Suppliers, consumer groups and
other interested parties

Email: priceprotectionpolicy@ofgem.gov.uk
Date: 28 June 2023

Dear stakeholder,

Price cap – Update on debt-related costs review

1. We have been undertaking a review of debt-related costs, with a view to considering whether or not we should make an adjustment to the debt-related costs allowance in the price cap. During this review, we have gathered a range of evidence, including through two Requests for Information (RFIs) sent to suppliers, and a Call for Input (CFI) seeking views from all stakeholders.[1]

2. We are grateful for the evidence we have received, and the engagement from the wide range of stakeholders who have contributed so far. The purpose of this letter is to provide an interim update on our review, and set out our anticipated next steps:

   - **Debt-related costs consultation:** Given the data and evidence we have received so far, we consider that there is not a material or systematic gap between the allowance within the price cap for debt-related costs and actual costs. We have therefore decided not to consult on a price cap adjustment for credit debt-related costs this summer. Instead, we intend to issue a third RFI this summer, and depending on the evidence received in response to that RFI, we may consult in autumn 2023, at the earliest, on a price cap adjustment. We intend to publish an update letter at the appropriate stage accordingly.

[1] Ofgem (2023), Call for Input on the allowance for debt-related costs, https://www.ofgem.gov.uk/publications/price-cap-call-input-allowance-debt-related-costs

- **Non-price cap mechanisms for debt recovery:** We have not identified an appropriate mechanism, or consensus of views, on a non-price cap recovery mechanism; we also note the lack of evidence above as to the need to introduce a non-price cap mechanism for supplier cost recovery. Given debt provisioning is partly based on forward-looking expectations, rather than current performance, it may also be less suited to mechanisms such as a levy (unless followed with a true-up). Any intervention would only be in relation to debt-related costs for default tariff customers, as recovery of debt for fixed tariff customers is a commercial decision for suppliers.

- **Prepayment meter moratorium:** We have considered evidence received in response to our RFI and CFI processes on the impact of the prepayment meter (PPM) moratorium. This evidence suggests that, to date, the costs of the PPM moratorium have been outweighed by the impact of government interventions, such as the Energy Price Guarantee (EPG), on the difference between debt-related costs and associated allowances. Looking ahead, the statutory consultation on Involuntary PPM sets out that the total potential impact of the proposed measures is likely to be between £3 and £14 per household, with costs expected to be towards the lower end in a central scenario.[2] Considering this in the round with 2022/23 costs, we consider the early indications to be that in a central scenario, it is not necessary or appropriate to introduce a wider allowance at this stage. We recognise, however, that the bad debt impacts of the revised PPM rules remain uncertain, so we intend to gather further data in our next RFI, which we intend to issue this summer.

- **Additional Support Credit allowance:** In response to our RFIs, we have seen significant evidence of a material increase in non-repayment of the Additional Support Credit (ASC) offered by suppliers to PPM customers. ASC is offered to customers at the point of self-disconnection, and any bad debt associated with the recent increase in ASC is not currently covered within the price cap. Given this is evidence of a material change in efficient costs, and it is targeted at supporting potentially vulnerable customers, we are today publishing a statutory consultation proposing to introduce an initial 12-month allowance into the PPM price cap from 1 October 2023 to account for the expected bad debt costs associated with ASC.

[2] Ofgem (2023), Involuntary PPM – Statutory Consultation, https://www.ofgem.gov.uk/publications/statutory-consultation-involuntary-ppm

- We are actively working with government to ensure this proposal is aligned with the government's commitment to remove the PPM premium.[3] Further detail is included in our consultation document,[4] and we welcome views from all stakeholders with an interest in the domestic retail energy supply market on this. While this allowance would be initially temporary for 12-months, we will consider whether this should become an enduring change to the price cap as part of our Operating Costs review.

Evidence and stakeholder views

3. From the evidence received so far, broadly, consumers and consumer groups are opposed to any increase to bills to cover additional debt, as they consider consumer debt to be a wider affordability issue that requires government intervention. We recognise these continued wider affordability issues, and continue to engage with government regarding options for consumer support beyond the price cap.

4. In contrast to this relatively consistent consumer-focused view, there is currently less consensus amongst suppliers on either the timing, implementation, or appropriate policy lever to make any adjustment. There is generally significant support across suppliers for a non-price cap mechanism to address debt-related costs. However, there is limited consensus on what the precise mechanism should be, and whether it should be in addition to, or instead of, a price cap adjustment.

5. Our preliminary analysis of debt-related costs data, covering more than 90% of the domestic retail market, suggests there was a marginal highly uncertain over-allowance for bad debt and debt administration costs in 2022/23. Due to insufficient current data and supplier assumptions on government support packages, we are not able to consistently review working capital costs at this stage. Because of this uncertainty, we plan to gather more consistent information through our forthcoming summer RFI, which will provide us with an updated view of debt-related costs.

6. The evidence received on the impact of the PPM moratorium, through our RFIs and CFI, suggests that while there are additional debt-related costs associated with the moratorium, they are currently at the lower end of original estimates this spring. However, the evidence received for overall debt-related costs in Q1 2023, suggests that on balance, government support provided through the EPG and Energy Bills Support

[3] HM Treasury (2023), "Policy paper – Spring Budget 2023', https://www.gov.uk/government/publications/spring-budget-2023/spring-budget-2023-html
[4] Ofgem (2023), Price cap – Statutory consultation on introducing an allowance for bad debt associated with Additional Support Credit, https://www.ofgem.gov.uk/publications/price-cap-statutory-consultation-introducing-allowance-bad-debt-associated-additional-support-credit

Scheme (EBSS) outweighed the impact of the first two months of the moratorium, leading the price cap allowance to be higher than debt-related costs during that quarter. We expect our summer RFI will reveal whether this trend continued in Q2 2023, given the continuation of government support through the EPG.

Next steps

7. We intend to continue to review and monitor debt-related costs, including in relation to the impact of the steps we are taking on Involuntary PPM, wider affordability pressures and the changes to government support, such as the EPG and EBSS.

8. As part of this, we intend to issue a third RFI this summer. This will collect supplier data for cap period 10a (Q2 2023), and will also include revised questions on working capital, with the intention that working capital costs can be included in our assessment going forwards. We appreciate suppliers' engagement with this RFI, given the importance of this evidence in deciding whether there is value in a future statutory consultation on this matter.

Yours faithfully,

Dan Norton
Deputy Director, Price Protection