Energy UK

The voice of the energy industry

Ofgem
10 South Colonnade
London
E14 4PU

2/11/23

Dear Dan and Team,

We are writing in response to Ofgem's Additional debt-related costs allowance policy consultation.

The increase in debt costs requires a prompt and proportionate temporary correction to the inadequacy of the price cap allowance. It is crucial that Ofgem sets the allowance reflective of a consumer-focused approach where the heightened debt numbers can be treated "*fairly and compassionately*"[1]. Further adjustment is also going to be needed to ensure debt allowance reflects suppliers' increasing costs.

Energy debt and the cost to suppliers is a systemic, material and growing issue and we welcome that Ofgem is taking steps to address it. It is vital for the future of the retail market that energy suppliers can promptly and confidently recover fair costs as part of price regulation. This is an important consultation to address the immediate costs associated with debt. However, it is beyond the scope of this consultation to seek to tackle the steady increase in the number of people who are in significant debt to their energy supplier. We have copied Government representatives into this response to highlight this, and the concern about further accrual of costs for consumers without Government intervention to support people who can least afford to pay for the energy they use.

Government funding to support consumer debt reduction would reduce cross subsidisation between bill payers, reduce supplier costs and therefore reduce overall customer costs. The build-up of debt will remain a consequence within the price cap allowances, if there continues to be no targeted energy debt relief or bill support intervention from Government.

This year has seen changes to supplier obligations to manage the increased propensity for consumer energy debt. This includes the increased provision of Additional Support Credit; strengthened obligations on consumer standards; and the Energy UK Voluntary Winter 2023 Debt Commitment. Given the changes to the way in which suppliers are required to, and are voluntarily committing to, incur and manage debt, Ofgem needs to set an allowance that allows cost recovery to take account of the extra costs of serving customers with more debt.

An additional debt allowance is necessary

During the current period of protracted high bills, more energy customers are struggling to afford to pay for the energy they use. Energy UK welcomes the approach from Ofgem to consider how to better reflect early indicators of debt.

[1] Ofgem (2023) Consumer Standards Decision

After factoring in Government support, energy bills are expected to be 13% higher than last winter[2], while consumer energy debt has hit £2.6bn and is rising.

The energy industry is seeing a specific set of customers falling into a significant amount of debt[3]. Despite suppliers doing all they can to help their customers, including debt relief, repayment holidays, and additional credit, the situation is unsustainable. With some forecasting energy prices not falling back to historic levels for the rest of the decade, this presents an enormous challenge for those customers in more vulnerable positions - leaving many unable to afford their basic needs[4].

As more customers move away from the price cap in the next year - the delay in the provision of adequate allowances leads to an increased risk of suppliers' costs becoming unrecoverable.

Data issues in the policy consultation

While we welcome Ofgem's prompt approach to consulting on this, the indicative data used is, in our view, misleading. The volume of debt is rising at the same time as the price allowance falling with the price cap and it is vital to avoid back loading the true-up by underestimating the scale of the issue.

Ofgem appears to have disproportionately relied on the first two RFIs which were likely heavily impacted by Energy Price Guarantee (EPG) and Energy Bill Support Scheme (EBSS) payments to show no material deviation from the allowance. The third RFI did show a need for an additional allowance. While the most recent fourth RFI for Q3 2023 is likely to show a greater deviation as growing and aging debt combines with a 40% fall in the cap and therefore the same reduction in the debt allowance and should be Ofgem's focus. Also, the data being collected by Ofgem in the latest RFI includes new questions of suppliers alongside increased monitoring of near-time indicators of debt. This is in addition to the future cost of the changes to supplier debt management which will not have been present in previous costs. Unfortunately, presenting the older data makes it particularly unhelpful in reflecting the scale of bad debt growth and its cost to manage.

The use of indicative data does not include the latest, important data that will likely reflect the direction and scale of bad debt allowance. So, while Ofgem's press release refers to a £17 increase in allowance, Ofgem's preferred Option 3 would create £5 over recovery. In the statutory consultation,

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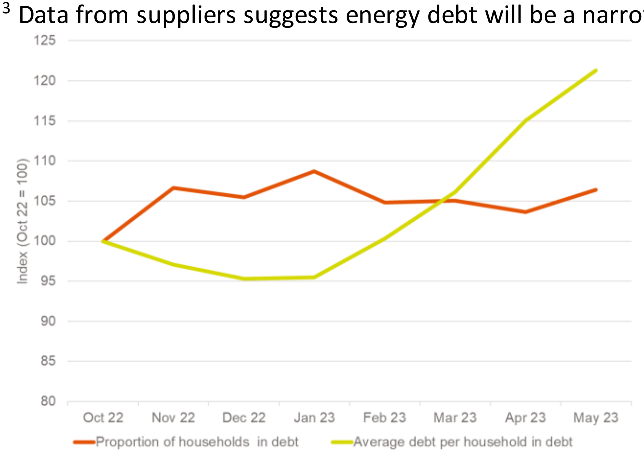
[2] Resolution Foundation (2023) [Gotta get through this]

[3] Data from suppliers suggests energy debt will be a narrow but deep problem (Source Energy UK)



[4] Energy UK (2023) [Additional support for customers]

Ofgem must fully consider the impact of the latest RFI data and provide aggregated views of the impact of different benchmarking approaches so that stakeholders can consider and engage with them productively.

Methodology and process

As with the recent wholesale cost allowance adjustment update, Ofgem's preferred approach to sharing the price cap methodology is not to provide full and early transparency. This is a concerning trend given the heterogeneity of suppliers and the scope for different interpretations to information requests. We encourage Ofgem to look at options for sharing more detail about their planned approach with suppliers early and efficiently. We do not want this to hold up allowances: Energy UK and our members are ready to respond promptly.

There is no comment on the sample that Ofgem are using in the current consultation, and we are concerned that an atypical supplier could be setting the benchmark.

Please see responses to the consultation questions below.

Please do get in contact if you have any questions about this response.

Kind regards

Ed Rees

Senior Policy Manager

Energy UK

1. Do you consider that we should make a temporary adjustment to the price cap to account for additional debt-related costs?

Yes. A prompt correction is clearly required to provide energy suppliers cost recovery for their obligated service provision via a temporary adjustment in the cap that is simple and transparent. However, further allowances are likely to be needed to improve the adequacy of the debt allowance in the interim to avoid a significant ex post correction. Then an assessment needs to be made for change on a more enduring basis is likely needed via the Opex review.

This assessment should focus on determining if the temporary adjustment has served its purpose and set at an accurate level and if it needs to be removed or extended for a further period of time.

2. Do you think that suppliers cost due to the moratorium on involuntary PPM installation should be included in the adjustment?

Yes. The moratorium was ordered by Ofgem to allow the regulator to gain confidence in involuntary prepayment processes. This was a regulatory choice for a universal moratorium so that Ofgem could require enhanced processes previously not required of suppliers. Additional requirements of suppliers must be recoverable under the price cap.

If Ofgem had evidence of suppliers in breach of their license conditions that led to overstating the costs of the moratorium, these costs should not be included in the adjustment.

3. Do you agree that any adjustment should be made using the existing price cap mechanism, rather than a bespoke levy or other new mechanism?

Ofgem's levelisation consultation proposes incorporating all prepayment standing charges, including fixed rate tariffs, within a levy. The discussion on the levy in this consultation does not appear consistent. Ofgem should seek to avoid silos between workstreams and ensure consistency. This debt allowance should not undermine the objective of PPM standing charge levelisation.

4. Do you have any views on whether it would be appropriate to explore a specific levy mechanism for DNI ('do not install') customers? This would be separate to any adjustment for additional debt-related costs.

No response

5. Do you agree that we should make an initial float adjustment in April 2024, followed by a later true-up? Do you agree it should be included within the cap for a 12 month period? Do you agree that this allowance should be temporary only?

There is significant scope for an ex post adjustment to be substantial. The volume of debt is rising at the same time as the price allowance is falling with the price cap and it is vital to avoid back loading the true-up by underestimating the scale of the issue.

Ofgem appears to have relied too heavily on the first two RFIs which were likely heavily impacted by EPG and EBSS payments to show no material deviation from the allowance. The third RFI did show a need for an additional allowance. While the most recent fourth RFI for data up to Q3 is likely to show a greater deviation as growing and aging debt combines with a 40% fall in the cap and therefore the same reduction in the debt allowance. Also, the data being collected by Ofgem in the latest RFI is adding new questions of suppliers alongside increased monitoring of near-time indicators of debt to provide a better early view of debt. Unfortunately, the longer tail approach to data is likely to be particularly unhelpful in reflecting the scale of bad debt growth and its costs to manage.

Not including inflationary costs within the initial allowance will also lead to a larger ex post adjustment. This is problematic as it will create a gap between when the debt cost was incurred and when it is applied which could lead to price shock when it is applied. We think it would be sensible for Ofgem to adjust the float as it receives more up to date bad debt data from suppliers to manage the size of any eventual true-up.

6. Should the debt-related costs allowance, if introduced for the April 2024 price cap, be subject to a later true-up, and if so, when should this adjustment occur?

Ofgem states that it will not have actual data until at least October 2024. It would be sensible for Ofgem to adjust the allowance as it receives more up to date bad debt data from suppliers to manage the size of any eventual true-up.

7. Do you agree that we should carry out only one wider debt-related costs true-up?

No response

8. Should the float allowance be uprated to account for inflation, or should we make no additional adjustments?

Inflation has risen dramatically since the COVID-19 true up, and incorporating costs in the initial allowance adjustment will reduce the scale of ex post adjustment.

9. Do you agree with the proposed overarching methodological approach for estimating the existing debt-related costs allowance, and using it to determine whether there has been an over or under-allowance for debt-related costs in 2022/23?

No response provided.

10. Do you have any other suggestions of alterative methodologies or other factors we should consider for how to calculate the debt-related costs over or under-allowance in 2022/23?

No response provided.

11. Do you agree that we should consider each debt-related cost (bad debt, debt-administrative costs, and working capital costs) in scope of this review?

It is vital that bad debt related costs are provided through an additional allowance by April 2024. There is concern amongst our members that the debt-administration costs and working capital cost allowances need more time to come to more stable and cost reflective provisions.

12. Which, if any, of the benchmarking options do you favour?

Given the age of the legacy benchmarks referred to in this consultation (and the potentially highly selective use of benchmarks) there is a substantial risk that Ofgem will be using unrepresentative numbers that will need to be significantly updated. However, this should not delay the provision of a bad debt cost allowance in April 2024.

The decision to use the lower quartile for debt administration costs and working capital was initially based on a precedent from 2018, although it is now acknowledged that the cap during that period didn't adequately cover supplier costs. A notable area of under recovery includes the cost of capital which was set at 10% under the price cap, for that period Ofgem agrees a 12.3% as appropriate. Ofgem should acknowledge that the landscape of bad debt and related processes has significantly changed since 2018.

In the original cap setting, the lower quartile benchmark was used as an incentive to encourage suppliers to aim for greater efficiency. However, this consultation deals with costs that have already been incurred or are currently being incurred creating unplanned under recovery which drives further uncertainty and cost rather than efficiency.

Energy UK is concerned that a lower quartile allowance will not be appropriate given the way that Ofgem has strengthened the scope for non-efficiency related costs through changes to the way debt is treated through Additional Support Credit; strengthened obligations on consumer standards; and the Energy UK Voluntary Winter 2023 Debt Commitment. These costs will only just be emerging or yet to emerge in supplier data.

Ofgem should not prioritise 'efficiency of debt administration'. Suppliers should be encouraged to recover costs that are in their consumers interests, which is contrary to this direction. While Ofgem's Consumer standards work encourages investing more in debt administration processes, such as promptly reaching out to customers after missed payments in accordance with the new Consumer Standards Framework, which will likely help reduce overall debt.

13. Do you have any views on which payment method allocation option would be preferable?

There is a clear policy ambition from both of the Government and the regulator to remove the PPM premium. It would seem counterproductive to remove charges from PPM under one workstream to deliver on this policy, then add to them via another workstream.

14. Do you agree with us allocating other debt-related costs (debt-related administrative and working capital costs) uniformly across payment method?

No response provided.

15. How should we apportion any debt-related costs allowance over the unit rate and standing charge elements of the cap only?

It is difficult to comment on this given the interactions between this proposal and PPM levelisation.

16. How should we apportion any debt-related costs allowance between fuel and meter types?

No Response provided.