Decision

Allowance for additional support credit bad debt costs

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We published a statutory consultation on 28 June 2023 proposing to introduce an initial 12-month allowance in the default tariff cap ('the cap') for bad debt costs associated with Additional Support Credit (ASC) given to prepayment meter (PPM) customers. This document sets out our decision to introduce a specific ASC bad debt allowance from 1 October 2023, and our associated considerations.

We have carefully considered all responses to our consultation, and are publishing non-confidential responses.

Any enquiries related to the text of this publication should be sent to Ofgem at:

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Executive Summary

Additional Support Credit (ASC) is credit provided by energy suppliers to prepayment meter (PPM) customers who may have exhausted alternative options (ie emergency or friendly hours credit) to avoid self-disconnection. ASC helps vulnerable consumers to stay on supply, reducing the physical and emotional harm that can result from self-disconnection. It is therefore crucial these customers are able to access ASC when they need it.

While ASC is repayable, some of it is not recovered by energy suppliers, and is therefore ultimately written off. This is referred to as 'ASC bad debt'. The default tariff cap ('the cap') currently provides an allowance to recover many debt-related costs, including some relating to ASC bad debt. The level recoverable through the cap reflects the fact that ASC bad debt levels were low historically.

We published a statutory consultation on 28 June 2023 setting out that we had seen evidence of what we consider to be a material increase in 2022/23 in both the overall level of ASC issued and the level of ASC bad debt. We considered it reasonable to expect demand for ASC to further increase this coming winter (2023/24) given continued affordability pressures, and the impact of our and industry action driven by evidence of energy suppliers breaching rules in force at the time on involuntary PPMs. We considered this would, in turn, be likely to increase the level of ASC bad debt.[1]

We proposed to include an initial 12-month allowance for ASC bad debt in the cap from October 2023. We proposed to calculate this allowance using a methodology based on a scenario (our central scenario) which sees the level of ASC issued increase by the proportionate increase in ASC from 2021/22 to 2022/23, while the proportion of ASC which becomes bad debt remains constant at the rate seen in 2022/23. This document sets out our decisions following our consultation.

[1] 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

Key decisions on allowance value and implementation

In summary, we have decided to:

- maintain our consultation position and introduce a specific allowance for ASC bad debt in the cap from cap period 11a (October 2023 – December 2023) for an initial 12-month period.
- maintain our consultation position to base the calculation of the allowance on our central scenario for anticipated ASC bad debt costs.
- maintain our consultation position to not cover historic ASC bad debt costs, or other ASC-related costs beyond bad debt.
- adjust our consultation position and include a baseline to account for costs we consider have been recoverable through the PPM cap already. To set this baseline cost, we use the cost incurred for ASC bad debt in the period 2021/22, scaled to the cap period 10b (July 2023 – September 2023) PPM price cap level.
- apportion the allowance to the standing charge element of the cap only at this stage, to ensure alignment with the government's expected approach to removing the PPM differential through the Energy Price Guarantee (EPG) until the end of March 2024.

In view of these decisions, and using updated data available since our consultation, **the allowance value for ASC bad debt in cap period 11a is £8.77 per typical PPM customer**. This is allocated to the PPM price cap only, rather than a wider group of default tariff customers.

Future reviews and interactions with government commitments

This represents an initial ex-ante allowance for 12 months, based on anticipated costs of ASC bad debt between October 2023 and September 2024. We will consider whether it is appropriate to adjust this allowance in 2024, for example if evidence suggests the actual costs for ASC bad debt differ significantly from the value of this ex-ante allowance. We intend to consult on this 'true-up', with this providing a further opportunity for review of the methodology used to calculate the allowance.

It remains the case that we do not expect this allowance to lead to PPM customers paying more on their bills than comparable direct debit (DD) customers for the first six months (October 2023 – March 2024). This is because at the Spring Budget, government made a commitment to align charges for comparable DD and PPM customers using the EPG until the end of March 2024, to ensure that PPM customers no longer pay a premium for their energy costs. Therefore, as long as the PPM price cap level remains higher than the equivalent DD level, we expect the additional cost of this allowance will be funded by government, not PPM customers, for the remainder of 2023/24.

Once the government commitment ends at the end of March 2024, this allowance would impact PPM customers' bills directly. However, our preference at this stage is for the cost of the allowance to be recovered across all customers, rather than just PPM customers. Creating a mechanism to spread this cost from April 2024, alongside other considerations around levelisation of payment methods, is the subject of an Ofgem policy consultation published alongside this decision.[2]

We believe this is an important intervention to help ensure PPM customers can access the right level of ASC support this winter, without which there may be an increased risk of self-disconnection. We are clear that in introducing this specific allowance, we expect more ASC to be issued this winter and we, of course, expect suppliers to adhere to the highest standards in their ASC and debt-management practices.

We will be closely monitoring suppliers' usage of this allowance, and have expanded our monitoring to help us identify if there are instances of poor practice in specific suppliers. We are also exploring additional measures, including as part of wider Ofgem work to find ways of raising standards and ensure consistency for consumers in, or at risk of, debt. We will be setting out more detail on this work in due course.

[2] Ofgem (2023) Levelling the cost of standing charges on prepayment meters, https://www.ofgem.gov.uk/publications/levelling-cost-standing-charges-prepayment-meters

1. Introduction

Chapter summary

This chapter provides background for this decision and sets out the structure of the document.

Structure of decision document

1.1 This document is structured as follows:

- This chapter (Chapter 1) introduces and sets out the context for our key decisions.
- Chapter 2 describes our decision-making process.
- Chapter 3 sets out our decision and rationale for introducing a specific allowance in the cap, for 12 months initially, for bad debt associated with Additional Support Credit (ASC).
- Chapter 4 sets out our decisions and associated considerations on the value of the allowance.
- Chapter 5 sets out our decisions and associated considerations on how the allowance will be implemented.
- Chapter 6 sets out our plans for monitoring and compliance to ensure the allowance benefits customers as intended.
- Chapter 7 sets out the interaction between this allowance and other workstreams.
- Chapter 8 covers our impact assessment (IA) on introducing a specific allowance for ASC bad debt.

Background

The default tariff cap

1.2 The default tariff cap ('the cap') was introduced on 1 January 2019 and protects existing and future domestic customers on standard variable and default tariffs (which we refer to collectively as 'default tariffs'), ensuring that customers pay a fair price for their energy that reflects the efficient underlying cost to supply that energy. The cap is set out in legislation through the Domestic Gas and Electricity (Tariff Cap) Act 2018 ('the Act').[3]

[3] Domestic Gas and Electricity (Tariff Cap) Act 2018, https://www.legislation.gov.uk/ukpga/2018/21

1.3 Under the Act, we must have regard to five matters when setting the cap:

- 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.
- the need to ensure that holders of supply licences who operate efficiently are able to finance activities authorised by the licence.
- the need to set the cap at a level that takes account of the impact of the cap on public spending.[4]

1.4 The requirement to have regard to the five 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 customers who pay default tariffs. In reaching decisions on particular aspects of the cap, the weight to be given to each of these considerations is a matter of judgement. Often, a balance must be struck between competing considerations.

1.5 The cap sets the maximum amount a supplier can charge default tariff customers for energy. It varies based on a number of different parameters, including fuel type, benchmark consumption, meter types, regional differences and payment methods. We calculate the cap using a bottom-up assessment of a notional supplier's costs (ie we calculate each cost component individually and then add them together) and set it to reflect the notionally efficient energy supply costs. In the aggregate, this approach ensures our benchmark (and cap) reflects the underlying efficient costs of supplying customers with energy.

Debt-related costs overview

1.6 Some energy bills are never paid, and therefore are written off by energy suppliers. This is referred to as bad debt. All energy suppliers accumulate some bad debt. It is usual for businesses in many industries, not just energy, to make a

[4] Domestic Gas and Electricity (Tariff Cap) Act 2018, section 1(6)(e) as inserted by Schedule 3 to the Energy Prices Act 2022. In performing the duty under section 1(6)(e) we must have regard to any information provided by the Secretary of State, or any guidance given by the Secretary of State on this matter (section 1(6A)).

provision for bad debt and to cover this through the pricing of their goods and services.

1.7 The cap provides an allowance to account for debt-related costs incurred by energy suppliers, which means all customers pay for the cost of bad debt incurred by customers who do not pay. The largest debt-related cost relates to the value of bills which are never paid. This cost is reflected in suppliers' accounts through the bad debt charge. The other debt-related costs are debt administration costs (the administrative costs to suppliers from dealing with customers in debt) and working capital costs (the cost to suppliers of raising capital for day-to-day operations and funding customers paying in arrears).[5]

Debt-related costs in the cap

1.8 The cap currently includes allowances for all three debt-related costs and the overall debt-related costs allowance broadly scales linearly with the overall level of the cap. Therefore, this overall allowance is now significantly greater than it was several years ago, given increases in the overall cost of energy.

1.9 We estimate that for cap period 10b (July 2023 – Sept 2023), the overall allowance for debt-related costs represents approximately 6% of typical dual fuel standard credit (SC) bills, 1% of typical dual fuel direct debit (DD) bills and 0.5% of typical dual fuel prepayment meter (PPM) bills. These percentages do not change significantly, but they adjust slightly with the level of the cap.

1.10 This variance in allowance size between payment types reflects the different levels of debt accrued by different customer types. For instance, we know debt-related costs are significantly higher for SC customers than DD customers, while PPM is the payment method least associated with the accrual of bad debt. This is because PPM customers top up their meter in advance of energy use, rather than pay for energy in arrears. While PPM customers may have debt originating from other payment methods they used previously, bad debt which originates from PPMs is primarily from the addition of ASC to the meter which is never repaid.

[5] The term 'bad debt' is commonly used as an overarching term to refer to all debt-related costs. However, for clarity we use 'debt-related costs' when referring to the three components of the costs (bad debt charge, debt-related administrative costs and associated working capital costs) and name the individual component when referring to it specifically.

Debt-related costs practice

1.11 Suppliers make estimates (known as provisions) for the amount which will never be repaid, and then adjust these over time. The provisioning process varies from energy supplier to energy supplier – some make an initial provision when consumption occurs or a bill is issued, while others may make provisions at a later stage. Through this process of provisioning and adjusting those estimates, outstanding debt will ultimately be fully provisioned for. From an accounting perspective, suppliers will eventually make write-offs to remove debt that will never be repaid from their balance sheet.

1.12 Where an energy supplier provisions for a debt they consider will not be paid, it does not mean the individual customer who incurred debt would have the debt 'forgiven' or their legal liability for it taken away. If the debt was subsequently recovered from the customer, the supplier would reflect this recovery in the bad debt charge. Once a supplier has exhausted all other avenues for recovering debt, they may also sell unrecoverable debt on to a third party who becomes the legal owner of the debt and may seek collection.

1.13 Suppliers are subject to the relevant standard licence conditions (SLCs)[6] across their debt-management practices, including agreeing affordable repayment plans. We expect them to adhere to the highest standards in the way they interact with customers and collect debts. Indeed, following evidence of energy suppliers falling short of these standards (as they applied at the time), we have taken a range of actions, including strengthening the rules around involuntary PPM.[7]

Additional Support Credit (ASC)

1.14 The definition of ASC is set out in the gas and electricity supplier SLCs.[8] It is defined as a fixed amount of credit provided to a domestic customer in a vulnerable situation when that domestic customer's PPM credit runs low or runs out, to ensure continuity of supply or return on supply. In practice, ASC is credit provided by energy suppliers to PPM customers typically in a vulnerable situation who may have exhausted alternative options (ie emergency or friendly hours

[6] Ofgem (2023), Standard conditions of electricity supply licence & Standard conditions of gas supply licence, https://www.ofgem.gov.uk/publications/licence-conditions
[7] Ofgem (2023), Statutory Consultation – Involuntary PPM, https://www.ofgem.gov.uk/publications/statutory-consultation-involuntary-ppm, and Ofgem (2023), Involuntary PPM – Supplier Code of Practice, https://www.ofgem.gov.uk/publications/involuntary-ppm-supplier-code-practice
[8] Ofgem (2023), 27A.9 of the Standard conditions of electricity supply licence & Standard conditions of gas supply licence respectively, https://www.ofgem.gov.uk/publications/licence-conditions

credit which are generally applied automatically to PPMs)[9] to avoid self-disconnection.

1.15 The SLCs set out the conditions and obligations for ASC. The statutory consultation on Involuntary PPMs[10] published in June set out further steps in relation to the Involuntary PPM Code of Practice[11] ('the Code') which would impact the level of ASC issued. These are:

- £30 repayable credit should be added to the meters of consumers who are subject to an involuntary PPM. This is to mitigate the risk that they go off supply in the short term after the PPM is installed. While this is defined separately as 'Involuntary PPM Credit', for the purpose of this decision we consider it reasonable and appropriate to regard this requirement, in practice, as ASC, given the purpose and nature of the payment. It therefore forms part of our overall assessment of ASC levels.
- That suppliers must apply existing ASC support where a customer is self-disconnecting. The Code and statutory consultation on Involuntary PPM refer to existing ASC support requirements, and, for Involuntary PPMs, adds guidance about offering appropriate support including sufficient ASC amounts and frequencies.
- Where a customer who has been subject to an involuntary PPM installation is reliant on ASC to remain on supply, suppliers must assess if a PPM remains safe and reasonably practicable. Further detail on considerations relating to this are set out in the Involuntary PPM statutory consultation, and will be set out in the forthcoming associated decision.

1.16 For the avoidance of doubt, our decisions in this document relate to ASC and, as noted above, we consider the new repayable Involuntary PPM Credit to be in practice, part of that. The decisions do not relate to emergency credit, friendly hours credit or any other forms of credit a supplier may provide.

[9] Under the gas and electricity supplier SLCs, suppliers are required to give other forms of credit as well. Emergency credit is a fixed amount of credit provided to customers when their meter runs low, or runs out, to ensure continuity of supply. Friendly hours credit is provided overnight, at weekends and public holidays, when top up points may be closed, and a customer's PPM runs low or runs out.
[10] Ofgem (2023), Involuntary PPM – Statutory Consultation, https://www.ofgem.gov.uk/publications/statutory-consultation-involuntary-ppm
[11] Ofgem (2023), Involuntary PPM – Supplier Code of Practice, https://www.ofgem.gov.uk/publications/involuntary-ppm-supplier-code-practice

2. Decision-making process

Chapter summary

This chapter summarises our decision-making process and related publications.

April 2023 Call for Input (CFI) on debt-related costs

2.1 We published a Call for Input (CFI) in April 2023 to seek views on our initial considerations and options around debt-related costs.[12]

2.2 We received 13 responses from energy suppliers, trade associations and consumer groups and charities, and almost 2,000 responses from individuals as part of a consumer campaign. In addition, we hosted a workshop with consumer groups and charities during the CFI window.

2.3 We published an interim update letter on 28 June 2023 on our review.[13] This set out that, given the data and evidence we had received at that point, we considered there was not a material or systematic gap between the allowance within the price cap for debt-related costs and actual costs. We said we had therefore decided not to consult on a price cap adjustment for credit debt-related costs this summer. We had, however, seen significant evidence of a material increase in the value of ASC provided by suppliers to PPM customers that was not repaid, and therefore had published a statutory consultation on ASC bad debt costs.[14]

June 2023 consultation

2.4 We published a statutory consultation on 28 June 2023 on introducing an initial 12-month allowance to the cap for ASC bad debt ('June consultation'). The consultation was open until 26 July 2023.[15]

[12] Ofgem (2023), Price cap - Call for Input on the allowance for debt-related costs, https://www.ofgem.gov.uk/publications/price-cap-call-input-allowance-debt-related-costs
[13] Ofgem (2023), Price cap - Update on debt-related costs review, https://www.ofgem.gov.uk/publications/price-cap-update-debt-related-costs-review
[14] 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
[15] 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

2.5 We received 67 written responses to this consultation and feedback during a regular consumer groups and charities call on 3 July 2023. These are summarised and referenced throughout this document. Following feedback on our methodology options, we issued a further email (Appendix 4 of this document) to consultation respondents, setting out considerations in relation to introducing a baseline and data updates. We received a further 11 written responses and we have considered these as part of our overall decision consideration.

Involuntary PPM statutory consultation – June 2023

2.6 The Involuntary PPM statutory consultation ('Involuntary PPM consultation') was also published on 28 June 2023.[16] It set out proposals to integrate the Code[17] into licence conditions. One of the questions in that consultation related directly to ASC, and we have therefore had regard to relevant parts of those responses as part of our decision-making process on ASC bad debt.

Related publications

2.7 The main documents relating to the cap are:

- Domestic Gas and Electricity (Tariff Cap) Act 2018: https://www.legislation.gov.uk/ukpga/2018/21
- 2018 decision on the cap methodology ('2018 decision'): https://www.ofgem.gov.uk/publications/default-tariff-cap-decision-overview
- Energy Prices Act 2022: https://www.legislation.gov.uk/ukpga/2022/44

2.8 The main documents relating to this decision are:

- April 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
- June 2023 - Update on debt-related cost review: https://www.ofgem.gov.uk/publications/price-cap-update-debt-related-costs-review

[16] Ofgem (2023), Statutory Consultation – Involuntary PPM',https://www.ofgem.gov.uk/publications/statutory-consultation-involuntary-ppm
[17] Ofgem (2023), Involuntary PPM - Supplier Code of Practice, https://www.ofgem.gov.uk/publications/involuntary-ppm-supplier-code-practice

- June 2023 – Statutory consultation – Involuntary PPM: https://www.ofgem.gov.uk/publications/statutory-consultation-involuntary-ppm
- June 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
- August 2023 – Consultation on levelling the cost of standing charges on prepayment meters: https://www.ofgem.gov.uk/publications/levelling-cost-standing-charges-prepayment-meters

Consultation process feedback

2.9 Some respondents to our June consultation commented on aspects of the consultation process, including its pace, and the drafting and accessibility of the consultation document itself. Consultation is at the heart of good policy development, and we are grateful to respondents for their feedback.

2.10 We recognise the demands faced by organisations and individuals who wish to engage as part of the consultation process, particularly when there may be multiple consultations of interest open at the same time. Alongside this consultation document, we therefore sought to engage with interested stakeholders, both through existing forums and bilaterally.

2.11 We also sought to ensure the consultation document was accessible and clear, while recognising the need to set out sufficient detail to allow for full consideration of our proposals by all stakeholders. We considered it was appropriate, therefore, to fully articulate key issues such as the interaction with the government's EPG in all relevant parts of the consultation document, even if this led to some repetition.

2.12 As set out in Chapter 3, we consider it is important to introduce this specific allowance from cap period 11a (October 2023 - December 2023) to help ensure PPM customers can access the right level of ASC support this winter. This necessitated moving straight to statutory consultation on this occasion.

2.13 Going forward, we will further consider the feedback received and how best to capture a wide range of stakeholders' views on the consultation process, and what more we could do to help facilitate engagement.

General feedback

2.14 We are also keen to receive your comments about this decision, and would 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. Any further comments

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

3. Introducing a specific allowance for ASC bad debt

Chapter summary

This chapter sets out our decisions and associated considerations on introducing a specific allowance for ASC bad debt to the cap.

Context

3.1 In our June consultation, we proposed to introduce a specific allowance to the cap for ASC bad debt costs only, for an initial 12 months from October 2023 – September 2024. We set out our assessment of anticipated ASC and ASC bad debt levels, and considered the anticipated costs of ASC bad debt to be material and systematic for the purposes of the cap.

Decisions

3.2 We have decided to maintain our consultation position and introduce a specific allowance into the cap for ASC bad debt costs, from October 2023, for 12 months initially.

3.3 We have decided to maintain our consultation on the scope of the allowance being for ASC bad debt costs only, between October 2023 and September 2024. The allowance therefore does not provide funding for other ASC-related costs or for ASC bad debt costs incurred before October 2023.

3.4 Our decisions and associated considerations for implementing the allowance, including reviewing it and considering whether a 'true-up' is necessary, are set out in Chapter 5 of this document.

Overview of responses

Introducing an allowance

3.5 All respondents commented on the overarching question of whether a specific allowance for ASC bad debt should be introduced to the cap.

3.6 Seven respondents (five suppliers and two charities) were broadly in agreement with the intention to introduce a specific allowance for ASC bad debt. Several agreed with our assessment that anticipated ASC bad debt costs were material and systematic for the purposes of the cap, and acknowledged the role ASC had in supporting vulnerable customers. Support from all of these respondents was caveated, including on the appropriate allowance value, implementation considerations and the interaction with the government's EPG (these are summarised in subsequent chapters).

3.7 One supplier opposed introducing an allowance, arguing our rationale incorrectly views customer debt as a variable that suppliers cannot control. They cited a number of potential moral hazards from introducing an allowance and said they did not see an urgent need to increase the cap in anticipation of bad debt costs which have not yet materialised. A trade association reflected both the arguments for and against the proposals.

3.8 Two consumer groups objected to introducing an ASC bad debt allowance. One of the groups argued that the cap level should not be increased, citing supplier profits and the potential for any increase to compound debt and affordability issues customers are facing.

3.9 We received 56 responses from individuals, most of whom broadly endorsed or directly referenced this consumer groups' opposition to the proposals. Some of the individuals also cited their personal circumstances in objecting to the proposals, for example that the original proposed allowance value was the equivalent of their energy budget for an entire week. A number of individuals also made additional points in objecting to the proposals, including that the allowance is inflationary and that it prioritises the interests of energy suppliers over consumers.

Scope of allowance

3.10 One supplier, who supported the introduction of the allowance, argued the scope should be widened to include previous ASC bad debt costs from 22/23. Another supplier argued the allowance should also account for costs associated with the operation and administration of ASC, rather than bad debt costs only.

Alternative approaches

3.11 Two suppliers who expressed support for introducing the allowance argued that a bespoke levy would be a better solution, as this would ensure suppliers received support proportionate to the needs of the customer base.

3.12 A response from a charity to the involuntary PPM consultation suggested the allowance should be used to support debt write-off initiatives that offer consumers debt relief. This was part of the respondents' wider concerns on ASC practice generally. A number of individuals suggested alternatives to recovery of ASC bad debt costs, including that energy suppliers or government should cover the costs.

Considerations

Overall ASC assessment

3.13 In our June consultation, we noted that the evidence from our RFIs (Request for Information) showed a significant increase in ASC being issued in 2022/23 compared to previous years. Looking ahead, there are also several factors which we continue to believe could reasonably increase demand for ASC, and in turn, the level of associated bad debt.

3.14 As part of the work on involuntary PPMs, we have set out our intention to implement the proposal for £30 repayable credit to be added to the meters of consumers who are subject to an involuntary PPM.[18] As noted in Chapter 2, we consider that, while this payment is to be separately defined as Involuntary PPM Credit, for the purpose of this decision it is reasonable and appropriate to regard it as ASC. Regarding demand for ASC, forward energy prices remain around double the historical average and there are continued cost of living and wider affordability pressures.

3.15 In view of these factors, our overall assessment remains that the level of ASC issuance is likely to rise this coming winter, and it is therefore reasonable to consider overall ASC bad debt levels will also increase in cash terms.

Material and systematic costs

3.16 In view of our assessment about ASC bad debt, we have considered whether these anticipated costs are material and systematic for the purposes of the cap.

3.17 In our 2018 decision on the design and implementation of the cap, we said: "if in the future we consider there are material systematic issues that require correction, we might modify the licence. The Act includes specific provision for us to make supplemental modifications to the licence conditions. This would allow us to make any changes required to correct how the cap was updated if it

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

systematically and materially departed from an efficient level of costs". We also said: "The type of specific systematic errors for which we would adjust the cap would need to be unforeseen, clear, material, and necessitate changes".[19]

3.18 We have applied this test when considering changes to the cap. As set out in our November 2021 wholesale consultation: "We broadly consider the case for amending the cap methodology against the test of whether a change in the costs facing suppliers is material and systematic, considering the market as a whole".[20]

3.19 Applying that test, we consider the anticipated ASC bad debt costs are material and systematic given our above analysis of ASC and ASC bad debt. We consider this represents a material change in PPM costs, and anticipate these costs to be systematic, particularly given the relevant changes on involuntary PPM. We consider this allowance is appropriate to ensure the cap reflects efficient costs relating to ASC bad debt. This is consistent with our June 2023 consultation position.

<u>Arguments against including a specific ASC bad debt allowance in the cap</u>

3.20 As part of our decision to introduce a specific allowance for ASC bad debt, we have carefully considered the arguments from consultation respondents who expressed fundamental disagreement with the proposals and with increasing the cap at this time. We have also carefully considered the arguments about the potential moral hazard and unintended consequences from this decision eg the allowance may reduce incentives on suppliers to, amongst other things, help customers manage their debt or to engage with their customers to recover ASC issued.

3.21 We do not consider these arguments change our assessment that the anticipated ASC bad debt costs are material and systematic for the purposes of the cap. Furthermore, we consider it is overall in the consumer interest to introduce this allowance given the benefits of ASC. We are clear that suppliers are, regardless of the cap level, obliged to provide ASC in line with the relevant SLCs. However, we consider that if the cap level does not reflect efficient costs, it is reasonable to

[19] Ofgem (2018), Default Tariff Cap decision – Overview, paragraphs 3.14 and 3.16. https://www.ofgem.gov.uk/publications/default-tariff-cap-decision-overview

[20] Ofgem (2021), Price Cap: Consultation on the potential impact of increased wholesale volatility on the default tariff cap, page 34, paragraph 4.16. https://www.ofgem.gov.uk/publications/price-cap-consultation-potential-impact-increased-wholesale-volatility-default-tariff-cap

consider that consistent application of best practice in relation to ASC may be adversely affected, particularly in view of the increased ASC-related obligations on suppliers.

3.22 Furthermore, we consider that in the design and implementation of the allowance (see Chapters 4, 5 and 6), we have significantly mitigated the potential moral hazard risks, and have a robust set of measures to identify any areas of poor practice, and ensure the allowance delivers its intended benefits. In particular, we recognise that under the relevant SLCs, there are occasions where a supplier has to exercise judgment when considering ASC requests and in Chapter 6, we set out our clear expectations for how these requests should be considered. This allowance should also be considered in the round with the policy interventions this winter to protect consumers in vulnerable situations, which are set out in further detail in Chapter 7.

Price cap as a mechanism for cost recovery

3.23 We do not consider a bespoke levy for recovering ASC bad debt costs would be preferable to recovery through the price cap at this stage. Primarily, the Act requires there to be one cap for all suppliers, and the cap therefore sets one level which incentivises efficiency amongst suppliers relative to that level. A levy, on the other hand, while potentially more cost reflective for individual suppliers, may reduce the incentive for suppliers to maximise the efficiency of their debt collection activities. Additionally, given debt provisioning is partly based on suppliers' own forward-looking expectations, rather than current performance, it may also be less well suited to a standalone levy.

3.24 Moreover, there would be practical challenges with a bespoke levy which we consider would negate any potential benefit at this stage. It would take time and resource to develop, test and implement, and it is likely this would not be in place for this winter when we expect ASC issuance to increase. The cap, on the other hand, is an existing mechanism for cost recovery for suppliers which allows for cost recovery of a number of similar costs.

Scope of adjustment – related costs and historical costs

3.25 We recognise that suppliers may incur some increased administrative costs when issuing ASC. However, we do not consider there is evidence to suggest that ASC administration costs for PPM customers will materially increase above the existing allowances.

3.26 Additionally, we do not consider the working capital costs of ASC will become materially larger than the estimated allowances in the price cap for PPM debt-related working capital. Given these costs are covered by existing allowances, we therefore consider it would not be appropriate to introduce a specific allowance which accounts for these costs.

3.27 Furthermore, we do not consider the allowance should cover costs in the period after the baseline (outlined in Chapter 4), prior to this allowance being introduced (April 2022 to September 2023). There was no expectation in this period that these costs would be covered by an ASC bad debt allowance. Despite the ASC costs in this period being higher than the costs in the baseline period, they were not significant relative to the increased level of the price cap during this period. Therefore, these costs could have been temporarily covered by the increased headroom allowance during this period.

Timing of introducing the allowance

3.28 We remain of the view that it is appropriate and optimal to introduce the allowance for ASC bad debt from October 2023. Demand for ASC is generally much higher in winter, and we consider this intervention will help ensure PPM customers can access the right level of ASC support this winter, without which there may be an increased risk of self-disconnection. The introduction of the allowance from October 2023 onwards is also aligned with the intended implementation of relevant changes to involuntary PPM practice.

3.29 The next opportunity to introduce an allowance would be January 2024 (cap period 11b – Jan 2024 – March 2024). This would only benefit from additional data covering the period up to October 2023, due to data lags, so we consider this marginal data benefit is outweighed by the detrimental impact of not having a specific allowance in the cap for the whole winter period (October 2023 – March 2024).

4. Allowance value and methodology

Chapter summary

This chapter sets out our decisions and associated considerations on the methodology and value of the initial 12-month ASC bad debt allowance.

Context

4.1 In our June consultation, we set out three potential scenarios for calculating the value of the proposed allowance:

- **Low scenario**: Both ASC issuance and ASC bad debt rate remain constant as a percentage of effective customers' bills[21] between 2022/23 and 2023/24.
- **Central scenario**: ASC level increases by the percentage increase of ASC between 2021/22 and 2022/23, and the ASC bad debt rate remains constant between 2022/23 and 2023/24. [22] This increases the level of ASC but assumes that the proportion of this ASC which becomes bad debt does not increase.
- **High scenario**: ASC level and ASC bad debt rate increase by their respective percentage increase between 2021/22 and 2022/23. This increases the level of ASC and assumes that the ASC bad debt rate (ie the proportion of all ASC which is written off) also increases.

4.2 We proposed to use our central scenario. Based on data available at the time, this gave a proposed allowance value of £13.00 per typical dual fuel PPM customer.[23]

Decisions

4.3 We have decided to maintain our consultation position and use our central scenario to calculate the specific ASC bad debt allowance. We have also recalculated each scenario based on new data submissions received since our consultation launched.

[21] By effective customer bills, we mean the amount that customers actually paid. Given the government support packages (Energy Bills Support Scheme (EBSS) and EPG) last winter, customers did not pay the cap level from October 2022 – April 2023. We therefore subtract the value of the government support package from the cap level to identify costs faced by customers.
[22] For clarity, our calculation takes into account the increase of ASC over the full year, not just the winter months.
[23] This is at benchmark Typical Domestic Consumption Values (TDCV) split evenly between gas and electricity. TDCV are 3,100 kWh per year for electricity (single register), 4,200 kWh per year for electricity (multi-register) and 12,000 kWh per year for gas.

4.4 We have decided to subtract a baseline value of £2.95 from the allowance. This baseline value was calculated by scaling up 2021/22 ASC bad debt by the cap period 10b cap level.

4.5 Following new data submissions, the ASC bad debt allowance value for cap period 11a will therefore be £8.77 per typical dual fuel PPM customer.[24]

Overview of responses

4.6 Of those who commented on the allowance value and methodology, there was a spread of preferences across the different options. Suppliers who responded typically preferred the medium or high scenarios, although one supplier urged a cautious approach and argued for the low scenario if an allowance was introduced.

4.7 Consumer groups and charities who commented on the allowance value had mixed views. One preferred a lower allowance and one supported an allowance at the upper bound of our scenarios for as long as the cost of the allowance is covered by government through the EPG.

4.8 The charity who argued for a lower allowance did so on the basis we should include a baseline in our calculations. They said funding is implicitly included in the cap within current debt allowances and the headroom allowance also exists to cover costs that may not be captured in specific allowances. They suggested that we should use 2022/23 as the baseline year.

4.9 We received 11 responses to our additional communication on accounting for a baseline of ASC bad debt costs recoverable in the cap already, and using updated data.

4.10 Two suppliers strongly opposed a baseline for ASC bad debt costs. Both cited the original methodology for setting the cap and disagreed that headroom could have covered ASC bad debt costs previously. One supplier commented there needs to be precise specification of which cap allowances or benchmarks any baseline allowance is assumed to be included in.

[24] This is calculated by subtracting a £2.95 baseline from the central scenario estimates bad debt of ASC of £11.71. Our estimate of ASC bad debt has decreased since our consultation, as we have received updated data from several suppliers.

4.11 Another supplier noted there may be a risk of double counting if we do not adjust the methodology to consider funds already provided for through the payment method uplift for ASC bad debt, but thought it was not appropriate to look towards headroom to cover this. They suggested we should undertake a more thorough analysis of bad debt outcomes during current market conditions to set the baseline. One supplier, while opposing an allowance overall, agreed a baseline should be included if an allowance is introduced.

4.12 A consumer group welcomed the acknowledgement of a baseline but restated their overall opposition to the allowance. They said that if we proceed to introduce an allowance, implementation should be delayed and a further consultation step be added so that any baseline methodology changes can be reviewed by the wider industry. This position was supported by six individuals who responded.

Considerations

<u>Overarching methodology</u>

4.13 We consider it is appropriate to maintain our consultation position and base our allowance calculation on the central scenario identified for ASC bad debt levels.

4.14 The Code and associated proposals in the involuntary PPMs consultation will introduce a requirement for suppliers to proactively issue involuntary PPM credit[25] automatically on the installation of involuntary PPMs. This reasonably could increase ASC issuance this winter. Conversely, we have not seen clear evidence that this will increase the bad debt rate. We also consider that the option to true up the allowance means that we can review this again at a later stage.

4.15 We have considered the arguments in response to our consultation that this underestimates the likely ASC bad debt rate. We note the evidence provided in response to our consultation about affordability challenges consumers are facing, and the likely difference between winter 2022/23 and winter 2023/24 in terms of level of government support (specifically in relation to the Energy Bills Support Scheme (EBSS)).

[25] As noted elsewhere, this is defined separately as 'Involuntary PPM Credit' but for the purpose of this decision we consider it reasonable and appropriate to regard this requirement, in practice, as ASC, given the purpose and nature of the payment. It therefore forms part of our overall assessment of ASC levels.

4.16 However, as things stand, the level of effective customer bills[26] is expected to be similar to last winter. Further, while the level of issuance of ASC changed significantly between 2021/22 and 2022/23 (146%), the bad debt rate only increased by 7%. Therefore, we do not consider that there is sufficiently compelling evidence to assume this rate will change further this winter.

4.17 We are committed to keeping this under review, but we consider it is in the interest of consumers and efficient public spending to take a balanced approach to setting this initial allowance. This approach also mitigates potential moral hazard risks, by continuing to provide suppliers with an incentive to improve the efficiency of their debt collection.

Choice of benchmark

4.18 We have considered how to benchmark suppliers' costs to help assess what the notionally efficient costs may be. We could set the benchmark at either the frontier, lower quartile or weighted average benchmark.[27]

4.19 In our consultation, we proposed to use a weighted average benchmark when calculating a specific allowance for ASC bad debt costs and one supplier supported this proposal.

4.20 We still consider that this benchmark is appropriate given the notable rise in ASC bad debt costs, which has been driven by increased ASC issuance and high energy prices. However, our decision does not pre-judge any future benchmarking method used in any subsequent true-up or elsewhere in the cap.

Sample selection

4.21 As stated above, the overarching methodology to calculate the estimated bad debt figures has not changed when compared to our June consultation. We detail the specific calculations used to calculate the ASC bad debt scenarios in Appendix 2. If we found that a supplier's ASC issuance practice was not in line with SLC

[26] By effective customer bills, we mean the amount that customers paid. Given the government support packages (EBSS and EPG) last winter, customers did not pay the cap level from Oct-22 – Apr-23. We therefore subtract the value of the government support package from the cap level to identify costs faced by customers, rather than solely the cap level which reflects the revenue suppliers received.

[27] A frontier benchmark would use the supplier with the lowest costs. A lower quartile benchmark is the cost of the supplier that is halfway (in number of suppliers) between the suppliers with the lowest and median costs. A weighted average benchmark will reflect the average cost across all suppliers, taking into account their size.

27A.7, then we would consider whether it would be appropriate to exclude them from our sample.

4.22 However, our estimates of ASC bad debt are now lower due to supplier data revisions and updates since we published our June consultation. Following our consultation, one supplier identified an error in their ASC and ASC bad debt numbers. Further to this, we also engaged with suppliers who had not submitted ASC bad debt numbers in response to our April 2023 RFI. Three additional suppliers were able to provide this data, enabling their inclusion in the sample.

4.23 This updated sample has reduced all three scenarios ASC bad debt estimates and ASC bad debt rates, particularly for the high scenario.[28] We consider that it is appropriate to use the best available data at the time of our decision.

4.24 This updated data reduced the ASC bad debt estimates across all scenarios, particularly the high scenario.[29]

Table 4.1: Estimated ASC bad debt allowance, by scenario

	Low	**Central**	**High**
ASC level scaling factor	1.00	2.46	2.46
ASC bad debt rate	18%	18%	19%
ASC bad debt scaling factor	1.00	2.46	2.61
ASC bad debt estimate	4.76	11.71	12.43
ASC allowance net of the baseline	1.82	8.77	9.48

Note: ASC bad debt allowance numbers are £ per typical dual fuel PPM customer.

[28] The differential between the central and high scenario ASC bad debt rate was seven percentage points in our June 2023 consultation, whereas now it is only one percentage point. 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

Baseline

4.25 Our consultation position proposed no baseline for ASC bad debt costs in the cap. However, as noted above and in view of consultation respondents' feedback, we consider there is a strong argument to account for some baseline costs, given costs were low but non-zero under the cap historically.

4.26 We consider these costs would have been recoverable in the cap through the PPM cap allowance, since ASC is the predominant debt a PPM customer can incur. We recognise that in 2022/23 ASC bad debt costs increased, but we consider any additional costs not covered by the existing PPM debt-related costs allowance would have been temporarily covered by the large contemporaneous rise in the headroom allowance.

4.27 There is not an obvious way to use the estimated debt-related costs allowance to calculate the baseline, as the overall debt-related costs allowance is split across multiple parts of the cap, and requires assumptions to disaggregate to the level of ASC issued. We therefore consider it appropriate to use the same cost data we are using for the ASC bad debt allowance.

4.28 We consider the most robust method is to use actual 2021/22 data, given 2022/23 was affected by gas price increases and 2020/21 was affected by COVID-19. This 2021/22 data is then scaled up with the cap level for 10b, as a proxy for future cap periods. This scaling is consistent with the approach to overall debt-related cost allowances.

4.29 Including a baseline reduces our central scenario by £2.95.

Cap allowance value for cap period 11a-12b

4.30 The allowance value in cap period 11a is therefore £8.77 per typical dual fuel PPM customer.

4.31 The impact on final customer bills in cap period 12a and 12b (April 2024 – September 2024) is subject to the outcome of the levelisation of payment type differentials workstream.[30] If such a levelisation mechanism is in place from April 2024, it would spread the remaining costs related to this allowance across other

[30] Ofgem (2023), Levelling the cost of standing charges on prepayment meters, https://www.ofgem.gov.uk/publications/levelling-cost-standing-charges-prepayment-meters

payment types, not just PPMs, leading to a significantly lower cost per dual fuel customer.

5. Implementing the allowance

Chapter summary

This chapter sets out how we will implement the allowance in the cap.

Context

5.1 In our June consultation, we proposed to allocate the full allowance for ASC bad debt to PPM customers only, which meant not allocating any of the allowance to credit customers.

5.2 In relation to allocation across the unit rate and standing charge, we proposed to align our apportionment, where possible, with the government's approach to levelising across payment types. We also proposed to adopt equal allocation across fuel and electricity meter types (ie the same pound uplift to each fuel and electricity meter type).

5.3 We proposed to implement the allowance through a 'float and true-up' approach, and to use the existing cap adjustment allowance ('Annex 8 – adjustment allowance methodology') to include the allowance in the cap.

Decisions

5.4 We have decided to maintain our consultation position and allocate the full allowance for ASC bad debt to PPM customers only. We are therefore not allocating any of the allowance to credit (DD and SC) customers.

5.5 We have decided to apportion the allowance to the standing charge element of the cap only at this stage, to ensure alignment with the government's expected approach to removing the PPM differential through the EPG until the end of March 2024.

5.6 We have decided to adopt equal allocation across fuel and electricity meter types (ie the same pound uplift to each fuel and electricity meter type).[31]

[31] The cap has two fuel type cap levels: one for gas and another for electricity. Within the electricity cap level there are two electricity meter type cap levels: one for single-rate and another for multi-register.

5.7 We have decided to maintain our consultation position to introduce this allowance using a 'float and true-up' approach. This means we are initially providing an ex-ante allowance for anticipated costs of ASC bad debt only, between October 2023 and September 2024. We intend to review this in 2024, to determine, for example, if the allowance materially differs from actual costs, and will consult on an adjustment (a 'true-up'), if necessary.

Overview of responses

Allocation of allowance

5.8 Two suppliers and a trade association commented directly on our proposals regarding payment method allocation. All were in broad agreement, with one expressing support for the allowance being entirely on the PPM cap in the current circumstances, noting they believe this will ensure suppliers are able to recover efficient costs of supplying energy to PPM customers, and removes the risk of any supplier gaining a windfall by recovering costs against their whole default tariff portfolio.

5.9 On other allocation considerations, one respondent set out their view that increases in daily standing charges has a disproportionate impact on low usage consumers and small households, such as pensioners. They believed that any increased allowance for bad debt will therefore impact groups such as this disproportionately, and tend to increase fuel poverty. One supplier commented that subject to how the government implements the EPG from October 2023, they believe it may make more sense for the ASC bad debt allowance to be applied to the standing charge rather than the unit rate.

Float and true-up

5.10 Most respondents commented on aspects of the float and true-up proposals. Three respondents expressed broad support for a float and true-up, a consumer group said a review was required when the government's EPG ends, and two suppliers expressed concerns about the similar process used for COVID-19 bad debt, believing it to be a highly complex and time-consuming process.

5.11 Another supplier opposed the 'float and true-up' approach, believing it may not adequately incentivise suppliers to provide the level of ASC support intended by Ofgem. They suggested an alternative involving paying any excess allowance into supplier hardship funds, with associated reporting. A consumer group commented on the timing, saying any increases in the cap should have strict review times. This position was endorsed by a number of individual respondents.

Considerations

Payment method allocation

5.12 We consider there is no reason to depart from our consultation position that it is appropriate to allocate all ASC bad debt costs to PPM customers at this stage.[32] By the nature of ASC, it is clear any bad debt resulting from it would have been incurred on a PPM. This contrasts with some other debt-related costs where it may be less apparent where and when the debt was incurred eg debt may have occurred on one payment type and been moved to another when the customer changed payment type.

5.13 Allocating all ASC bad debt costs to PPM customers also ensures that the allowance more closely reflects the variances across suppliers in their customer base, supporting supplier financeability.

5.14 Our considerations and decision on payment method allocation for this allowance do not prejudice any future decisions made in relation to levelisation of payment methods.

Unit rate or standing charge allocation

5.15 To ensure this allowance does not run counter to or undermine the government's commitment to remove the PPM premium using the EPG until the end of March 2024, we consider it appropriate to align how we implement this allowance with how levelisation will be applied via the EPG.

5.16 The government has recently consulted with suppliers on the modifications necessary to implement the PPM premium commitment by adjusting the standing charge from October 2023 until the end of March 2024. Our firm understanding is that government intends to proceed to implement the PPM premium on this basis, and will set out its final decision imminently.[33] In the unlikely event the

[32] Ofgem (2023), Price cap – Statutory consultation on introducing an allowance for bad debt associated with Additional Support Credit, page 34, paragraph 5.1 https://www.ofgem.gov.uk/publications/price-cap-statutory-consultation-introducing-allowance-bad-debt-associated-additional-support-credit
[33] Relevant information will be available imminently at https://www.gov.uk/government/publications/energy-bills-support

government adopts a different approach, we will consider the impact of this misalignment as part of our review and true-up.

5.17 In our policy consultation on levelisation of payment methods,[34] we set out that our current preference is that from April 2024, the remaining costs of this allowance are spread across all payment methods' standing charges. This would mean this decision on apportioning the allowance via the standing charge would continue to be aligned with wider levelisation considerations. However, if that preferred position was to change materially, we will consult on any proposed consequential changes for this ASC bad debt allowance.

Fuel type allocation

5.18 We remain of the view, set out in our June consultation, that we expect customers will request ASC proportional to the cost of their energy consumption. The level of the PPM cap at typical consumption remains higher for electricity than gas over a year. Therefore, ASC and ASC bad debt could be higher for electricity meters than for gas meters.

5.19 However, PPM customers' energy costs are more directly proportional to their consumption in any given month than DD customers, as they must top up their meter to consume energy, whereas DD customers' energy costs are spread evenly throughout the year. Since gas consumption has higher seasonality[35] compared to electricity, with higher usage during the winter, it would therefore be plausible that PPM customers may need more ASC (also predominantly issued during winter) to pay for their gas than their electricity.[36] Any increase in ASC would consequently increase the level of associated bad debt.

5.20 We consider that requesting more detailed data including the fuel split would not be proportionate, particularly given data from last winter would not be representative of the cost splits for 2023/24, as EBSS support vouchers were applied to electricity meters only. Further, since most customers are dual fuel, cost allocation between fuels should also have a relatively limited impact on individual customers.

[34] Ofgem (2023), Levelling the cost of standing charges on prepayment meters, https://www.ofgem.gov.uk/publications/levelling-cost-standing-charges-prepayment-meters

[35] 73% of gas is consumed in winter, compared to 56% of electricity.

[36] Although electricity only customers would also consume more energy in the winter months, akin to gas demand.

5.21 Therefore, while we recognise that suppliers with a non-average fuel mix split potentially could be disadvantaged (to the extent that costs vary between fuels), we consider that equal allocation of costs between fuel types is a simple and robust approach that avoids us introducing potentially circumstantial and complex assumptions which we could not evidence.

<u>Meter type allocation</u>

5.22 The cap has two levels for electricity: one for single-rate meters, and another for multi-register meters. Multi-register meter customers tend to use more energy on average, so the typical consumption benchmark for the multi-register meter cap is set at a higher level of consumption.

5.23 Similar to fuel type, we could not directly control for any differences in the propensity to incur ASC bad debt by meter type, as we did not request the data at a granular level.

5.24 The levels of ASC and ASC bad debt are likely to be proportional to customers' bills. This means that multi-register customers could incur a higher level of ASC bad debt than single-rate meter customers (driven by the amount of their bill, rather than their propensity to request ASC or incur bad debt from ASC).

5.25 As outlined earlier, we intend to ensure our proposal to introduce a specific allowance for ASC bad debt does not run counter to, or undermine, government's commitment to levelising across payment method types.

5.26 Given our decision in this chapter to allocate the allowance to the standing charge element of the cap, scaling the allowance up for multi-register customers would penalise low consumption multi-register customers. If from 1 January 2024, levelising was achieved via unit rates, then we would also keep the unit rates equal between single register and multi-register customers (with the latter's higher consumption leading to higher average costs in cash terms).

5.27 Overall, we consider that ASC scales with demand, so it would be appropriate to be on the unit rate element of the cap. However, because of the considerations in relation to levelising set out elsewhere in this document, we consider this initial 12-month allowance is best suited to being on the standing charge. We will reconsider this as part of the Operating Costs review (Chapter 7), in the context of levelisation options available at that time.

How the cap is adjusted

5.28 We consider that using the 'Annex 8 - adjustment allowance methodology' model is the simplest and most flexible method for including this allowance in the cap. This approach is also consistent with other one-off adjustments, such as the one-off COVID-19 true-up allowance,[37] and we have not received any views from stakeholders proposing alternative methods.

5.29 We have also published a final version of Annex 8 alongside our decision, and detailed the methodology behind this model in Appendix 3.

Review of allowance

5.30 As set out in Chapter 3, we consider it appropriate to include an initial ex-ante allowance from October 2023 for anticipated ASC bad costs. In doing so, it is important and appropriate to have the option to review and, if necessary, true-up the allowance if costs significantly differ from the initial allowance. We recognise there is inherent uncertainty around anticipated ASC bad debt costs. The review and any true-up would significantly mitigate the risks associated with an under or over allowance being provided initially.

5.31 We recognise that in conducting a review to determine whether a true-up is necessary, there is the potential for suppliers' actual or realised costs to affect allowances, which could reduce efficiency incentives. However, a supplier has no guarantee there would be a true-up adjustment (we would review to determine if one was necessary) and if we did implement one, we would seek to ensure the design and implementation of it mitigated those risks as much as possible.[38]

5.32 Additionally, we acknowledge the concerns raised in response to our consultation about the complexity, timing and resource considerations for a true-up. We are committed to ensuring the review and any true-up process is conducted efficiently and in a timely manner. Our intention is to conduct the review in 2024, with the

[37] Ofgem (2023), Price Cap – Decision on the true-up process for COVID-19 costs, https://www.ofgem.gov.uk/publications/price-cap-decision-true-process-covid-19-costs
[38] Ofgem (2023), Price Cap – Decision on the true-up process for COVID-19 costs, https://www.ofgem.gov.uk/publications/price-cap-decision-true-process-covid-19-costs

precise timing determined when considering all relevant factors in the round, such as availability of data.

5.33 One respondent proposed an alternative to a true-up would be for suppliers to pay any excess allowance into supplier hardship funds, with associated reporting. We do not consider this to be viable or preferable to a review and true-up. It is not clear how this would be implemented or monitored, and we are mindful of retaining the incentives for suppliers to manage ASC bad debt costs efficiently. We also consider this would risk generating confusion over sources of funding being used to support customers.

6. Monitoring and compliance

Chapter summary

In this chapter, we set out our approach to ensuring this allowance delivers the intended benefits for vulnerable PPM customers.

Context

6.1 In our June consultation, we set out that we will closely monitor suppliers' provision of ASC, to ensure that consumers benefit from the allowance as intended.

Decisions

6.2 We will take a multifaceted approach to ensuring the ASC bad debt allowance is used appropriately and helps ensure the right level of ASC will be provided to customers in need this coming winter. This will, as a starting point, include a review and if necessary a 'true-up' in 2024, and enhanced 'inflight' monitoring and assurance.

6.3 We will also explore which further measures may be appropriate to ensure the allowance is used effectively, and more broadly, continues to drive best practice in relation to ASC and debt management by suppliers. This will be taken forward as part of our ongoing work on involuntary PPMs, and the wider collaborative work with industry, consumer groups and government to ensure we are supporting customers struggling with their bills this coming winter.

Overview of responses

6.4 How we ensure this allowance benefits customers was a prominent theme in responses to the June consultation, the Involuntary PPM consultation and during the consumer groups and charities call on 3 July 2023. Six respondents to the June consultation (including suppliers, consumer groups and charities and a trade association) commented on aspects of how the allowance, or ASC issuance generally, would be monitored. One of the consumer group responses was cited or endorsed in the majority of responses from individuals who responded.

6.5 One supplier was in favour of suppliers being mandated to report publicly on their ASC bad debt, as a form of reputational incentive. They considered this could be part of an alternative to the float and true-up. A charity argued that alongside any allowance, suppliers should be mandated to publicly report as a reputational incentive and to help increase transparency and scrutiny.

6.6 A supplier, who opposed the allowance, said they believed Ofgem can use monitoring and targeted compliance activity to make sure that suppliers issue sufficient ASC. They also noted that ASC policies were already the subject of Ofgem market compliance reviews (MCR) and RFIs over the past year, and that Ofgem has also very recently taken action in relation to non-compliance with licence conditions around ASC.

6.7 A charity said compliance with SLCs should be ensured through comprehensive monitoring and enforcement, and we should make clear that any perceived inadequacy of cap allowances is not an acceptable justification for non-compliance. A consumer group, whose response was endorsed by the majority of individual respondents, expressed a similar view and asked about protections in place to ensure the allowance is used appropriately. We have also had regard to other evidence, including from charities and consumer groups, about debt management and ASC practices. We note, for example, there are concerns about consistency of ASC issuance and practice.

Considerations

Overarching approach

6.8 We consider it important to ensure that this allowance works in parallel with existing and expected new licence obligations to deliver the benefits intended for customers, including customers in vulnerable circumstances. We recognise from the feedback to our consultation, and wider evidence we have received, that many stakeholders want to have confidence that this happens consistently.

6.9 There are several facets to how we intend to ensure the allowance is used appropriately. First, we recognise it is necessary to be clear about our expectations; suppliers are, regardless of the cap level, obliged to provide ASC in line with the relevant SLCs and, furthermore, we are strengthening the protections through our wider work on involuntary PPMs. However, there will still be occasions where a supplier has to exercise judgement, including about what may be in the best interests of the individual consumer when considering ASC provision. In introducing this allowance, we want to reinforce that customers in vulnerable circumstances must be able to access the right level of support to keep them on supply, and avoid the serious harm that can be caused by self-disconnection and self-rationing, as set out in the statutory consultation on Involuntary PPM.

6.10 Given the severity of this harm, we consider there to be a high threshold before a supplier can properly determine that issuing ASC is not in the "best interest" of a customer in a vulnerable situation. When considering ASC provision, suppliers must consider how factors such as wider affordability pressures, the cost of living, and colder weather increase the severity of detriment from self-disconnection to households.

6.11 In practice, we consider that the risk and extent of serious detriment from self-disconnection should, in almost all circumstances, override the risk of increasing consumer debt when considering ASC provision for customers in vulnerable circumstances. Suppliers are required to consider alternative methods of support, such as non-repayable financial support and/or signposting to debt advice services, when it is considered ASC is not the right way forward for that customer, and we are clear they should also consider whether any alternative support would help prevent self-disconnection and therefore be in a customer's best interest.

6.12 As set out in our consultation on Involuntary PPM protections, where a customer who is subject to an involuntary PPM is reliant on ASC to remain on supply, suppliers should be assessing if a PPM remains safe and reasonably practicable for the customer.[39]

6.13 We will be engaging further with suppliers ahead of this allowance being implemented in the cap in October 2023, to support the delivery of these expectations.

Monitoring

6.14 A key part of ensuring these expectations are delivered consistently is our enhanced 'inflight' monitoring of ASC-related metrics. We already closely monitor ASC practice and we have recently expanded our approach to gather additional monthly data on wider aspects of ASC, including customer self-disconnection rates by supplier. These high frequency indicators are designed to help us quickly

[39] Ofgem (2023), Statutory Consultation – Involuntary PPM, page 8, paragraph 3.4, https://www.ofgem.gov.uk/publications/statutory-consultation-involuntary-ppm

identify trends and areas of concern, including within specific suppliers. Where issues are identified, they will be followed up with proportional escalation where necessary.

6.15 Alongside enhanced monitoring, we will continue to engage closely with consumer groups and other third parties to gather wider evidence on ASC practice and trends. We already receive intelligence from consumer groups on where they consider there to be concerns or poor practice, and we carefully consider this in the round with all other evidence, to determine what action should be taken. This holistic, 'inflight' monitoring underpins what will be an evidence-based approach to ensuring the ASC bad debt allowance delivers the benefits intended.

Transparency and incentives

6.16 While our own monitoring and analysis will be crucial, we recognise that wider transparency around the allowance's usage, and ASC practice more generally, could enable valuable external scrutiny. We appreciate that, as suggested by some consultation respondents, there are mechanisms which could provide a reputational incentive for energy suppliers to further improve their ASC practices.

6.17 We will consider these proposed transparency measures in the round with other Ofgem work relating to ensuring vulnerable customers are protected this coming winter and beyond.

Compliance

6.18 We have previously taken strong action on suppliers where we have identified non-compliance with the licence conditions on ASC. This includes compliance cases,[40] engagement processes where less material concerns have been identified,[41] and MCRs which have covered aspects of ASC provision.[42]

6.19 Looking ahead, our planned programme of work includes a market-wide review of suppliers' ASC policies and practice. This will allow us to closely scrutinise

[40] For example, a recent case resulted in 25,000 customers receiving compensation from their supplier and a substantial payment into the Energy Redress Fund, which supports energy consumers in vulnerable situations, amongst other innovation and carbon emission reducing investments.
[41] Compliance engagement processes are not typically published but some have addressed issues with how suppliers provide ASC.
[42] For example, the ongoing PPM MCR is considering ASC issuance immediately after involuntary PPM installation.

suppliers' compliance with their ASC and other related obligations, and ensure that there has been appropriate provision of ASC following this decision.

6.20 We will also dedicate resource to actively manage any concerns raised through our enhanced monitoring processes. As part of our handling of these cases, we may request information from relevant suppliers in addition to that already provided.

6.21 Where we determine that there may have been non-compliance, we will engage with the relevant suppliers. We will then take appropriate steps, using a variety of tools, to bring suppliers into compliance, address poor practice, and, above all, ensure any consumer detriment is remedied. We will escalate matters through the appropriate channels should we find evidence of more material failures.

6.22 We expect suppliers to engage proactively during any investigation, responding to requests for further information promptly and accurately. The level and quality of such engagement will be taken into consideration as part of any compliance related action we deem necessary.

7. Interaction with other workstreams

Chapter summary

In this chapter, we set out the interaction between the specific ASC bad debt allowance and other work undertaken by Ofgem and across government.

Context

7.1 As outlined in our June consultation, there are interactions between the ASC bad debt allowance and a range of other Ofgem workstreams and work across government. This includes our work on levelisation and the Operating Costs review, and the government's commitment to remove the PPM differential via the EPG until the end of March 2024. There are also direct interactions with the Code and associated work on involuntary PPMs, which is discussed throughout this document.

Decisions

7.2 We have decided to introduce this allowance to the cap for 12 months initially, with the ongoing Operating Costs review considering whether this should become an enduring allowance.

Overview of responses

7.3 A number of respondents commented on interactions with other work. Five suppliers expressed broad support for work around levelisation of payment methods, with one saying it is essential to ensure costs are fairly apportioned between payment methods and tariff types. A trade association noted that most of its members expected Ofgem to present plans on levelisation for post-April 2024. A charity said their support for the allowance post-April 2024 was dependent on the outcome of the work on levelisation, and said there needs to be a review of the allowance costs once the EPG ends (end of March 2024).

7.4 One supplier noted that, as things stand, they are opposed to a reconciliation mechanism in relation to the PPM differential, noting it could dull the incentive on suppliers to prevent their customers from needing to move onto a PPM, or to contain the cost of serving PPM customers.

7.5 Three suppliers commented on the interaction with the Operating Costs review, including on this being an allowance for 12 months initially. One supplier said changing debt allowances within the Operating Costs review is likely to be more efficient and better for consumers, and that doing so will allow Ofgem to take into account factors pushing operating costs down, such as technology innovations.

7.6 Two suppliers believed the ASC bad debt allowance should be permanent. One believed it was unhelpful and unnecessary to frame it as temporary given the weight of evidence of historic levels of ASC provision, bad debt and ongoing need for this funding. The other supplier believed Ofgem should commit to reassess the ASC bad debt allowance in a year's time to determine whether it should continue.

Considerations

EPG and levelisation

7.7 Our decision on this allowance has an important interaction with the government's EPG, as it ultimately affects the impact on individual customers' bills and the impact on public spending.

7.8 As set out in our June consultation, the government has committed to align charges for comparable DD and PPM customers to ensure that those on PPMs no longer pay a premium for their energy costs. This is being delivered using the EPG until the end of March 2024. We have been working with government to ensure that our decision is aligned with that commitment.

7.9 This means that as long as the PPM price cap level remains higher than the equivalent DD level, we expect the additional cost of this allowance will be funded by government, not PPM customers, for the remainder of 2023/24. The costs of the allowance would fall directly to customers from April 2024. As noted elsewhere, we have published a policy consultation setting out our preference at this stage is, from April 2024 onwards, to levelise the remaining cost of this allowance across all payment method standing charges, supported by a reconciliation mechanism. If this is introduced, it would lead to a significantly lower cost per dual fuel customer.

Operating Costs review

7.10 We have decided this allowance will be an initial 12-month allowance. The ongoing Operating Costs review will consider whether and how this allowance is set on an enduring basis, with a decision currently expected in winter 2024/25. In reviewing this ASC bad debt allowance in 2024 to determine whether a true-up is necessary (Chapter 5), we will assess ASC bad debt costs over the year, which will provide evidence for consideration in the Operating Costs review.

Involuntary PPM and customer standards

7.11 Following the June statutory consultation on Involuntary PPMs[43], we will soon set out the action we are taking to tighten up the rules around PPMs. The proposed changes will integrate the Code published in April into licences and guidance. The final set of measures will be outlined in the associated decision, but for the purpose of this decision on this allowance, we have assumed the proposed changes relevant to ASC (eg that suppliers provide £30 credit to meters of customers where an involuntary PPM is installed[44]) will be implemented in full.

7.12 Furthermore, our consumer standards work includes proposals to assist those struggling with their bills, such as pausing debt repayments in certain circumstances and early, proactive debt support.[45] In the coming months we will continue to work with consumer groups and industry to find ways of raising standards and ensuring consistency for consumers in, or at risk of, debt.

[43] Ofgem (2023), 'Statutory Consultation – Involuntary PPM', https://www.ofgem.gov.uk/publications/statutory-consultation-involuntary-ppm
[44] As noted elsewhere in this document, while this is defined separately as 'Involuntary PPM Credit', for the purpose of this decision we consider it reasonable and appropriate to regard this requirement, in practice, as ASC, given the purpose and nature of the payment. It therefore forms part of our overall assessment of ASC levels.
[45] Ofgem (2023), Consumer Standards - Statutory Consultation, https://www.ofgem.gov.uk/publications/consumer-standards-statutory-consultation

8. Impact assessment

Chapter summary

In this chapter, we set out how we assess the impact of our decision to introduce an initial 12-month allowance in the cap for ASC bad debt. This includes a distributional analysis.

Context

8.1 As outlined in Chapter 2, we must exercise our functions with a view to protecting existing and future consumers who pay standard variable and default rates. In doing so we must have regard to the five matters identified in section 1(6) of the Act in our decision-making process.

8.2 In reaching our decisions, we have been mindful of the trade-offs between consumers' interests in minimising the immediate impact on energy bills, and in ensuring resilient suppliers who can efficiently manage risks. As part of our decision-making, we conducted an impact and equalities assessment.

8.3 We carried out four assessments of the impacts of introducing a specific allowance for ASC bad debt from cap period 11a (October 23 – December 23) onwards:

- High-level qualitative analysis: we assess the potential impact of including a specific ASC bad debt allowance in the cap on default tariff customers and suppliers.
- Bill impact analysis: we assess the potential distributional impact on bills.
- Equality Act impacts: we assess the potential impact on groups with protected characteristics.
- Potential impact on public spending duty.

High level qualitative assessment

<u>Policy context</u>

8.4 Energy prices are forecast to remain around double historical averages, and there are continued cost of living and wider affordability pressures. The further steps we are taking in relation to Involuntary PPMs also mean there are a number of further conditions and measures which could increase the level of ASC that suppliers are expected to issue. This would in turn be expected to increase the amount of ASC bad debt.

8.5 As set out in earlier chapters of this decision, the government's commitment to remove the PPM premium means that in practice, we do not expect this ASC bad debt allowance to lead to PPM customers paying more on their bills than comparable DD customers for the first six months of the allowance (October 2023 – March 2024). The costs of the allowance would fall directly to customers from April 2024, but our preference at this stage is, from April 2024 onwards, to levelise the remaining cost of this allowance across all payment method standing charges. If this mechanism is introduced, it would lead to a significantly lower cost per dual fuel customer.

Assessment

8.6 We focus this assessment on the customer and supplier impacts of the factual scenario of introducing a specific ASC bad debt allowance to the cap, against the main counterfactual scenario of not introducing one.

8.7 We expect the costs for this allowance between October 2023 to the end of March 2024 to be funded by public spending, rather than customer bills, for the purpose of this assessment.

Suppliers

8.8 In the factual scenario of introducing a specific ASC bad debt allowance to the cap, suppliers would be able to fully recover the expected efficient costs of the notional supplier. Over time we do not consider that it would be in customers' interests to prevent suppliers from recovering their efficiently incurred additional costs. In general, we seek to set the cap to reflect notionally efficient costs, and under-recovery could ultimately have negative impacts on customers, including via lower supplier resilience and increasing the future additional costs that they would incur due to the Supplier of Last Resort ('SoLR') and/or Special Administration Regime ('SAR') processes.

Customers

8.9 As stated above, we expect the costs of the allowance to not fall to customers for the remainder of 2023/24. We consider the cost to government is justified on the basis that the allowance helps ensure the right level of support is available for

PPM customers, without which there may be an increased risk of self-disconnection which can cause serious harm.

8.10 From April 2024, the costs will fall directly to consumers. Regardless of whether there is a levelisation mechanism or not, PPM customers will therefore experience some increase in their energy bills in the factual scenario (ie an increase in the cap level) between April 2024 and September 2024, compared to a scenario with no allowance. However the impact would be significantly lower if a levelisation mechanism was in place.

8.11 Given the purpose of ASC, we consider that the PPM households who require ASC will typically be at the point of 'self-disconnection', and without ASC being issued may face the associated detriment of self-disconnection as a result. In the counterfactual, we consider that the absence of a specific allowance in the cap for ASC bad debt creates an increased risk of self-disconnection for these customers.

8.12 PPM customers are more likely to be households with incomes lower than the UK median. Data from Ofgem's Consumer Impacts of Market conditions survey also shows that PPM consumers are more likely to have a long-term illness, physical or mental health problem or disability (45% of PPM customers compared to just 29% of all DD households). Adding a cost to PPM bills will therefore have a financial impact on these households.

8.13 Citizens Advice research found that 47% of those who self-disconnected cited negative impacts on their physical health and 63% on their emotional wellbeing. 19% who had self-disconnected had not washed or showered as a result and 17% had skipped a meal. Twenty-five percent had to borrow money from friends or relatives. These disconnection effects are further exacerbated by regular or long disconnections.

8.14 Further, PPM customers who require ASC and benefit from this allowance are likely to be at the point of self-disconnection. It is reasonable to consider that some of them are likely to be more vulnerable than the average PPM or energy consumer, both on a financial basis, but also in the risk of further harm to their mental and physical health that can result from self-disconnection.

8.15 Given this high-level assessment on costs and benefits, we consider that the net benefits of introducing a specific allowance for ASC bad debt in the cap outweigh the costs of not including one, especially given the particular risk of mental and physical harm resulting from self-disconnections.

Bill impact analysis

Distributional analysis

8.16 As stated above, we do not expect this ASC bad debt allowance to lead to PPM customers paying more on their bills than comparable DD customers in 2023/24. The costs of the allowance would fall directly to customers from April 2024.

8.17 We do not expect that there would be a significant bill impact for credit customers, although precise impacts will depend on the outcome of the levelisation workstream from April 2024. As noted elsewhere, our current preference is for the costs of the allowance in this period to be spread across all payment method standing charges. This would reduce the cost for PPM customers, as the costs would be spread over a far wider customer base.

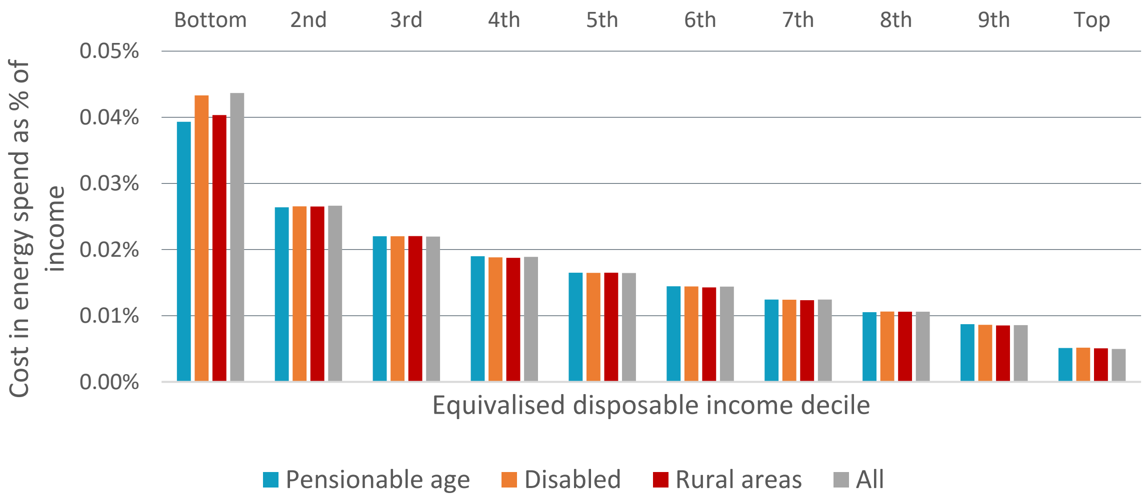
8.18 However, as the levelisation proposals are only at policy consultation stage, we deem it too early to estimate the allowance cost following levelisation. Therefore, while we do not think this following scenario is likely to occur, we base our analysis on the scenario of all costs from April 2024 – September 2024 falling to PPM customers. We consider this can provide stakeholders with a 'worst case' view on the scale and distribution of costs PPM customers could face over that period.

8.19 We have carried out a distributional analysis of the ASC bad debt allowance for cap periods 12a - 12b (April 2024 – September 2024) on customer energy bills given that, through the EPG, we expect the government will in effect cover the full cost of this allowance in cap periods 11a - 11b (October 23 – March 24).

8.20 We have had particular regard to the interest of the individuals who are disabled or chronically sick, of a pensionable age, of low incomes, and/or residing in rural areas in accordance with our duties under the Gas Act 1986 and Electricity Act 1989.[46]

[46] We consider the impact on protected groups under the Equalities Act in the following section.

Figure 8.1: Estimated impact of ASC bad debt allowance



The bar graph shows the change in energy expenditures as a percentage of income following the introduction of ASC bad debt allowance for pensionable age, rural area, disabled, and all customers based on Ofgem's levelisation not proceeding. It assumes equal income distribution among payment methods. It indicates that those in the equivalised bottom income decile will incur the highest costs.

8.21 Figure 8.1 shows the distributional impact of the specific ASC bad debt allowance against the counterfactual of not introducing one (if our levelisation mechanism was in place from April 2024, then the impact on incomes would be significantly lower).

8.22 The allowance costs consumers at the lower end of the income distribution significantly more on a relative income basis. Within each group, the disabled group is impacted the most, while the pensionable age group is impacted the least. The allowance would cost the bottom income decile ~0.04% of their income.

Public sector equality duty assessment

Overview

8.23 Under the Equality Act 2010 we are required to have regard to the public sector equality duty as well as considering how our policies or decisions affect default tariff customers protected under the Act. In paragraph 8.20 in the section above, we also assessed the impact on customers who are disabled or chronically sick, of a pensionable age, of low incomes, and/or residing in rural areas.

8.24 We do not hold data on the energy consumption of some groups with protected characteristics: gender reassignment, marriage and civil partnership, pregnancy and maternity, religion or belief, or sexual orientation. We have not seen evidence which would suggest that these groups with protected characteristics would have a differential impact when compared to other customers.

8.25 The Centre for Sustainable Energy created 13 archetypes (last updated in 2020) using the data on energy consumption of the remaining protected characteristics (age, disability, race and sex) and other common socio-economic characteristics (income, employment status). Each archetype represents a typical GB household.

Analysis

8.26 Our analysis provided below is based on a scenario of government covering the costs between October 2023 and March 2024, and the remaining costs of the allowance falling directly on PPM customers from April 2024 – September 2024.

8.27 Table 8.1 shows the average cost in pounds (£) and the total cost for each archetype group from April 2024 – September 2024 if Ofgem's levelisation was not implemented (we use this scenario for the same reasons set out in paragraph 8.18).

Table 8.1: Distributional impacts, split by archetype.

Archetype	**Key Words**	**Average cost per household (£) - PPM**	**Average Impact**	**No PPM Households**	**PPM households as a percentage of archetype**
A1	High income, owner occupied, working age families, full time employment, low consumption, regular switchers.	£4.38	£1,007,999	229,991	8%
A2	High income, owner occupied, middle aged adults, full time employment, big houses, very high consumption, solar PV installers, care for the environment.	£4.38	£1,064,587	242,903	8%
B3	Average income, retired, owner occupied - no mortgage, lapsed switchers, late adopters.	£4.38	£2,146,436	489,744	13%
B4	High income, owner occupied, part-time employed, high consumers, flexible lifestyles, environmental concerns.	£4.38	£1,357,150	309,656	13%

C5	Very low income, single female adult pensioners, non-switchers, disconnected (no internet or smart phones).	£4.38	£2,133,719	486,843	25%
D6	Low income, disability, fuel debt, disengaged, social housing, BME households, single parents.	£4.38	£1,242,800	283,565	18%
D7	Middle aged to pensioners, full time work or retired, disability benefits, above average incomes, high consumers.	£4.38	£703,989	160,627	13%
E8	Low income, younger households, part-time work or unemployed, private or social renters, disengaged non-switchers.	£4.38	£1,892,720	431,855	18%
E9	High income, young renters, full time employments, private renters, early adopters, smart phones.	£4.38	£1,807,002	412,297	13%
F10 (off gas)	Middle aged to pensioners, full time work or retired, owner occupied, higher incomes, oil heating, rural, RHI installers, late adopters.	£2.19	£558,517	254,870	13%
G11 (off gas)	Younger couples or single adults, private renters, electric heating, employed, average incomes, early adopters, BME backgrounds, low levels of engagement.	£2.19	£441,088	201,283	13%
H12 (off gas)	Elderly, single adults, very low income, medium electricity consumers, never-switched, disconnected, fuel debt.	£2.19	£357,470	163,125	25%
H13 (off gas)	Off gas, low income, high electricity consumption, disability benefits, over 45s, low energy market engagement, late adopters.	£2.19	£211,284	96,416	18%

8.28 It indicates that the households within archetype A1-E9 will all incur the same average cost per household, which is expected given our decision to apportion this allowance to the standing charge element of the cap only. Archetypes F10-H13 would incur a lower cost since they are off-gas so will only pay the standing charge related to the electricity cap.

8.29 Given the flat cost across customer groups (due to full allocation on the standing charge), this does not disproportionately affect groups with the included protected characteristics on a cash terms basis. However, where groups with protected characteristics have lower average incomes than society as a whole, and/or are more likely to be PPM customers, this cost being on PPM customer bills may disproportionately negatively impact those groups on a relative income basis.

8.30 As noted in Table 8.1 above, this impact is justified on the basis of mitigating the particular risk of mental and physical harm resulting from self-disconnections. Where groups with protected characteristics are more likely to be at the point of self-disconnection (eg through increased financial vulnerability), this allowance therefore disproportionately positively impacts those groups.

8.31 Given the benefit of avoided physical and mental harm is likely to be significantly higher than the cost of the allowance (£4.38 in the worst-case scenario for customers in archetypes A1-E9), we are content that this policy is consistent with the Equality Act 2010, and supportive of those households with protected characteristics who find themselves at the point of self-disconnection this winter.

Impact on public spending

8.32 We are required to exercise our functions under the Domestic Gas and Electricity (Tariff Cap) Act 2018 with a primary focus on protecting customers on default rates, while having regard to specified considerations (see s. 1(6) of that Act). Following the coming into force of the Energy Prices Act 2022, those specified considerations include "the need to set the cap at a level that takes account of the impact of the cap on public spending".[47]

8.33 The specified considerations reflect the fact that, while the government's EPG is in force, the cap level can directly affect public spending. For instance, if the cap level is above the level of the EPG, all of the excess costs of energy bills would be covered by the government. As discussed above, there are also public spending implications arising from the interaction between this allowance and the government's commitment to remove the PPM premium through the EPG.

8.34 Table 8.2 shows our estimate of the potential impact of this decision on government spending[48] based on our decision to allocate the ASC bad debt allowance to the standing charge element of the cap.

[47] Domestic Gas and Electricity (Tariff Cap) Act 2018, section 1(6)(d) as inserted by Schedule 3 to the Energy Prices Act (2022).
https://www.legislation.gov.uk/ukpga/2018/21/section/1
[48] We have assumed that the number of default tariff PPM customers is constant throughout the recovery period of this allowance, using numbers from the April 2023 customer account and tariff RFI. The outturn cost would depend on several factors such as changes in customer numbers.

Table 8.2: Estimated impact on public spending from the ASC bad debt allowance

Cap period	Cost per individual cap period
11a	£8m
11b	£8m
Total	£16m

8.35 We consider that this decision takes proper account of the impact the ASC bad debt allowance may have on public spending. Overall, this decision is intended to help ensure PPM customers are able to access the right level of ASC and to enable suppliers to recover efficient costs of supplying energy (which include higher ASC bad debt). The adjustment is no more than appropriate for that purpose. Furthermore, enabling suppliers to recover the efficient costs of their supply activities is likely to reduce the risk of suppliers failing and becoming insolvent, which otherwise would impact public spending eg through the cost to the taxpayer of a SAR.

8.36 We provided the opportunity for the Department for Energy Security and Net Zero (DESNZ) and HM Treasury to provide any further representations on the impact of any aspect of our proposed decision on public spending, having regard to the new consideration in the Act.

Appendices

Index

Appendix 1 - ASC bad debt allowance value - cap period 11a – 12b

A1.1 Table A1 sets out the ASC bad debt allowance value in cap period 11a-12b which has been included in 'Annex 8 – adjustment allowance methodology'. We detail specific changes to Annex 8 in Appendix 3 of this decision.

Table A1: Estimates of the annualised ASC bad debt allowance for PPM customers only.

	Electricity (single rate) (£)Nil	**Electricity (single rate) (£)TDCV**	**Electricity (Multi-register) (£)Nil**	**Electricity (Multi-register) (£) TDCV**	**Gas (£)Nil**	**Gas (£)TDCV**
Cap period 11a – 12b	4.38	4.38	4.38	4.38	4.38	4.38

Source: Ofgem calculations based on April 2023 debt-related costs RFI.

Notes: ASC bad debt allowance cost is applied to the standing charge element of the PPM cap only, so the cost is the same at Nil and Typical Domestic Consumption Levels (3,100 kWh for electricity single rate, 4,200 kWh for multi-register and 12,000 kWh for gas).

Appendix 2 - Detailed allowance methodology description

Overview

A2.1 In this appendix, we explain the method which was used to calculate the allowance options (low, central and high scenario) described in Chapter 4.

A2.2 These methods use a weighted average approach and attempt to estimate the level of ASC bad debt from October 2023 to September 2024.

A2.3 For each method, we use the same data, however we change the assumption on how ASC and ASC bad debt scale between 2022/23 and 2023/24.

Data request

A2.4 We have used data collected from the April 2023 debt-related costs RFI to calculate the ASC bad debt allowance. We requested ASC data from January 2021 – March 2023.

A2.5 This RFI was sent out to domestic suppliers who had at least 100,000 default tariff customer accounts in cap period 9b:

- We requested the value of approved ASC applications per month.[49]
- We requested the amount of ASC bad debt per month.
- We requested the number of customer accounts split by fuel, tariff and payment method per month.

A2.6 We have considered three scenarios when calculating the allowance for bad debt costs associated with ASC for October 2023 to September 2024. As an overview:

- **Low scenario**: Both ASC level and ASC bad debt rate remain constant as a percentage of effective customers' bills[50] between 2022/23 and 2023/24.
- **Central scenario**: ASC level increases by the percentage increase of ASC between 2021/22 and 2022/23 and the ASC bad debt rate remains

[49] Unlike customer accounts, we did not request either the value of approved ASC applications or the amount of ASC bad debt to be split by fuel or tariff type.
[50] By effective customer bills, we mean the amount that customers paid. Given the government support packages (EBSS and EPG) last winter, customers did not pay the cap level from Oct-22 – Apr-23. We therefore subtract the value of the government support package from the cap level to identify costs faced by customers, rather than solely the cap level which reflects the revenue suppliers received.

constant. This increases the level of ASC but assumes that the proportion of this ASC which becomes bad debt does not increase.

- **High scenario**: ASC level and ASC bad debt rate increase by their respective percentage increase between 2021/22 and 2022/23. This increases the level of ASC and assumes that the ASC bad debt rate (ie the proportion of all ASC which is provisioned for as unlikely to be repaid) also increases.

<u>ASC bad debt allowance calculation assumptions</u>

A2.7 Below we detail the calculations and assumptions which we used to calculate the estimated ASC bad debt allowance for each scenario. Since the June 2023 consultation, we have amended the method to subtract a baseline from the estimated ASC bad debt figure. We have also received and included additional data. Both of these changes were detailed in Chapter 4.

Table A2.1: Estimated ASC bad debt allowance, by scenario

	Low	**Central**	**High**
ASC bad debt estimate	4.76	11.71	12.43
Baseline	2.95	2.95	2.95
ASC bad debt allowance	1.82	8.77	9.48

Table A2.2: ASC level and ASC bad debt scaling factors, and bad debt rate

	Low	**Central**	**High**
ASC level scaling factor[51]	1.00	2.46	2.46
ASC bad debt scaling factor[52]	1.00	2.46	2.61
ASC bad debt rate	18%	18%	19%

[51] Both the central and high ASC level scaling factors are calculated using Equation 1.
[52] The ASC bad debt scaling factor for the central scenario is calculated using Equation 1. The ASC bad debt scaling factor for the high scenario is calculated using Equation 2.

A2.8 Firstly, we multiply the level of ASC and ASC bad debt between April 2022 and March 2023 by their respective scaling factors (see the table above for each scenario). We detail the equations for the scaling factors below.

Equation 1: ASC level scaling factor

$$ASC\ level\ scaling\ factor_{central,high} = \frac{ASC\ level\ _{Apr22-Mar23}}{ASC\ level\ _{Apr21-Mar22}}$$

Equation 2: ASC bad debt scaling factor

$$ASC\ bad\ debt\ level\ scaling\ factor_{high} = \frac{ASC\ bad\ debt\ level\ _{Apr22-Mar23}}{ASC\ bad\ debt\ level\ _{Apr21-Mar22}}$$

Calculation methodology

A2.9 We have a sample of 11 suppliers which covers just ASC (91.4% of the PPM market), and of which seven suppliers were able to provide ASC bad debt (99.8% of the PPM market).

A2.10 Below we detail the method of our calculations.

Step 1. We calculate the ASC per PPM customer account for the sample of 11 suppliers. This is calculated by dividing the value of ASC by the number of PPM customer accounts for each month using April 2022 – March 2023 customer numbers.

Step 2. We calculate the ASC per PPM customer account for the sample of 7 suppliers which is calculated by dividing the value of ASC by the number of PPM customer accounts for each month.

Step 3. We calculate the weighted average ASC bad debt per PPM customer account using a sample of 7 suppliers. This was calculated by dividing the value of total ASC bad debt by the number of PPM customers' accounts for our sample in each month.

Step 4. We then calculate the ASC bad debt provision rate using a sample of 7 suppliers which provided ASC bad debt figures. To calculate this, we divided the result from Step 3, by the result from Step 2.

Step 5. We then estimate the ASC bad debt for a larger sample of 11 suppliers who provided ASC data. This is calculated by multiplying the result of Step 4 by the result of Step 1, and assumes that the smaller seven supplier sample is compositionally the same in all regards as the 11 supplier sample.

Step 6. To calculate the 2022/23 effective customer bills, we used demand and time weights, and took into consideration EPG & EBSS to calculate the amount customers paid last year (rather than how much suppliers received). Our best estimate of the 2023/24 effective bills is currently the cap period 10b DD level (we use DD, due to the government's commitment to levelisation until the end of March 2024). Therefore, we scale up the estimation of 2022/23 effective customer bills to cap 10b levels.

Step 7. We also calculated a baseline period using the same method as described above, however for April 2021 – March 2022 costs. This was also scaled up by the change in the price cap level between April 21 – March 22 and 10b.

Step 8. Finally, to produce the weighted ASC bad debt allowance, we subtract the baseline figure from our estimate of ASC bad debt costs (calculated in Step 6).

Appendix 3 - Annex 8 methodology

A3.1 In this appendix we summarise the modifications to 'Annex 8 – methodology for adjustment allowance' of standard licence condition 28AD of the electricity and gas supply licences (SLC28AD).

A3.2 A revised version of Annex 8 has also been published alongside this decision.[53]

Tab '1a Adjustment Allowance'

A3.3 Cells AF69:AJ69, AF153:AJ180, AF237:AJ264: We have updated the cells to draw in the ASC bad debt allowance for each fuel, charge restriction region, benchmark metering arrangement and 28AD charge restriction period from cell C8 in tab '3m ASC'. This allowance is only applied to PPM customers.

Tab '3m ASC'

A3.4 New tab created to input the ASC bad debt allowance per customer account. This input was calculated from our analysis of supplier data from the April 2023 debt-related costs RFI.

A3.5 Cell C8: inputs the ASC bad debt allowance for October 2023 – April 2024. This number has had the baseline subtracted from it.

[53] Revised version of Annex 8 is available here: https://www.ofgem.gov.uk/publications/allowance-additional-support-credit-bad-debt-costs

Appendix 4 - Additional communication to consultation respondents

Additional communication to consultation respondents - 7 August 2023.

Dear stakeholder,

Thank you for your response to the statutory consultation on proposals to introduce an initial 12-month allowance to the price cap for bad debt associated with Additional Support Credit (ASC) given to prepayment meter (PPM) customers.

Potential methodology change
In response to our consultation, it has been proposed that we should amend our proposed methodology (Chapter 4 of our statutory consultation) to include a baseline to account for funding already provided to energy suppliers through the price cap for bad debt costs associated with ASC.

As part of our wider considerations, we are therefore considering whether to include a baseline in our methodology, and if so, how to do it. Given the data available through our Request for Information (RFI) to energy suppliers, we are considering whether to use the cost incurred in the period 2021/22 to set a baseline cost, with the debt-related costs and headroom allowances in the price cap having both contributed to cover these baseline costs. The baseline would be adjusted for the overall level of the price cap in 2023/24 in a similar way to how the other relevant allowances in the price cap are adjusted. **All else equal, the inclusion of a baseline would reduce the size of any allowance introduced.**

Data updates
We have also received several data updates, additions, and clarifications from energy suppliers since our consultation was published on 28 June 2023. These data updates are in response to the RFI we launched in April, and they change the value of our three consultation options for a prospective allowance. Given the principle of basing the decision to introduce a new allowance on the best data available at that time, **we intend to consider which of this additional or updated data is appropriate to use to calculate any allowance. Please note, we are unable to consider or use any updated data provided after Wednesday 9 August 2023**.

Feedback
Given our statutory consultation proposed to include this allowance on a float and true-up basis, if we decide to introduce an allowance on that basis there would be further opportunity for reviews of the methodology and updates of data as part of any true-up consultation process.

However, as neither information on how we might approach a baseline methodology option nor details of the cut off point for the updated data were included in our statutory consultation, we think it appropriate in this case to communicate our consideration of these issues to you now. **If you have anything to add to or alter from your**

previous consultation response in light of either of these issues, please contact priceprotectionpolicy@ofgem.gov.uk by no later than Friday 11 August 2023.

Please state if you wish your response to this email to be treated as confidential. We will publish non-confidential responses and/or a summary of responses, on our website at https://www.ofgem.gov.uk/energy-policy-and-regulation/engagement/consultations.

Kind regards,

Price Protection Policy
Ofgem