National Energy Action (NEA) response to the Energy Price cap: Additional debt costs review consultation. About National Energy Action (NEA)

NEA[1] works across England, Wales, and Northern Ireland to ensure that everyone in the UK[2] can afford to live in a warm, safe and healthy home. To achieve this, we aim to improve access to energy and debt advice, provide training, support energy efficiency policies, work on local projects, and coordinate other related services which can help change lives.

Background to our response

NEA is concerned about the record levels of debt and arrears in the market, recently reaching £2.6bn. This figure demonstrates that an increasing number of households are struggling to afford their ongoing costs of energy and are falling behind. With the majority of the £2.6bn figure coming from arrears, there is a clear need for energy suppliers to ensure that affordable repayment arrangements are being created. The overall figure of debt and arrears does not demonstrate the full extent of the debt risk in the energy sector, as many households are not captured by the definitions of debt which energy suppliers report. We therefore expect that the problem is far greater than it is depicted in this consultation.

Debt can cause physical and mental harm to households, as they resort to extreme forms of self-rationing to maintain some level of control over energy bills. It also puts at risk supplier resilience, which could mean further harm to consumers if this risk is not addressed. Around half (46%) of people in problem debt also have a mental health problem. Almost one in five (18%) people with mental health problems are in problem debt. People experiencing mental health problems are three and a half times more likely to be in problem debt than people without mental health problems (5%).[3] Mental health and debt levels are interlinked. This is an important factor to consider for evaluating the impact of an additional debt-related allowance in the price cap, and what form that allowance takes.

Summary of our response:

The quantum of debt in the energy market has recently reached new highs. Ofgem, in this consultation, is proposing to increase the debt allowance in the price cap to ensure that suppliers can fund their activities, particularly regarding servicing debt. While this action is possibly necessary (due to the duties placed on Ofgem through the Domestic Gas and Electricity [Tariff Cap] Act 2018), it does not serve to solve the problem of mounting debt and will likely increase the level of debt in the market, as it will mean that energy becomes even less affordable for households.

Ofgem has sought a voluntary agreement with energy suppliers at the same time as releasing this consultation. This new agreement, signed by almost all energy suppliers covering 95% of the market, contains only two new provisions to help with debt.[4] While these new provisions are important and welcome, they will not have a material impact on the level of debt in the market. While NEA recognises that it is largely out of Ofgem's remit to introduce policies that can reduce the overall level of debt, it is important to recognise that this consultation cannot provide a solution to the record levels of debt. Ofgem must therefore consider what it is able to do, within its powers as the regulator, to tackle levels of debt in the market on an enduring basis.

With this in mind, our response to the consultation assumes that Ofgem does intend to introduce a new debt-related cost in the price cap and focuses on how to do this in a way that is least bad for fuel poor households. It focuses on three main areas:

- A progressive approach to recovery

- Ensuring that an increased debt allowance has a positive impact for indebted households
- Doing more to tackle debt

These are discussed in turn below.

A progressive approach to recovery

If Ofgem is to introduce a new debt-related allowance to the price cap, it is important that it is done in a way that is progressive and fair, not just seeking the most 'cost-reflective' route.

Since debt allowances in the price cap scale alongside wholesale costs, the absolute level of debt allowance has come down recently as wholesale prices have fallen. However, the way in which debt-related costs are allocated mean that some consumers, especially standard credit consumers, are paying significantly more than households on direct debit to pay for debt-related costs. Standard credit is the payment method where most of the debt costs faced by suppliers arise from, and the share of bad debt costs paid for by standard credit households is therefore a reflection of their cost to serve on an aggregate basis. However, since it is clear households on standard credit are most likely to be unable to afford their ongoing energy costs, we believe it is counter-intuitive to place the highest proportion of debt-related costs on them.

Applying an additional debt-related allowance to the price cap will undoubtedly hurt households. It will push some households into fuel poverty, while pushing fuel poor households into deeper poverty. We recognise Ofgem's view that the price cap must allow cost recovery based on the expected costs of a notionally efficient supplier, otherwise there is an increased risk of market exit(s). However, we feel this must be done in a way to ensure the least-worst outcome for households.

In absolute terms, there are more households who are fuel poor on direct debit than the other two payment methods combined. However, this does not mean that fuel poor households as a collective would be better off with an allocation of debt-related costs that favours direct debit customers. Households that pay by prepayment are most likely to be fuel poor, with standard credit the second most likely payment method to be fuel poor and direct debit the least likely to be fuel poor.

In discussing how additional debt-related costs would be recovered, we argued in the Additional debt-related costs allowance policy consultation that the options for an additional debt allowance could significantly alter the benefits and detriments of measures that could be announced following the levelisation of payment methods consultation. For example, if the additional debt related allowance were to be applied to the standing charge of direct debit customers, this would reduce the benefit for prepayment households under the proposal to levelise prepayment standing charges.

In this context, we are pleased to see that Ofgem is proposing to recover costs equally over direct debt and standard credit customers, with zero recovery over PPM customers. We also agree with the proposal to recover through the unit rate only. We believe the proposed approach is the most progressive. Based on the options outlined in the previous consultation, the approach outlined here will have the least impact on fuel poor households, while allowing for a greater benefit from other workstreams, such as the levelisation of payment methods workstream.

Ensuring that an increased debt allowance has a positive impact for indebted households

While we recognise enduring support to tackle levels of debt in the energy market is a matter which requires government intervention, we feel it is important to stress here that such support is desperately needed. Debt levels have risen to a record amount, £2.6bn. This is without factoring in a significant proportion of households who pay by direct debit, but whose direct debit level is lower than the cost of their ongoing energy consumption. These households, in addition to households who pay using credit facilities such as credit cards – in some cases moving energy debt out of the market and becoming credit card debt – are not captured in the £2.6bn figure.

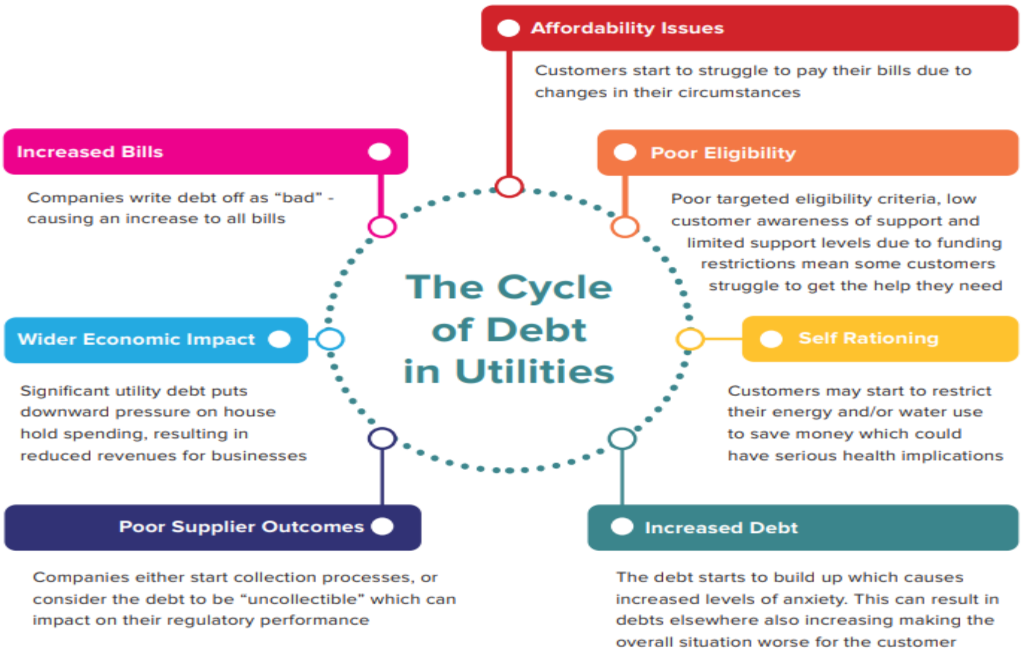
The purpose of a debt-related allowance is to provide suppliers with the ability to recover costs for writing off debt, which is unlikely to be repaid. To add an additional allowance into the price cap should therefore correlate with an increased level of debt write-offs from energy suppliers. There should, therefore, be transparency over the level of these write-offs so that stakeholders can see the impact that this significant extra funding for debt-related activity is having.

Doing more to tackle debt

As already mentioned, adding further charges to the cap will only serve to produce more debt in the market. But we understand the perception that the cap must allow suppliers to recover costs that would be incurred by a notionally efficient supplier. We recognise that there is a level of concern around suppliers' financial resilience, since market exits could result in a greater cost for consumers than the costs imposed by an additional debt allowance. Our responses to discussions on the need for an additional debt-related allowance have assumed that an allowance will be added. Our aim is to ensure that the least-worst outcome for households is achieved.

This consultation on the need for an additional allowance demonstrates that debt risk is greater than ever. Ofgem has sought a voluntary agreement with energy suppliers at the same time as discussing the need for an additional debt-related allowance. This new agreement, signed by almost all energy suppliers covering 95% of the market, contains only two new provisions to help with debt.[5] While these new provisions are important and welcome, they will not have a material impact on the level of debt in the market. While NEA recognises that it is largely out of Ofgem's remit to introduce policies that can reduce the overall level of debt, it is important to recognise that this consultation cannot provide a solution to the record levels of debt. Ofgem must therefore consider what it is able to do, within its powers as the regulator, to tackle levels of debt in the market on an enduring basis.

The availability of support with debt is much more advanced in the water sector than the energy sector. In the water sector, 'restart schemes' are common practice. If you take part, you start a regular payment plan and the payments you make are matched by the water company. If you keep up with the payments, the rest of your debt may be written off. To our knowledge there is little evidence of this approach being taken in the energy sector. Ofgem has a role in ensuring that energy companies can learn from other sectors, such as water, in effectively reducing the debt on their books, in addition to ensuring that they remain financeable through the price cap.[6]



References and Notes

[1] For more information visit: www.nea.org.uk.

[2] NEA also work alongside our sister charity Energy Action Scotland (EAS) to ensure we collectively have a UK wider reach.

[3] Money and Mental Health

[4] Energy UK have confirmed to NEA that the agreement contains only two new firm commitments:

- Suppliers will fully consider information (including budgets, affordable payment offers and prepared Standard Financial Statements) and third-party authority forms from a customer's chosen credible debt or consumer body organisations, including FCA-authorised debt advisors.
- Policies for the use of High Court enforcement and County Court Judgements (CCJs) for debt will be signed off at board level or equivalent.

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[6] NEA has previously submitted a short paper on accelerating the clearance of utility debt. Further information on the cycle of debt utilities and our suggestions for solutions can be found within it. We would be happy to share our paper again if helpful.