serving default tariff customers.

3.2. As proposed in our May 2021 consultation,[12] we have decided to only provide an adjustment where there is significant and clear evidence that suppliers are likely to incur material additional costs due to COVID-19 for serving domestic default tariff customers.

3.3. We have decided to maintain the majority of the methodological features we set out in our February 2021 decision relating to cap periods four to six. We have decided to make the following amendments to our methodology for determining the impact of COVID-19 on debt-related costs for cap period seven:

- to include additional filters; and
- to include an assessment of external forecasts of key economic metrics to form a view on the fundamental need for a float.

[11] Ofgem (2021), Decision on the potential impact of COVID-19 on the default tariff cap, paragraph 2.7.
https://www.ofgem.gov.uk/publications-and-updates/decision-potential-impact-covid-19-default-tariff-cap
[12] Ofgem (2021), Reviewing the potential impact of COVID-19 on the default tariff cap: cap period seven, paragraph 3.2.
https://www.ofgem.gov.uk/publications-and-updates/price-cap-consultation-reviewing-potential-impact-covid-19-default-tariff-cap-cap-period-seven

3.4. Given we have decided that a further float in cap period seven is not necessary (as discussed in Chapter 2 and 4), we currently do not need to decide whether to introduce a sharing factor for it. As such there is no decision set out in this document relating to a 50:50 sharing factor as proposed in our May 2021 consultation.[13]

Scope of our assessment

Context

3.5. In our February 2021 decision, we decided to only adjust for debt-related costs for credit meter default tariff customers for cap periods four to six. We said that this was the only area where we had seen clear evidence of a likely increase in the efficient costs of serving default tariff customers that was not addressed in the existing cap methodology or by a separate process.[14]

3.6. In our March 2021 working paper, we noted the uncertainties on the extent and speed of the economic recovery in 2021. We said that, due to these uncertainties, it was unclear whether suppliers would incur material additional debt-related costs as a result of COVID-19 in cap period seven and whether a float would be necessary for either credit or PPM customers.

3.7. In our May 2021 consultation, we set out our scope for reviewing whether there was significant and clear evidence that suppliers were likely to incur material additional costs due to COVID-19 for serving domestic default tariff customers.[15] We considered that a float for additional COVID-19 costs would only be required to the extent that these additional costs were material. We continued to expect suppliers to manage ordinary variations in actual costs from forecasts, which could both increase and decrease costs compared to the allowance. We also continued to expect that

[13] Ofgem (2021), Reviewing the potential impact of COVID-19 on the default tariff cap: cap period seven, paragraph 3.3.
https://www.ofgem.gov.uk/publications-and-updates/price-cap-consultation-reviewing-potential-impact-covid-19-default-tariff-cap-cap-period-seven
[14] Ofgem (2021), Decision on the potential impact of COVID-19 on the default tariff cap, paragraph 2.7.
https://www.ofgem.gov.uk/publications-and-updates/decision-potential-impact-covid-19-default-tariff-cap
[15] Ofgem (2021), Reviewing the potential impact of COVID-19 on the default tariff cap: cap period seven, paragraph 3.4-3.23.
https://www.ofgem.gov.uk/publications-and-updates/price-cap-consultation-reviewing-potential-impact-covid-19-default-tariff-cap-cap-period-seven

small changes (increasing and/or decreasing efficient costs) could be covered by existing uncertainty allowances and prudent assumptions in the cap methodology.[16]

3.8. We also set out in that consultation that we intended to consider bad debt, working capital, and debt-related administrative costs for both credit and PPM customers in cap period seven.[17] In addition, we intended to consider additional bad debt costs due to COVID-19 for serving PPM customers during cap periods four to six.

Decisions

3.9. In line with our February 2021 decision,[18] we have decided to only assess suppliers' additional debt-related COVID-19 costs for serving default tariff customers.

3.10. As proposed in our May 2021 consultation,[19] we have decided to only provide an adjustment where there is significant and clear evidence that suppliers are likely to incur material additional debt-related COVID-19 costs for serving default tariff customers.

3.11. For credit customers, we have decided to assess whether there are likely to be material additional COVID-19 costs for bad debt in cap period seven. This is because we have already considered and provided a float for material additional costs for cap periods four to six in our February 2021 decision.[20]

---

[16] Ofgem (2021), Reviewing the potential impact of COVID-19 on the default tariff cap: cap period seven, paragraph 3.20.
https://www.ofgem.gov.uk/publications-and-updates/price-cap-consultation-reviewing-potential-impact-covid-19-default-tariff-cap-cap-period-seven

[17] We define bad debt as the unrecoverable debt that suppliers write off. We define working capital as current assets minus current liabilities for the domestic supply business, in line with the definition we used in our November 2020 consultation. The debt-related administrative costs are the costs of chasing debt before it is written off.

[18] Ofgem (2021), Decision on the potential impact of COVID-19 on the default tariff cap, paragraph 2.7.
https://www.ofgem.gov.uk/publications-and-updates/decision-potential-impact-covid-19-default-tariff-cap

[19] Ofgem (2021), Reviewing the potential impact of COVID-19 on the default tariff cap: cap period seven, paragraph 3.2.
https://www.ofgem.gov.uk/publications-and-updates/price-cap-consultation-reviewing-potential-impact-covid-19-default-tariff-cap-cap-period-seven

[20] Ofgem (2021), Decision on the potential impact of COVID-19 on the default tariff cap, paragraph 4.55.
https://www.ofgem.gov.uk/publications-and-updates/decision-potential-impact-covid-19-default-tariff-cap

3.12. For PPM customers, we have decided to assess whether there are likely to be material additional COVID-19 costs for bad debt throughout the COVID-19 pandemic (cap periods four to seven). This is in line with our February 2021 decision where we noted that we would review PPM costs.[21]

3.13. We have decided to assess the bad debt costs for PPM customers separate to credit customers. This is because we consider it is much harder for a PPM customer to incur debt. If a PPM customer does incur debt, it is unlikely to be as much as the amount a credit customer can accrue over time due to the different payment structure and the ability to access credit for PPM customers.

3.14. We have decided to assess working capital costs and debt-related administrative costs for credit and PPM customers together. This is because suppliers cannot provide us with disaggregated data on these costs by payment method. As we have already considered these costs for cap periods four to six as part of our February 2021 decision, we have decided to only consider whether there are likely to be material additional COVID-19 costs in cap period seven.

3.15. Table 3.1 summarises the cap periods that we have decided to assess for whether there is clear and significant evidence that suppliers are likely to incur material additional debt-related costs due to COVID-19 for serving default tariff credit and PPM customers.

[21] Ofgem (2021), Decision on the potential impact of COVID-19 on the default tariff cap, paragraph 5.5.
https://www.ofgem.gov.uk/publications-and-updates/decision-potential-impact-covid-19-default-tariff-cap

Table 3.1: Summary of our decision on cap periods to include for each debt-related cost for credit and PPM customers

Debt-related costs	Bad debt	Working capital costs	Debt-related administrative costs
Credit customers	Cap period seven	Cap period seven	Cap period seven
PPM customers	Cap periods four to seven	Cap period seven	Cap period seven

Overview of stakeholder responses and considerations

Overall scope

3.16. Several stakeholders supported our proposal to only consider whether there was significant and clear evidence that suppliers were likely to incur material additional debt-related costs due to COVID-19 in cap period seven.

3.17. No stakeholders commented on our methodology for how we consider debt-related costs for credit and PPM customers and what cap periods to include in responding to our May 2021 consultation. One stakeholder said that we should only look at cap periods that were under the control of Ofgem (since January 2021) in responding to our March 2021 working paper.

3.18. As noted in the September 2020 consultation, the Competition and Markets Authority (CMA) would not have been able to make any adjustment to the PPM cap to recognise any impacts of COVID-19 given that the CMA PPM cap ended at the end of 2020.[22] We therefore concluded that it was appropriate that we consider whether to make an adjustment for the exceptional PPM impacts of COVID-19 within the default tariff cap despite some of these potential costs occurring during the CMA's PPM cap. We continue to hold this view. However, we note that, in general, we agree that the appropriateness of the level of the PPM cap since its introduction in 2017,

[22] Ofgem (2020), Reviewing the potential impact of COVID-19 on the default tariff cap: September 2020 policy consultation, paragraphs 5.6–5.8.
https://www.ofgem.gov.uk/publications-and-updates/reviewing-potential-impact-covid-19-default-tariff-cap-september-2020-policy-consultation

was a matter for the CMA and is not in scope when setting the level of the default tariff cap in other areas.

Other costs

3.19. One supplier wanted us to consider other costs such as Smart Metering Net Cost Change (SMNCC) costs, industry costs (ie capacity market costs) and other third-party costs which had also been impacted by the COVID-19 pandemic.

3.20. We are considering SMNCC costs for credit and PPM customers in separate reviews and decisions. In our February 2021 decision, we decided that apart from debt-related costs, no adjustments were necessary to any of the cost components we set out in that document, which included capacity market costs.[23] We maintain our position that for most of the other costs that were discussed in our February 2021 decision, the existing methodology is sufficient to take into account the impact of COVID-19 for individual allowances. For more detail on our considerations, please see Chapters 2 and 6 of our February 2021 decision.

Costs to serve PPM customers

3.21. In responding to our March 2021 working paper, one stakeholder agreed with our approach to keep the bad debt costs for PPM customers separate to credit customers because they did not think it would be fair for PPM customers to pay for the additional debt incurred by credit customers. Three stakeholders agreed with our proposal of no float for PPM customers in responding to our May 2021 consultation.

3.22. One supplier said that legacy suppliers had a high cost to serve for PPM customers because they had taken extra measures to support PPM customers. Another supplier thought the cap's methodology was not adjusted to reflect additional obligations and associated costs incurred by PPM suppliers.

---

[23] Ofgem (2021), Decision on the potential impact of COVID-19 on the default tariff cap, paragraph 6.1 and 6.3.
https://www.ofgem.gov.uk/publications-and-updates/decision-potential-impact-covid-19-default-tariff-cap

3.23. As said in our February 2021 decision,[24] we have revisited the effects of COVID-19 on supplying PPM customers as part of this review. We are assessing whether there are likely to be material additional debt-related COVID-19 costs for PPM customers. We provide further considerations on this in Appendix 4.

True-up

3.24. Three suppliers commented on the true-up process and thought the true-up process should be considered for cap period seven. One supplier wanted us to design the true-up process quickly. Another supplier commented that the COVID-19 RFI should be used in the true-up process.

3.25. We note the points suppliers made and will consider them when designing the true-up process.

Overall methodology

Decision

3.26. We continue to err on the side of customers when deciding whether there are material additional costs as a result of COVID-19 in cap period seven. This is to protect customers' interests. Our intention is to avoid default tariff customers unduly bearing the risk of cost uncertainty. As such, we have decided to only introduce a further float if there is significant and clear evidence that suppliers are likely to incur material additional costs due to COVID-19 for serving default tariff customers in cap period seven.

3.27. We have decided to broadly follow the same methodology as we used to set the initial float for credit customers for cap periods four to six, but amend the methodology to include additional filters and an assessment of external forecasts of key economic metrics to form a view on the fundamental need for a float.

[24] Ofgem (2021), Decision on the potential impact of COVID-19 on the default tariff cap, paragraph 5.5.
https://www.ofgem.gov.uk/publications-and-updates/decision-potential-impact-covid-19-default-tariff-cap

3.28. We have decided to only introduce a further float in cap period seven when two conditions are met:

- after applying our methodology, the calculation of the incremental debt-related costs at a lower quartile benchmark using the RFI data we collected shows that suppliers are likely to incur material additional debt-related costs due to COVID-19; and

- the assessment of external forecasts of key economic metrics shows a significant structural break in the direction of economic growth. This means there would need to be clear evidence that the economy will go into a recession in cap period seven and that the unemployment rate will rise significantly, so the impact of COVID-19 on customers' ability to pay energy bills will increase. Therefore, the level of debt-related costs would increase significantly.

3.29. We have decided to not introduce a float if the evidence from both the RFI data and forecasts on key economic metrics are not consistent. If our calculation of the RFI data shows material incremental debt-related costs for cap period seven, but the forecasts of key economic metrics maintain the current positive outlook for cap period seven, we would not include a further float in cap period seven.

Overview of stakeholder responses and considerations

3.30. One supplier commented that clear evidence might not yet be available so there were limitations in developing a position based on the information and data currently available from RFI submissions.

3.31. We recognise the risk of setting a float based on non-final data. Therefore, we have decided to adopt a conservative approach to setting the float in favour of default tariff customers, in order that suppliers bear more of the cost uncertainty around the impacts of COVID-19. This approach is the same as our February 2021 decision.[25] There is significant uncertainty on whether suppliers are likely to incur material

[25] Ofgem (2021), Decision on the potential impact of COVID-19 on the default tariff cap, paragraph 3.23.
https://www.ofgem.gov.uk/publications-and-updates/decision-potential-impact-covid-19-default-tariff-cap

additional costs as a result of COVID-19 for serving domestic default tariff customers. The hard-to-predict impact of COVID-19 on the economy and welfare means that the amount of uncertainty in any forecast can be reasonably large.

3.32. In our March 2021 working paper, we considered that suppliers' forecasts continued to provide the best available data source for additional COVID-19 debt-related costs.[26] We maintain this view and have used suppliers' forecast debt-related costs to assess whether there is significant and clear evidence that suppliers are likely to incur material additional debt-related costs as result of COVID-19.

3.33. We have decided to amend our methodology to include additional filters and an assessment of external forecasts of key economic metrics. Please see details of our amended methodology in the sections below.

Methodology for assessing suppliers' forecast debt-related costs

3.34. When assessing suppliers' forecast debt-related costs for cap period seven, we have decided to base our methodology on the one used to set the initial float for cap periods four to six.[27] We have decided to amend the methodology by applying additional filters before including an individual supplier's forecasts in the sample we use to benchmark costs.

3.35. We have decided to use our amended methodology to assess all costs in scope of this decision. This approach is unchanged from our May 2021 consultation.[28]

[26] Ofgem (2021), Reviewing the potential impact of COVID-19 on the default tariff cap: cap period seven, paragraph 3.7.
https://www.ofgem.gov.uk/publications-and-updates/price-cap-working-paper-reviewing-potential-impact-covid-19-default-tariff-cap-cap-period-seven
[27] Ofgem (2021), Decision on the potential impact of COVID-19 on the default tariff cap, paragraph 3.37.
https://www.ofgem.gov.uk/publications-and-updates/decision-potential-impact-covid-19-default-tariff-cap
[28] Ofgem (2021), Reviewing the potential impact of COVID-19 on the default tariff cap: cap period seven, paragraph 3.32.
https://www.ofgem.gov.uk/publications-and-updates/price-cap-consultation-reviewing-potential-impact-covid-19-default-tariff-cap-cap-period-seven

Use of additional filters

Context

3.36. In our May 2021 consultation,[29] we proposed to amend our existing methodology by using additional filters to ensure the data in the sample that we used to benchmark costs were consistent and comparable. We proposed to check data consistency and remove any suppliers' forecasts if they were not representing reasonable estimates or not comparable between the baseline and the cap period assessed or with other suppliers in the sample that we used to benchmark costs.

Decision

3.37. We have decided to use the following additional filters to scrutinise whether the assumptions underpinning suppliers' forecast costs are updated and reasonable as well as check data consistency. This approach is unchanged from our May 2021 consultation:[30]

- completeness and comparability between the baseline period and the relevant cap period;
- appropriateness of suppliers' forecast methodologies;
- reasonableness and up to date assumptions underpinning suppliers' forecast costs;
- appropriate justification for any inconsistency on suppliers' forecasts;
- consistency of supplier's forecasts with the stock of debt older than six months held by the supplier; and

[29] Ofgem (2021), Reviewing the potential impact of COVID-19 on the default tariff cap: cap period seven, paragraph 3.49-3.52. https://www.ofgem.gov.uk/publications-and-updates/price-cap-consultation-reviewing-potential-impact-covid-19-default-tariff-cap-cap-period-seven
[30] Ofgem (2021), Reviewing the potential impact of COVID-19 on the default tariff cap: cap period seven, paragraph 3.36. https://www.ofgem.gov.uk/publications-and-updates/price-cap-consultation-reviewing-potential-impact-covid-19-default-tariff-cap-cap-period-seven

- comparability of suppliers' forecasts with other suppliers' forecasts.

3.38. We have also decided to introduce an additional filter to exclude PPM specialists from our calculation of additional costs relating to credit customers. This is because while they may have some credit customers, their specialism means that as a whole, their costs are less relevant for the credit-only cost assessment.

Overview of stakeholder responses and considerations

3.39. In responding to our March 2021 working paper, one supplier agreed with our proposal and commented that we should discard outlier forecasts or data that was not robust. In responding to our May 2021 consultation, two suppliers supported our proposal of using additional filters to ensure the data are reasonable and consistent. Two suppliers disagreed with applying additional filters as they felt there was a lack of transparency in how we applied the additional filters.

3.40. One supplier who supported our proposal commented that we should ensure appropriate weighting of suppliers' methodologies at the true-up stage as it thought suppliers' forecast methodologies were different from each other.

3.41. We will consider whether to review suppliers' methodologies at the true-up stage.

3.42. One supplier made similar comments to its previous response to our March 2021 working paper. This included comments on transparency, judgement on applying the additional filters and auditor scrutiny of suppliers' methodologies. We have addressed these comments in our May 2021 consultation.[31] For more detail on this, please see Appendix 5 of this document.

3.43. One supplier commented that if we did not apply the filters symmetrically (excluding unusually low-cost forecasts as well as unusually high forecasts), the filters could

[31] Ofgem (2021), Reviewing the potential impact of COVID-19 on the default tariff cap: cap period seven, paragraph 3.39-3.46.
https://www.ofgem.gov.uk/publications-and-updates/price-cap-consultation-reviewing-potential-impact-covid-19-default-tariff-cap-cap-period-seven

lead to downward bias. It also said that there was a risk of double counting by using filters alongside the lower quartile benchmark.

3.44. We consider using additional filters is an additional mitigation to limit the risk that an unrepresentative sample will lead to an unreasonable float. As part of this process, we consider whether a supplier had a methodology that led to unreasonable higher or lower costs. In either case we would exclude the supplier data from our sample. We therefore do not consider that additional filters would introduce a downward bias to our float calculation.

3.45. This is different from the purpose of the lower quartile benchmark. We set a lower quartile benchmark to reduce the risk of customers temporarily overpaying due to limitations in the information available at this stage. We also use this benchmark to drive-efficiency and because some suppliers are more efficient than others in how they collect debt. Our view on using a lower quartile benchmark is not changed from our February 2021 decision and our November 2020 consultation.[32, 33]

3.46. We consider we are providing sufficient transparency on our decision-making process. We have provided information in the main text and appendices on the reasons we would exclude a supplier's data. We have summarised the instances where suppliers' data were excluded (please see Appendices 1 to 4) from our sample. We are also publishing key statistics of our sample (mean and standard deviation) in Appendices 1, 3 and 4, and this will provide stakeholders with a better understanding of the data range of our sample and how our data points spread out in the range. We do not consider it would be appropriate to publish or disclose suppliers' individual data due to the commercially sensitive and confidential nature of the data.

[32] Ofgem (2021), Decision on the potential impact of COVID-19 on the default tariff cap, paragraph 3.67.
https://www.ofgem.gov.uk/publications-and-updates/decision-potential-impact-covid-19-default-tariff-cap
[33] Ofgem (2020), Reviewing the potential impact of COVID-19 on the default tariff cap: November 2020 consultation, paragraph 3.70, 3.85 and 3.90.
https://www.ofgem.gov.uk/publications/reviewing-potential-impact-covid-19-default-tariff-cap-november-2020-consultation

Sharing factor

Context

3.47. In our May 2021 consultation[34], we proposed to introduce a sharing factor. We considered that a sharing factor of 50:50 was an appropriate and fair proportion for customers and suppliers bearing the additional cost due to COVID-19 equally, given that COVID-19 was a one-off shock to both suppliers and customers. We also considered that introducing a sharing factor would ensure that any float would be conservative and would create incentives on suppliers to lower these costs.

Decision

3.48. We have not reached a decision to introduce a sharing factor before calculating the amount to recover from customers. This is because we have decided that a further float in cap period seven is not necessary. Therefore, there is no need to reach a decision on whether to introduce a sharing factor at this stage.

Overview of stakeholder responses and considerations

3.49. In responding to our May 2021 consultation, four suppliers disagreed with the introduction of a sharing factor for a float. One supplier agreed with our proposal and said energy retailers, like businesses in other sectors, should be expected to carry some of the burden associated with the COVID-19 pandemic and costs should not be fully passed on to customers.

3.50. Suppliers who did not agree with our proposal raised similar arguments as the ones made by suppliers who responded to our March 2021 working paper.[35] These comments included that suppliers should be able to recover their efficiently incurred costs and there was a risk of supplier failure due to low margins. Several suppliers also mentioned that other tools such as lower quartile benchmark, additional filters

[34] Ofgem (2021), Reviewing the potential impact of COVID-19 on the default tariff cap: cap period seven, paragraph 3.49-3.52.
https://www.ofgem.gov.uk/publications-and-updates/price-cap-consultation-reviewing-potential-impact-covid-19-default-tariff-cap-cap-period-seven
[35] Ofgem (2021), Stakeholder responses to March 2021 working paper.
https://www.ofgem.gov.uk/sites/default/files/docs/2021/05/stakeholder_responses.zip

and economic metrics, were already being used to make sure the float was conservative and reflected efficient costs.

3.51. We have addressed these concerns in our May 2021 consultation, for more detail on this, please see Chapter 3 of our May 2021 consultation.[36] In Appendix 6 we have included the stakeholder comments on a sharing factor, but we will not be addressing them individually as they have been superseded by our decision to not introduce a further float in cap period seven.

Other decisions

Decision on other factors

3.52. We have decided to base our methodology on the one used to set the initial float for cap periods four to six, with the additional changes described in this chapter. However, there are also other decisions we need to make in our methodology when we assess suppliers' forecast debt-related costs.

3.53. We have decided to update customer accounts from the April 2021 snapshot in our calculation in time for the August decision.

3.54. We have decided to calculate the bad debt cost increment for credit customers at the domestic customer level. This approach is unchanged from our February 2021 decision.[37] Using data at domestic customer level enables us to rely on data representing a greater share of the domestic market.

Context and decision on using March RFI data

3.55. In our March 2021 working paper, we said that we intended to design our float if needed based on the March RFI submission. We said that the May RFI submission would only be used for the purpose of providing additional context for our decision

[36] Ofgem (2021), Reviewing the potential impact of COVID-19 on the default tariff cap: cap period seven, paragraph 3.53-3.62.
https://www.ofgem.gov.uk/publications-and-updates/price-cap-consultation-reviewing-potential-impact-covid-19-default-tariff-cap-cap-period-seven
[37] Ofgem (2021), Decision on the potential impact of COVID-19 on the default tariff cap, paragraph 3.69.
https://www.ofgem.gov.uk/publications-and-updates/decision-potential-impact-covid-19-default-tariff-cap

on whether a float would be necessary for cap period seven alongside our continued monitoring of economic forecasts.[38]

3.56. In our May 2021 consultation, we said that our preliminary analysis of the May RFI suggested no significant change in debt-related costs forecasts that would have materially changed the results of the analysis compared to the March RFI.[39] We also said that we did not intend to use the May RFI data as part of the calculation of the float.

3.57. We have decided to continue using March RFI data as part of our calculation of incremental debt-related costs due to COVID-19. We have carried out analysis using the May RFI data we received on 12 May. It showed no difference in the lower quartile benchmark for each debt-related cost from our samples. Therefore, we have decided to not update the calculation with the May RFI data in this decision.

Overview of stakeholder responses and considerations

3.58. No stakeholders commented on our methodology for updating customer accounts from the April 2021 snapshot.

3.59. One supplier did not agree with our proposal to calculate the bad debt cost increment for credit customers at an overall domestic customer level. It said that using the domestic customer level would not be representative of the costs incurred for default tariff customers which were expected to be higher than other customers and it would not align to the wider cap method.

3.60. Only one supplier responded saying it would be able to split debt-related costs by tariff type. Other suppliers who responded to our draft RFI said that they were unable to split debt-related costs by tariff type or that it would be very difficult.

[38] Ofgem (2021), Reviewing the potential impact of COVID-19 on the default tariff cap: cap period seven working paper, paragraph 3.30.
https://www.ofgem.gov.uk/publications-and-updates/price-cap-working-paper-reviewing-potential-impact-covid-19-default-tariff-cap-cap-period-seven
[39] Ofgem (2021), Reviewing the potential impact of COVID-19 on the default tariff cap: cap period seven, paragraph 4.52.
https://www.ofgem.gov.uk/publications-and-updates/price-cap-consultation-reviewing-potential-impact-covid-19-default-tariff-cap-cap-period-seven

Therefore, we do not have data which isolates the impact of COVID-19 on default tariff customers from the domestic customer base as a whole.

3.61. As set out in our November 2020 consultation,[40] given that we do not have data for default tariff customers we would need to make assumptions to adjust for differences in characteristics between default tariff customers and the customer base as a whole. This would limit the extent to which we could be confident that we would be improving our float calculation by trying to take payment methods into account.

3.62. We have also received stakeholder comments on the impact that customer mix could have on the costs incurred by supplier. We summarise the responses and our considerations in Appendix 7.

Methodology for assessing external forecasts of key economic metrics

Context

3.63. In addition to our assessment of suppliers' forecast debt-related costs due to COVID-19, in our March 2021 working paper,[41] we noted that we intended to consider the evidence on key economic metrics. This included evidence on the expected growth in the economy, the outlook of the labour market and customers' financial resilience, as well as the inherent uncertainty of the forecasts and economic conditions when deciding whether to introduce a further float in cap period seven.

Decision

3.64. We have decided to include an assessment of external forecasts of key economic metrics to form a view on the fundamental need for a float for cap period seven.

[40] Ofgem (2020), Reviewing the potential impact of COVID-19 on the default tariff cap: November 2020 consultation, paragraph 3.96.
https://www.ofgem.gov.uk/publications/reviewing-potential-impact-covid-19-default-tariff-cap-november-2020-consultation
[41] Ofgem (2021), Reviewing the potential impact of COVID-19 on the default tariff cap: cap period seven, paragraph 2.15
https://www.ofgem.gov.uk/publications-and-updates/price-cap-working-paper-reviewing-potential-impact-covid-19-default-tariff-cap-cap-period-seven

3.65. We consider that given the uncertainty on the speed of the recovery, it is appropriate to develop a balanced view on the need for a float. While our calculation of any float would still be based on supplier data, we consider it is appropriate to weigh it against leading institutions' expectations on the impact of COVID-19 on the economy.

3.66. We have decided to use the economic and unemployment rate forecasts from the Bank of England, the Office for Budget Responsibility (OBR), and HM Treasury to inform our view on the expected recovery of the economy.

3.67. In addition, we have decided to consider evidence on the financial resilience of customers in order to decide the need for a float for cap period seven. As we do not have access to forecasts of financial resilience for cap period seven, we have decided to consider whether the latest available information to us on financial resilience contradicts or is consistent with the overarching forecasted economic outlook discussed above.

Overview of stakeholder responses and considerations

3.68. Stakeholders supported our proposal to make reference to key economic forecasts and indicators when deciding whether a float was needed, in responding to our March 2021 working paper and May 2021 consultation.

3.69. Our approach is unchanged from our May 2021 consultation. For more details on our considerations, please see Chapter 3 of our May 2021 consultation.[42]

[42] Ofgem (2021), Reviewing the potential impact of COVID-19 on the default tariff cap: cap period seven, paragraph 3.72-3.76
https://www.ofgem.gov.uk/publications/price-cap-consultation-reviewing-potential-impact-covid-19-default-tariff-cap-cap-period-seven

4. Need for a float for COVID-19 costs

Chapter summary

This chapter outlines the evidence that supports our decision to not introduce a further float to account for the potential impacts of the COVID-19 pandemic in cap period seven. We have also decided to not introduce a float for PPM customers' bad debt costs for cap periods four to seven.

It summarises our assessment of suppliers' forecast debt-related costs and our review of external forecasts of key economic metrics.

Summary

4.1. We have carried out our assessments of suppliers' forecast debt-related costs and external forecasts of key economic metrics. We do not consider that there is significant and clear evidence that suppliers are likely to incur material additional costs due to COVID-19 in cap period seven for serving credit customers and across cap periods four to seven for serving PPM customers. Therefore, we have decided to not introduce a further float in cap period seven.

Evidence from suppliers' forecast debt-related costs

Context

4.2. We have collected suppliers' forecast debt-related costs through an RFI we sent to suppliers with at least a 1% market share in any fuel in the domestic market segment.

4.3. In our May 2021 consultation, we said that we were aware the April 2021 snapshot of the 'Domestic Customer Account & Tariff RFI' would become available after we published the consultation.[43] We have decided to update customer accounts from the

[43] Ofgem (2021), Reviewing the potential impact of COVID-19 on the default tariff cap: cap period seven, paragraph 1.21-1.22, A1.
https://www.ofgem.gov.uk/publications/price-cap-consultation-reviewing-potential-impact-covid-19-default-tariff-cap-cap-period-seven

April 2021 snapshot in our calculation in time for the August decision. Therefore, the calculations are slightly different from those of our May 2021 consultation.

4.4. We have decided to remove some suppliers' incomplete and non-comparable data from the sample that we use to benchmark costs. We provide the details on how we have applied additional filters on the RFI data and the data quality of our sample for the specific debt-related costs in Appendices 1 to 4 of this decision and in Appendices 1 to 3 in our May 2021 consultation.[44]

4.5. We have not excluded any suppliers' forecast data due to unreasonable forecast methodologies and data.

4.6. We summarise our considerations on stakeholders' comments and outline the updated calculation of benchmarks for our samples of each debt-related costs and provide key statistics of our samples in Appendices 1 to 4 of this decision.

Bad debt costs for credit customers

Decision

4.7. We have decided to not introduce a float for additional bad debt costs due to COVID-19 for serving domestic credit customers in cap period seven. This is because the lower quartile benchmark for incremental bad debt costs for credit customers is not material for cap period seven due to COVID-19.

Considerations

4.8. We are satisfied with the size and quality of the data sample for suppliers' bad debt forecasts at domestic customer level after applying additional filters. We discuss our data sample and how we applied the additional filters in more detail in Appendix 1 of this decision.

[44] Ofgem (2021), Reviewing the potential impact of COVID-19 on the default tariff cap: cap period seven, paragraph 1.10-1.13, A1, 1.8-1.11, A2, 1.25-1.26, A2 and 1.11-1.15, A3. https://www.ofgem.gov.uk/publications/price-cap-consultation-reviewing-potential-impact-covid-19-default-tariff-cap-cap-period-seven

4.9. The lower quartile benchmark for the incremental bad debt costs is approximately −£0.62 per customer account for cap period seven.

4.10. We consider this is not a material change in the bad debt costs of supplying credit customers resulting from COVID-19 for cap period seven.

Working capital costs

Decision

4.11. We have decided to not introduce a float for additional working capital costs due to COVID-19 for serving credit and PPM customers in cap period seven as we do not have confidence in the robustness of suppliers' working capital forecasts.

Considerations

4.12. We do not have confidence that the RFI data collected on working capital costs are consistent between suppliers and can provide a robust and meaningful estimate for the impact of COVID-19 on suppliers' working capital costs. This included some suppliers who provided incomplete data sets or provided working capital costs for the business as a whole, rather than just for the domestic customers' energy supply. We discussed the main data issues associated with suppliers' working capital costs in our May 2021 consultation.[45] We discuss our data sample and how we applied the additional filters in more detail in Appendix 2 of this decision.

4.13. In addition, taking the data at face value, the lower quartile benchmark for the incremental working capital cost is approximately £0.23 per customer account for cap period seven.

4.14. We consider this is not a material increase in the working capital costs of supplying credit and PPM customers resulting from COVID-19 for cap period seven.

---

[45] Ofgem (2021), Reviewing the potential impact of COVID-19 on the default tariff cap: cap period seven, paragraph 1.9-1.11, A2.
https://www.ofgem.gov.uk/publications/price-cap-consultation-reviewing-potential-impact-covid-19-default-tariff-cap-cap-period-seven

Debt-related administrative costs

Decision

4.15. We have decided to not introduce a float for additional debt-related administrative costs due to COVID-19 for serving credit and PPM customers in cap period seven. This is because the lower quartile benchmark for the incremental debt-related administrative costs for credit and PPM customers for cap period seven is not material due to COVID-19.

Considerations

4.16. We are satisfied with the size and quality of the data sample for suppliers' debt-related administrative costs at domestic customer level after applying additional filters. We discuss our data sample and how we applied the additional filters in more detail in Appendix 3 of this decision.

4.17. We have calculated the additional debt-related administrative costs for credit and PPM customers for cap period seven. The lower quartile benchmark for the incremental debt-related administrative costs is approximately £0.01 per customer account for cap period seven.

4.18. We consider this is not a material increase in the debt-related administrative costs of supplying both credit and PPM customers resulting from COVID-19 for cap period seven.

Bad debt costs for PPM customers

Decision

4.19. We have decided to not introduce a float for additional bad debt costs due to COVID-19 for serving domestic PPM customers in cap periods four to seven. This is because the lower quartile benchmark for the incremental bad debt costs for PPM customers for cap periods four to seven is not material due to COVID-19.

Considerations

4.20. We are satisfied with the size and quality of the data sample for suppliers' bad debt forecasts at PPM customer level after applying additional filters. We discuss our data sample and how we applied the additional filters in more detail in Appendix 4 of this decision.

4.21. We have calculated the additional bad debt costs for PPM customers for cap periods four to seven. The lower quartile benchmark for the total incremental bad debt costs is approximately −£0.07 per customer account for cap periods four to seven.

4.22. We consider this is not a material change in the bad debt costs for serving PPM customers resulting from COVID-19 over cap periods four to seven.

Evidence from external forecasts of key economic metrics

Context and decision

4.23. We carried out an assessment of external forecasts of key economic metrics in our May 2021 consultation.[46] We looked at forecasts on the GDP growth rate and expected unemployment rate for cap period seven, and the latest information on labour market data from a range of sources.[47] We also considered available evidence on the financial resilience of customers. We summarised the research findings from academics, Citizens Advice, the Financial Conduct Authority (FCA) and our "consumers' experiences with energy during the COVID-19 pandemic survey" in our May 2021 consultation.[48]

4.24. We considered that the underlying evidence available at the time of the publication of our May 2021 consultation did not suggest a structural break in the UK economic recovery. We also said that expected economic recovery lowered the likelihood that there would be material additional costs in cap period seven.[49]

[46] Ofgem (2021), Reviewing the potential impact of COVID-19 on the default tariff cap: cap period seven, paragraph 4.35-4.45. https://www.ofgem.gov.uk/publications/price-cap-consultation-reviewing-potential-impact-covid-19-default-tariff-cap-cap-period-seven
[47] These sources include the Bank of England, OBR, HM Treasury survey and the office for National statistics (ONS)
[48] Ofgem (2021), Reviewing the potential impact of COVID-19 on the default tariff cap: cap period seven, paragraph 4.46-4.50. https://www.ofgem.gov.uk/publications/price-cap-consultation-reviewing-potential-impact-covid-19-default-tariff-cap-cap-period-seven
[49] Ofgem (2021), Reviewing the potential impact of COVID-19 on the default tariff cap: cap period seven, paragraph 4.32. https://www.ofgem.gov.uk/publications-and-updates/price-cap-consultation-reviewing-potential-impact-covid-19-default-tariff-cap-cap-period-seven

4.25. We maintain this view. There is no clear evidence that the economy will go into a recession in cap period seven and that the unemployment rate will significantly rise, so the impact of COVID-19 on customers' ability to pay energy bills will increase.

Overview of stakeholder responses

4.26. In responding to our May 2021 consultation, the main comments were that suppliers thought our assessment of economic metrics that supported our proposal of no float for cap period seven was not consistent with Ofgem's engagement with suppliers on the voluntary winter commitments to support domestic customers.[50]

4.27. In responding to our March 2021 working paper, suppliers had mixed views on customers' financial resilience in cap period seven. One supplier expected that its customers would start to get out of debt over the next six to twelve months. Two suppliers expected that the financial impact of COVID-19 to customers as well as suppliers' bad debt costs would persist over several years.[51] In response to our May 2021 consultation, one supplier agreed with us that individual financial resilience was hard to determine at this point in time.

Considerations

Updates on economic metrics

4.28. One supplier commented that it remained unclear whether the impact of COVID-19 would last. It said we should consider the overall uncertainty of economic conditions.

4.29. Since the publication of our March 2021 working paper and May 2021 consultation, it is becoming clearer that the economy is set for stronger economic growth and recovery. The labour market is also showing signs of recovery.[52] The Office for

[50] Energy UK, Voluntary winter commitments to support domestic customers, time limited to 31 March 2022.
https://www.energy-uk.org.uk/publication.html?task=file.download&id=7962
[51] Ofgem (2021), Reviewing the potential impact of COVID-19 on the default tariff cap: cap period seven, paragraph 3.70 and 3.71.
https://www.ofgem.gov.uk/publications-and-updates/price-cap-consultation-reviewing-potential-impact-covid-19-default-tariff-cap-cap-period-seven
[52] ONS, Labour market overview, UK: June 2021.
https://www.ons.gov.uk/employmentandlabourmarket/peopleinwork/employmentandemployeetypes/bulletins/uklabourmarket/june2021

National Statistics (ONS) showed a quarterly decrease in the unemployment rate, while the employment rate increased in March to May 2021.[53, 54]

4.30. Since our May 2021 consultation, only HM Treasury updated its survey results for the forecasts of key economic metrics. In comparison to its previous survey that we included in our May 2021 consultation,[55] it showed an increase in the expected GDP growth rate by 1.4 percentage points in 2021 to 7.1%, and a decrease by 0.2 percentage points to 5.4% in 2022. The average forecasts also suggested that the unemployment rate would be 0.8 percentage points lower in Q4 2021 (5.4%) and 0.7 percentage points lower in Q4 2022 (4.7%) than its previous survey in April that we included in our May 2021 consultation.[56]

4.31. These new updates further support the outlook we set out in our May 2021 consultation,[57] therefore, we maintain our view that the information available provides a more positive outlook for the UK economy for the periods between the last quarter of 2021 and the first quarter of 2022, during cap period seven.

4.32. There is no updated information on customers' financial resilience. Therefore, we maintain our view described in the May 2021 consultation that the available information on financial resilience does not contradict the outlook of the UK economy for cap period seven.

[53] ONS, Labour market overview, UK: July 2021.
https://www.ons.gov.uk/employmentandlabourmarket/peoplenotinwork/unemployment
[54] At the time of our May 2021 consultation, the ONS estimated unemployment rate was 4.9% for December 2020 to February 2021. There was a decrease of 0.1 percentage point in the unemployment to 4.8% for March to May 2021.
[55] HM Treasury (2021), Forecasts for the UK economy: a comparison of independent forecasts, April 2021.
https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/979184/Forecasts_for_UK_economy_April_2021.pdf
HM Treasury (2021), Forecasts for the UK economy: a comparison of independent forecasts, July 2021.
https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/1004540/Forecomp_July_2021.pdf
[56] Ofgem (2021), Reviewing the potential impact of COVID-19 on the default tariff cap: cap period seven, paragraph 4.36.
https://www.ofgem.gov.uk/publications-and-updates/price-cap-consultation-reviewing-potential-impact-covid-19-default-tariff-cap-cap-period-seven
[57] Ofgem (2021), Reviewing the potential impact of COVID-19 on the default tariff cap: cap period seven, paragraph 4.33.
https://www.ofgem.gov.uk/publications-and-updates/price-cap-consultation-reviewing-potential-impact-covid-19-default-tariff-cap-cap-period-seven

Customers' financial resilience

4.33. We have addressed stakeholders' comments on customers' financial resilience to our March 2021 working paper in our May 2021 consultation. For more detail on our considerations, please see Chapter 3 in our May 2021 consultation.[58]

Voluntary winter commitments to support domestic customers

4.34. Suppliers commented that Ofgem's engagement with suppliers on the voluntary winter commitments to support domestic customers said that there was a risk of consumers getting into (or further into) debt on their household bills, which they said was inconsistent with our proposal to not introduce a float for cap period seven.

4.35. We do not consider that the voluntary winter commitments[59] are inconsistent with our decision to not introduce a float for cap period seven. Our cap float decision is based on an assessment of whether there is significant and clear evidence that suppliers are likely to incur material additional debt-related COVID-19 costs for serving default tariff customers as a whole in the periods assessed. As described in this decision, our analysis of both suppliers' data and the external forecasts of key economic metrics shows that we have not found this to be the case for default tariff customers as a whole.

4.36. However, this does not mean that some customers will not need additional support this winter. This is why we have worked with government and industry on the voluntary winter commitments that suppliers have signed up to improve the quality and availability of support offered to customers in need – whether that be from financial difficulties, mental or physical health issues, or other events.

[58] Ofgem (2021), Reviewing the potential impact of COVID-19 on the default tariff cap: cap period seven, paragraph 3.68-3.76.
https://www.ofgem.gov.uk/publications-and-updates/price-cap-consultation-reviewing-potential-impact-covid-19-default-tariff-cap-cap-period-seven

[59] Voluntary winter commitments to support domestic customers (time limited to 31 March 2022) include: raise awareness of support available to customers; ensure customers in financial difficulty can easily make contact; ensure bills are accurate as they can be; and take all reasonable steps to ensure that prepayment meter customers are able to receive smart meters as soon as practicable.
https://www.energy-uk.org.uk/media-and-campaigns/press-releases/497-2021/7963-energy-sector-offers-helping-hand.html
https://www.energy-uk.org.uk/publication.html?task=file.download&id=7962

Appendices

Index

Appendix 1 – Bad debt costs for credit customers

1.1. We set out in this appendix our considerations on the detailed stakeholder comments on bad debt costs. We also set out that our calculation of the incremental cost of the bad debt charge at lower quartile for cap period seven for serving domestic credit customers is not material.

Considerations of stakeholder comments

March 2021 working paper responses

1.2. One supplier said bad debt provisions represented the best and most reliable source of data on the overall bad debt costs of COVID-19. Another supplier said it had concerns on its increased debt during the first lockdown.

1.3. Two stakeholders said they had not seen a material increase in the level of bad debt as a result of COVID-19.

1.4. One supplier said that accounting provisions relied on estimates of what the default rate would be in the future. It also said that estimates were inherently uncertain. One supplier said that we should use the additional data requested in our RFI and it thought we should breakdown costs by payment method.

1.5. Our approach of using supplier forecasts is the same as in our February 2021 decision.[60] For more detail on our considerations, please see Chapter 4 of our November 2020 consultation.[61]

1.6. One stakeholder expected us to publish more detailed information to allow stakeholders to understand how we reached our decision. We published the key statistics of our sample (mean and standard deviation) in our May 2021 consultation

---

[60] Ofgem (2021), Decision on the potential impact of COVID-19 on the default tariff cap, paragraph 4.14.
https://www.ofgem.gov.uk/publications-and-updates/decision-potential-impact-covid-19-default-tariff-cap
[61] Ofgem (2020), Reviewing the potential impact of COVID-19 on the default tariff cap: November 2020 consultation, paragraph 4.25-4.28.
https://www.ofgem.gov.uk/publications-and-updates/reviewing-potential-impact-covid-19-default-tariff-cap-november-2020-consultation

and this decision (Appendices 1, 3 and 4). This will provide stakeholders with a better understanding of the data range for our sample and how our data points spread out in the range.

May 2021 consultation responses

1.7. One supplier said that we should have used an average cost benchmark as suppliers were already incentivised to efficiently collect debt.

1.8. As previously explained in our May 2021 consultation, the hard-to-predict impact of COVID-19 on the economy means that the amount of uncertainty in any forecast can be large.[62] We consider that using a lower quartile benchmark helps to drive efficiency and set a conservative float to protect default-tariff customers. We have previously benchmarked the efficient level of costs in our 2018 analysis which used a lower quartile benchmark (for the payment method uplift) and a near lower quartile benchmark (for operating costs). We also discuss our choice of lower quartile benchmark in Chapter 3 of this document.

1.9. One supplier was disappointed that we did not assess suppliers' bad debt provisions on a cumulative basis (cap period four onwards). It said that our approach risked under stating the overall lower quartile costs due to timing differences between suppliers for when they made provisions.

1.10. We consider that assessing supplier's bad debt provisions on a cumulative basis would mean we would need to re-examine the float for cap periods four to six which was decided in our February 2021 decision before we have more certainty on the final costs of COVID-19 for those periods. We can consider this suggestion of using suppliers' bad debt provisions on a cumulative basis at the true-up stage.

[62] Ofgem (2021), Reviewing the potential impact of COVID-19 on the default tariff cap: cap period seven working paper, paragraph 3.56.
https://www.ofgem.gov.uk/publications/price-cap-consultation-reviewing-potential-impact-covid-19-default-tariff-cap-cap-period-seven

1.11. One supplier said it was concerned about the economic uncertainty this winter which it believed would increase the bad debt charge and debt-related administrative costs.

1.12. We do not consider that there is significant and clear evidence that suppliers are likely to incur material additional costs due to COVID-19 for serving domestic credit customers in cap period seven. We can consider as part of our true-up exercise whether it is appropriate to review whether there will have been any additional material costs from COVID-19 for cap period seven, this will be subject to when suitable data becomes available.

Calculations of bad debt costs increment

1.13. We set out the steps taken to calculate the lower quartile benchmark of the incremental bad debt costs (described in Chapter 4) by using our amended methodology that we set out for assessing suppliers' forecast debt-related costs in Chapter 3.

Calculation steps

1.14. We have taken the following steps for calculating the lower quartile benchmark for the bad debt costs increment:

- we applied additional filters to the RFI data (set out in Chapter 3) to get our final sample;
- for each supplier in our sample, we calculated the bad debt cost per customer account for cap period seven;
- we calculated the change in bad debt cost in cap period seven (October 2021 – March 2022) relative to a baseline period, cap period three scaled up (October 2019 – February 2020)[63]; and

[63] We chose not to include March 2020 data in the baseline because the data in this month could be impacted by COVID-19, given restrictions were put in place from late March 2020. Instead, we scaled up the October 2019 to February 2020 period to produce an appropriate six-month baseline.

- we then selected the lower quartile benchmark of these increments for cap period seven.

Applying additional filters

1.15. We received 11 submissions to the bad debt charge questions from our March 2021 RFI.[64]

1.16. After applying additional filters, we have excluded three data sets that were not complete or not comparable between the baseline period and cap period seven. This approach is unchanged from our May 2021 consultation:[65]

- one supplier was unable to provide forecast costs of bad debt charges for cap period seven;
- one supplier provided incomplete data which only covered the first half of cap period seven (October 2021 to December 2021); and
- one supplier's bad debt charge costs for the baseline period and forecast period were not comparable because of a business acquisition.

1.17. We also excluded one PPM specialist from our sample. We excluded the supplier as we consider that the sample without this PPM specialist provides a better reflection of the potential material additional costs for credit customers.

1.18. Following the application of the additional filters, our sample represents approximately 66% of the domestic energy market share.[66] Seven suppliers were included in our sample for calculating the bad debt costs increment per customer account. We are satisfied with the size and quality of the data sample.

[64] We asked suppliers to submit their bad debt charge baseline (January 2019 – January 2021) and bad debt charge forecast (February 2021 – March 2022).
[65] Ofgem (2021), Reviewing the potential impact of COVID-19 on the default tariff cap: cap period seven, paragraph 1.11, A1. https://www.ofgem.gov.uk/publications/price-cap-consultation-reviewing-potential-impact-covid-19-default-tariff-cap-cap-period-seven
[66] We calculate the market share using the updated April 2021 snapshot of the 'Domestic Customer Account & Tariff RFI'.

Calculating cost per customer

1.19. When calculating the cost per customer account, our approach is unchanged from our February 2021 decision.[67] We updated the customer accounts for October 2021 – March 2022 using the April 2021 snapshot. We have explained this in Chapter 4.

Benchmark at lower quartile

1.20. For each supplier, we calculated the bad debt charge cost increment per customer account for cap period seven. The lower quartile bad debt benchmark of our sample is approximately -£0.62 per customer account for cap period seven.

Statistics of our sample

1.21. We have set out below the key statistics for the bad debt charge cost increment per customer account of our sample (mean and standard deviation). The key statistics are different from our May 2021 consultation as we have updated the customer accounts data using the April 2021 snapshot:

- mean (simple average) = £1.16; and
- standard deviation = 2.30.

[67] Ofgem (2021), Decision on the potential impact of COVID-19 on the default tariff cap, paragraph 4.59.
https://www.ofgem.gov.uk/publications-and-updates/decision-potential-impact-covid-19-default-tariff-cap

Appendix 2 - Working capital costs

1.1. We set out in this appendix our considerations on the stakeholder comments on working capital costs. We also set out that our calculations of the incremental cost of the working capital cost at lower quartile for cap period seven for serving domestic credit and PPM customers is not material.

Considerations of stakeholder comments

1.2. In response to our March 2021 working paper, one stakeholder expected us to publish more detailed information to allow stakeholders to understand how we reached our decision. Given the small sample size in our final working capital cost sample, we cannot provide similar statistics on our sample as we did in Appendices 1, 3 and 4. We consider this would disclose suppliers' individual data and we consider it is not appropriate to do that due to the commercially sensitive and confidential nature of the data.

1.3. In responding to our May 2021 consultation, one supplier said that we should ensure a cost of capital of 9.6% to be applied to working capital, which was suggested in the credit balances consultation.[68]

1.4. In our May 2021 consultation, we applied a cost of capital of 10% to convert the amount of working capital into a cost which was consistent with our February 2021 decision and used in our 2018 cap decision.[69]

1.5. We consider the differences from the calculation of incremental working capital costs using 9.6% and 10% are not material when we are assessing whether a float is

[68] Ofgem (2021), Supplier licensing review: reducing credit balance mutualisation, paragraph 3.10. https://www.ofgem.gov.uk/publications/supplier-licensing-review-reducing-credit-balance-mutualisation
[69] Ofgem (2021), Decision on the potential impact of COVID-19 on the default tariff cap, paragraph 4.48.
https://www.ofgem.gov.uk/publications-and-updates/decision-potential-impact-covid-19-default-tariff-cap
Ofgem (2018), Default tariff cap: decision – overview –appendix 8 – Payment method uplift.
https://www.ofgem.gov.uk/system/files/docs/2018/11/appendix_8_-_payment_method_uplift.pdf

necessary for cap period seven. Therefore, we have decided to follow the same methodology used in our February 2021 decision.[70]

Calculations of working capital costs increment

1.6. We set out the steps taken to calculate the lower quartile benchmark of the incremental working capital costs (described in Chapter 4) by using our amended methodology that we set out for assessing suppliers' forecast debt-related costs in Chapter 3. In Chapter 3, we decided to consider this cost for credit and PPM customers together.

Calculation steps

1.7. We followed the same steps discussed in Appendix 1 to calculate the working capital cost increment per customer account.

1.8. To convert the amount of working capital into a cost, we applied a cost of capital of 10% to working capital, this is consistent with our approach in our February 2021 decision.[71]

Applying additional filters

1.9. We received 11 submissions to the working capital questions from our March 2021 RFI.[72]

---

[70] Ofgem (2021), Decision on the potential impact of COVID-19 on the default tariff cap, paragraph 4.48.
https://www.ofgem.gov.uk/publications-and-updates/decision-potential-impact-covid-19-default-tariff-cap

[71] Ofgem (2021), Decision on the potential impact of COVID-19 on the default tariff cap, paragraph 4.48.
https://www.ofgem.gov.uk/publications-and-updates/decision-potential-impact-covid-19-default-tariff-cap

[72] We asked suppliers to submit their working capital baseline (January 2019 – March 2020) and working capital forecast (October 2021 – March 2022).

1.10. After applying the additional filters to the RFI data, we excluded five suppliers' data that were not complete or not comparable between the baseline period and cap period seven. This approach is unchanged from our May 2021 consultation:[73]

- one supplier was unable to provide forecast costs of working capital for cap period seven;
- three suppliers provided incomplete data which only covered the first half of cap period seven (October 2021 to December 2021); and
- one supplier's working capital for the baseline period and forecast period were not comparable because of a business acquisition.

1.11. We also excluded another three suppliers' data as they were not comparable with other suppliers' data. These suppliers provided their working capital for their whole corporate businesses, rather than just for supplying domestic energy customers. These approaches are unchanged from our May 2021 consultation.[74]

1.12. We consider that it is not appropriate to include any supplier whose working capital cost covers a customer base outside of the domestic energy supply business. This is because we cannot be confident that changes to working capital costs would represent the additional costs of supplying default tariff customers as a result of COVID-19 given that COVID-19 has impacted the wider economy.

1.13. Following the application of additional filters, our sample represents approximately 25% of the domestic energy market share. Three suppliers were included in our sample for calculating the working capital costs increment per customer account. We consider that this is insufficient to enable us to adequately assess whether there is significant and clear evidence on material additional working capital costs resulting

[73] Ofgem (2021), Reviewing the potential impact of COVID-19 on the default tariff cap: cap period seven, paragraph 1.9, A2.
https://www.ofgem.gov.uk/publications/price-cap-consultation-reviewing-potential-impact-covid-19-default-tariff-cap-cap-period-seven
[74] Ofgem (2021), Reviewing the potential impact of COVID-19 on the default tariff cap: cap period seven, paragraph 1.9-1.10, A2.
https://www.ofgem.gov.uk/publications/price-cap-consultation-reviewing-potential-impact-covid-19-default-tariff-cap-cap-period-seven

from COVID-19 for the float in cap period seven. This is because it does not give us confidence that the results would represent the market impact of COVID-19.

Calculating cost per customer

1.14. When calculating the cost per customer account, our approach is unchanged from our February 2021 decision.[75] We updated the customer accounts for October 2021 – March 2022 using the April 2021 snapshot. We have explained this in Chapter 4.

Benchmark at lower quartile

1.15. For each supplier, we calculated the working capital cost increment per customer account for cap period seven. The lower quartile working capital cost benchmark of our sample is approximately £0.23 per customer account for cap period seven.

[75] Ofgem (2021), Decision on the potential impact of COVID-19 on the default tariff cap, paragraph 4.59.
https://www.ofgem.gov.uk/publications-and-updates/decision-potential-impact-covid-19-default-tariff-cap

Appendix 3 - Debt-related administrative costs

1.1. We set out that our calculations of the incremental cost of the debt-related administrative cost at lower quartile for cap period seven for serving domestic credit and PPM customers is not material.

Considerations of stakeholder comments

1.2. No stakeholder commented on debt-related administrative costs in response to our March 2021 working paper and May 2021 consultation.

Calculations of debt-related administrative costs increment

1.3. We set out the steps taken to calculate the lower quartile benchmark of the incremental debt-related administrative costs benchmark (described in Chapter 4) by using our amended methodology that we set out for assessing suppliers' forecast debt-related costs in Chapter 3.

1.4. In our March 2021 working paper, we stated the reasons for us considering debt-related administrative costs together for credit and PPM.[76]

Calculation steps

1.5. We followed the same steps discussed in Appendix 1 to calculate the debt-related administrative cost increment per customer account.

Applying additional filters

1.6. We received 11 submissions to the debt-related administrative cost questions from our March 2021 RFI.[77]

[76] Ofgem (2021), Reviewing the potential impact of COVID-19 on the default tariff cap: cap period seven working paper, paragraph 3.25 and 4.26. https://www.ofgem.gov.uk/publications-and-updates/price-cap-working-paper-reviewing-potential-impact-covid-19-default-tariff-cap-cap-period-seven

[77] We asked suppliers to submit their debt-related administrative costs baseline (January 2019 – March 2020) and debt-related administrative costs forecast (October 2021 – March 2022).

1.7. After applying the additional filters to the March RFI data, we have excluded three suppliers' data sets that are not complete or not comparable between the baseline period and cap period seven for the same reasons as discussed in Appendix 1. This approach is unchanged from our May 2021 consultation.[78]

1.8. Following the application of the additional filters, our sample represents approximately 50% of the domestic energy market share.[79] Eight suppliers were included in our sample for calculating the debt-related administrative costs increment per customer account. We are satisfied with the size and quality of the data sample.

Calculating cost per customer

1.9. When calculating the cost per customer account, our approach is unchanged from our February 2021 decision.[80] We updated the customer accounts for October 2021 – March 2022 using the April 2021 snapshot. We have explained this in Chapter 4.

Benchmark at lower quartile

1.10. For each supplier, we calculated the debt-related administrative cost increment per customer account for cap period seven. The lower quartile debt-related administrative cost benchmark of our sample is approximately £0.01 per customer account for cap period seven.

Statistics of our sample

1.11. For the same reason set out in Appendix 1, we are publishing key statistics of our sample (mean and standard deviation):

---

[78] Ofgem (2021), Reviewing the potential impact of COVID-19 on the default tariff cap: cap period seven, paragraph 1.26, A2.
https://www.ofgem.gov.uk/publications/price-cap-consultation-reviewing-potential-impact-covid-19-default-tariff-cap-cap-period-seven
[79] This is a different sample of suppliers than the sample discussed in Appendix 1.
[80] Ofgem (2021), Decision on the potential impact of COVID-19 on the default tariff cap, paragraph 4.59.
https://www.ofgem.gov.uk/publications-and-updates/decision-potential-impact-covid-19-default-tariff-cap

- mean (simple average) = £0.14; and
- standard deviation = 0.55.

Appendix 4 – Bad debt costs for PPM customers

1.1. We set out in this appendix our considerations on the detailed stakeholder comments on bad debt costs for PPM customers. We also set out that our calculations of the incremental cost of the bad debt charge at lower quartile for cap periods four to seven for serving PPM customers is not material.

Considerations of stakeholder comments

Discretionary credit and administrative costs

1.2. In response to our March 2021 consultation, two suppliers welcomed our consideration of whether an adjustment for PPM customers was necessary. One of them said that we needed to consider the support it had offered to vulnerable PPM customers to prevent self-disconnection. One supplier said that we should issue further RFIs on discretionary credit and administrative costs for PPM customers.[81]

1.3. One supplier commented there were higher levels of discretionary credit applied to PPM customers and higher administrative costs as a result of an increased number of PPM customers contacted as well as an increase in requests for replacement PPM keys and cards.

1.4. We have addressed similar comments on discretionary credit and administrative costs from suppliers previously. In our February 2021 decision, we said that the extra discretionary credit due to COVID-19 was unlikely to turn into bad debt in the long term. In terms of additional administrative costs for serving PPM customers due to COVID-19, we said we had seen some reductions in costs, for example from reduced 'routine' calls, which many suppliers actively discouraged during the lockdown phase of the pandemic, and we had not seen evidence that any cost increases had been greater than those reductions.[82] We maintain our considerations. We consider that there is not sufficient evidence or rationale to provide an

[81] Administrative costs include the costs associated with customer contact from customers in vulnerable situations or in order to arrange discretionary or emergency credit, and the replacement of prepayment keys and cards.
[82] Ofgem (2021), Decision on the potential impact of COVID-19 on the default tariff cap, paragraph 5.32.
https://www.ofgem.gov.uk/publications-and-updates/decision-potential-impact-covid-19-default-tariff-cap

adjustment for administrative costs for PPM and this is unchanged from our February 2021 decision.[83]

1.5. For more detail on our considerations and rationale please see Chapter 5 in our February 2021 decision.

Calculations of bad debt increment for PPM customers

1.6. We set out the steps taken to calculate the lower quartile benchmark of the incremental bad debt cost benchmark (described in Chapter 4) by using our amended methodology that set out for assessing suppliers' forecast debt-related costs in Chapter 3.

Calculation steps

1.7. We followed the same steps discussed in Appendix 1 to calculate the bad debt cost increment per customer account for serving PPM customers, however, as we stated in our May 2021 consultation, we considered it would be appropriate to consider an adjustment for the impact of COVID-19 costs for bad debt throughout the COVID-19 pandemic (cap periods four to seven).

Applying additional filters

1.8. We received seven submissions to the bad debt charge questions from our March 2021 RFI for PPM.[84]

1.9. After applying our methodology, for the March RFI data, we have excluded two data sets that are not complete or comparable between the baseline period and relevant cap period. This approach is unchanged from our May 2021 consultation:[85]

---

[83] Ofgem (2021), Decision on the potential impact of COVID-19 on the default tariff cap, paragraph 5.31.
https://www.ofgem.gov.uk/publications-and-updates/decision-potential-impact-covid-19-default-tariff-cap
[84] We asked suppliers to submit their bad debt charge baseline (January 2019 – January 2021) and bad debt charge forecast (February 2021 – March 2022) for PPM customers.
[85] Ofgem (2021), Reviewing the potential impact of COVID-19 on the default tariff cap: cap period seven, paragraph 1.12, A3.

- one supplier provided incomplete data which only covered the forecast periods, without a pre-COVID-19 baseline period; and

- one supplier provided data which did not meet our RFI guidance requirement. We asked suppliers to provide the bad debt charge by payment method at the point when customers incurred debt other than the customers' current payment method. This supplier submitted the bad debt charge data for PPM customers when they were on credit meters and incurred debt. Therefore, we excluded this supplier from our sample as we consider it does not represent PPM costs.

1.10. Following the application of the additional filters, our sample represents approximately 59% of the PPM energy market share. Five suppliers were included in our sample for calculating the bad debt costs increment per customer account for serving PPM customers. We are satisfied with the size and quality of the data sample.

Calculating cost per customer

1.11. When calculating the cost per customer account, our approach is unchanged from our February 2021 decision.[86] We updated the customer accounts for April 2021 – March 2022 using the April 2021 snapshot. We have explained this in Chapter 4.

Benchmark at lower quartile

1.12. For each supplier, we calculated the bad debt charge cost increment per customer account for each cap period for serving PPM customers. We then selected the lower quartile benchmark for each cap period as shown in Table A3.1. The total lower quartile bad debt benchmark for cap periods four to seven is approximately −£0.07 per customer account.

---

https://www.ofgem.gov.uk/publications/price-cap-consultation-reviewing-potential-impact-covid-19-default-tariff-cap-cap-period-seven
[86] Ofgem (2021), Decision on the potential impact of COVID-19 on the default tariff cap, paragraph 4.59.
https://www.ofgem.gov.uk/publications-and-updates/decision-potential-impact-covid-19-default-tariff-cap

Table A3.1: Lower quartile benchmark for PPM bad debt cost increment for each cap period

Cost item	Unit	Cap period 4	Cap period 5	Cap period 6	Cap period 7	Total
Bad debt charge	£/customer	1.00	-0.31	0.25	-1.01	-0.07

Statistics of our sample

1.13. For the same reason set out in Appendix 1, we are publishing key statistics of our sample (mean and standard deviation).

Table A3.2: Breakdown of the mean and standard deviation for each cap period

	Cap period 4	Cap period 5	Cap period 6	Cap period 7
Mean (simple average)	£1.85	£0.39	£1.15	-£0.77
Standard deviation	2.54	2.37	2.39	0.52

Appendix 5 – Stakeholder comments on additional filters

1.1. We set out in this appendix our considerations on the detailed stakeholder comments on applying additional filters. Our considerations are unchanged from our May 2021 consultation.[87]

Transparency

March 2021 working paper stakeholder responses and considerations

1.2. In response to our March 2021 working paper, one supplier disagreed with applying additional filters and one supplier commented that we should have more confidence in the robustness of suppliers' forecasts, given that suppliers' methodologies for bad debt provisions would be subject to regular scrutiny by auditors.

1.3. In our May 2021 consultation, we considered that suppliers' forecasts on debt-related costs involved an additional degree of judgement beyond that usually required to determine the bad debt charges, which are then reviewed by auditors. This is because suppliers had to set their expectations on future movements of their bad debt charges when providing these forecasts. This involves judgement on a supplier's own experience through its customers. Therefore, we did not consider that the fact that bad debt provisions are scrutinised by auditors means there is no need for additional filters.

May 2021 consultation stakeholder responses and considerations

1.4. One supplier said that it was difficult to scrutinise the filters as very little detail was provided to them, it also believed there was a risk of double counting by applying filters alongside the lower quartile benchmark. A different supplier said that without a more comprehensive explanation of how we applied the filters, our approach would remain unclear.

[87] Ofgem (2021), Reviewing the potential impact of COVID-19 on the default tariff cap: cap period seven, paragraph 3.39-3.46.
https://www.ofgem.gov.uk/publications-and-updates/price-cap-consultation-reviewing-potential-impact-covid-19-default-tariff-cap-cap-period-seven

1.5. One supplier disagreed with filtering suppliers' data as the application required judgment. It further said that it was unclear how filters could be applied in a manner which ensured consistency while setting a precedent that lacked transparency and undermined trust in our approach.

1.6. One supplier thought we over-stated the risk that suppliers would provide overly pessimistic data, it noted that suppliers' forecast methodology would likely be reviewed by external auditors.

1.7. We have addressed similar comments from suppliers previously. We maintain our considerations and rationale that we set out before in our May 2021 consultation.[88]

1.8. We have provided detailed explanations for applying additional filters to each debt-related cost in our May 2021 consultation and in Appendices 1 to 4 of this decision. These appendices included information explaining why suppliers' data was excluded from our sample.

Debt over six months old

March 2021 working paper stakeholder responses and considerations

1.9. In response to our March 2021 working paper, one supplier commented that the movement of debt older than six months old would only capture the short-run impact and it did not reflect the long-run impact of COVID-19 on the collectability of debt.

1.10. In our May 2021 consultation, we considered that debt older than six months old could provide us with a sense check on suppliers' assumptions on the collectability of debt when deciding whether a forecast is reasonable.[89]

---

[88] Ofgem (2021), Reviewing the potential impact of COVID-19 on the default tariff cap: cap period seven, paragraph 3.39-3.42.
https://www.ofgem.gov.uk/publications/price-cap-consultation-reviewing-potential-impact-covid-19-default-tariff-cap-cap-period-seven
[89] Ofgem (2021), Reviewing the potential impact of COVID-19 on the default tariff cap: cap period seven, paragraph 3.46.
https://www.ofgem.gov.uk/publications/price-cap-consultation-reviewing-potential-impact-covid-19-default-tariff-cap-cap-period-seven

Appendix 6 – Stakeholder comments on a sharing factor

1.1. We have not reached a decision on whether to introduce a sharing factor before calculating the amount to recover from customers. This is because we have decided that a float for cap period seven is not necessary. Therefore, we will not be addressing stakeholder comments on a sharing factor individually as they have been superseded by our decision to not introduce a float in cap period seven.

1.2. We note the points stakeholders made and we can consider them when next relevant.

1.3. We have addressed stakeholders' comments to our March 2021 working paper. For more detail on this, please see our May 2021 consultation.[90]

Recovery of efficiently incurred costs

March 2021 working paper stakeholder responses

1.4. Three suppliers who disagreed with our proposal of introducing a sharing factor commented that a sharing factor would limit the recovery of efficiently incurred costs. They did not see a justification for an arbitrary sharing factor.

May 2021 consultation stakeholder responses

1.5. Several suppliers said that a sharing factor did not support the core principle of allowing suppliers to recover their efficiently incurred costs whether it is a one-off or on-going. One supplier said that a sharing factor is not aligned with the design of the price cap.

1.6. One supplier said that our approach should reflect the efficient level of costs and it should encourage suppliers to manage debt-related costs, as customers on default tariffs are disproportionately on lower incomes or vulnerable. It also noted that most

[90] Ofgem (2021), Reviewing the potential impact of COVID-19 on the default tariff cap: cap period seven, paragraph 3.53-3.62.
https://www.ofgem.gov.uk/publications-and-updates/price-cap-consultation-reviewing-potential-impact-covid-19-default-tariff-cap-cap-period-seven

suppliers target the cap by increasing default prices to the maximum permitted level.

Risk of supplier failure

March 2021 working paper stakeholder responses

1.7. Two suppliers commented that retail supply sector finances continued to be constrained, and it would not be in the interest of customers to see further supplier insolvencies. One supplier did not see compelling justification for a sharing factor when the sector remained structurally loss making.

May 2021 consultation stakeholder responses

1.8. Three suppliers said that a sharing factor would increase the risk of supplier failure which they said would not be in the interest of customers.

1.9. One supplier noted that capping suppliers' ability to pass on additional bad debt as a result of COVID-19 would mean suppliers could fail to adequately fund support for customers, or they would fund support they do not have the balance sheet to carry, which could lead more suppliers into a Supplier of Last Resort situation.

1.10. One supplier referred to Ofwat's business retail market customer bad debt consultation which proposed a sharing factor. This supplier noted that the energy industry was already loss making before COVID-19 while Ofwat's proposals enabled greater debt recovery and margins are significantly higher in the water and wastewater industries.

Other tools being used to make sure the float was conservative

May 2021 consultation stakeholder responses

1.11. Three suppliers referred to the other tools which were used to determine whether additional bad debt costs incurred were efficient, which included lower quartile benchmark, additional filters, economic metrics, financial resilience and true-up.

1.12. One supplier said that if we applied our methodology and found significant and clear evidence of material additional costs, we would have determined there is an efficient cost to suppliers that is not currently recoverable within the cap. The supplier then concluded that therefore applying a sharing factor would not be appropriate or proportionate.

Other points

March 2021 working paper stakeholder responses

1.13. Two stakeholders agreed with introducing a sharing factor and argued that the financial resilience of suppliers would be much greater than that of customers, particularly low-income customers. They said no further additional burdens should be placed on already struggling households, particularly struggling PPM customers.

Appendix 7 – Stakeholder comments on customer mix

1.1. We outline our considerations on the stakeholder comments on customer mix in this appendix.

1.2. In response to our March 2021 working paper, one supplier said that a lower quartile benchmark was not appropriate as the efficiency of a supplier was not the main determinant in a customer's likelihood of falling into debt. One supplier commented that vulnerable customers were not distributed equally across suppliers, so some suppliers would bear a higher proportion of the increased costs to serve.

1.3. In response to our May 2021 consultation, one supplier said that its analysis showed a strong correlation between the propensity to fall into debt and payment method, meter type, socio-economic status, and being on the priority services register.

1.4. One supplier mentioned debt was more closely associated with a supplier's customer mix, rather than its efficiencies. Two suppliers commented that suppliers who had higher debt-related costs due to their customer mix were penalised by the cap.

1.5. One of these suppliers said that this could risk making vulnerable customers unattractive to smaller suppliers. It commented that we had continued to focus on credit meter customers, but legacy suppliers have high cost to serve PPM customers. It said that smaller suppliers would not bear higher costs to serve due to having a customer portfolio with no or few vulnerable customers, which resulted in smaller suppliers having a lower COVID-19 impact.

1.6. One supplier commented that we had not explained how we would control for differences between suppliers, such as the payment method or tariff type mix.

1.7. There are a large number of possible ways in which suppliers' customer bases could vary. Any impact on benchmarking would depend on the extent of variation in these characteristics between suppliers, and on the extent to which these characteristics affect suppliers' COVID-19 costs. We intended to collect the breakdown of debt-related costs by payment method and tariff type for cap period seven, however, most suppliers who commented on our draft RFI told us that they were unable to provide a breakdown for these costs.[91] For the true-up, we can consider whether additional data gathering would be helpful to understand customer mix further. We expect suppliers will be able to provide this data as they will have had more time available to gather it.

1.8. For the float, we maintain our decision to base our decision on the same benchmark methodology as cap period six. We consider our approach is appropriate given that we are determining whether a float for cap period seven is necessary, which can be trued-up later once the final costs of COVID-19 are known. As noted in Chapter 3, we also use this benchmark to drive-efficiency and because some suppliers are more efficient than others in how they collect debt. Our view on using a lower quartile benchmark is not changed from our February 2021 decision and our November 2020 consultation.[92, 93]

1.9. For more detail our considerations please see Chapter 3 of our February 2021 decision.[94]

[91] Ofgem (2021), Reviewing the potential impact of COVID-19 on the default tariff cap: cap period seven working paper, paragraph 3.25.
https://www.ofgem.gov.uk/publications-and-updates/price-cap-working-paper-reviewing-potential-impact-covid-19-default-tariff-cap-cap-period-seven
[92] Ofgem (2021), Decision on the potential impact of COVID-19 on the default tariff cap, paragraph 3.67.
https://www.ofgem.gov.uk/publications-and-updates/decision-potential-impact-covid-19-default-tariff-cap
[93] Ofgem (2020), Reviewing the potential impact of COVID-19 on the default tariff cap: November 2020 consultation, paragraph 3.70, 3.85 and 3.90.
https://www.ofgem.gov.uk/publications/reviewing-potential-impact-covid-19-default-tariff-cap-november-2020-consultation
[94] Ofgem (2021), Decision on the potential impact of COVID-19 on the default tariff cap, paragraph 3.75-3.98.
https://www.ofgem.gov.uk/publications-and-updates/decision-potential-impact-covid-19-default-tariff-cap