

Chris McDermott
Supply and Retail Market
Ofgem
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12 July 2024

Dear Chris,

PRICE CAP - CONSULTATION ON ASC BAD DEBT COSTS ALLOWANCE EXTENSION

We welcome the opportunity to respond to Ofgem's proposal to extend the bad debt allowance for Additional Support Credit (ASC) given to prepayment meter (PPM) customers beyond September 2024.

We acknowledge the crucial role suppliers play in supporting vulnerable customers at risk of self-disconnection, and we recognise the importance of ASC payments in preventing this. We have seen rising demand for ASC and we expect this to persist through the coming winter due to continuing high energy bills and the wider cost-of-living crisis. We are seeing that, increasingly, customers are unable to repay their ASCs leading to rising bad debt costs. We consider these ASC payments and the associated bad debt to be an efficiently incurred cost, and we support extending the current ASC allowance to allow suppliers to continue recovering these costs prior to a true-up process and the introduction of the new operating cost allowance. Enabling suppliers to continue recouping ASC-related bad debt costs will help them maintain their vital support for vulnerable customers without putting their financial viability at risk.

In addition to supporting the proposal to extend, we would like to raise two key points that are relevant to a future review and the Operating Cost review:

1. The 'ASC baseline'

Although we support the extension of the ASC in its current form in the short term, we disagree with Ofgem's position introduced in its August 2023 decision¹ that there is already £2.95 funding in the price cap for ASC-related bad debt costs via the allowances for debt-related costs and headroom - an 'ASC baseline'.² This baseline was the justification for

¹ [Allowance for additional support credit bad debt costs \(ofgem.gov.uk\)](https://www.ofgem.gov.uk/pricing-regulation/rfrs/price-cap/2023/allowance-for-additional-support-credit-bad-debt-costs)

² The £2.95 baseline allowance was derived from the cost of ASC bad debt in the period 2021/22, scaled to the cap period 10b (July 2023 – September 2023) PPM price cap level.

reducing the allowance from the central scenario estimate of ASC bad debt of £11.71 to £8.77 per typical dual fuel PPM customer.

In our response to Ofgem of 10 August 2023³, we made the following points in support of our position that if there was a specific allowance for ASC-related bad debt in the price cap it would be negligible:

- The payment method adjustment additional cost (PAAC) allowance represents the allowance given to suppliers for the additional costs to serve PPM customers, which was said to include any debt-related costs. This calculation was based on the CMA's 2016 estimate of the PPM-DD differential⁴, which predates the 2020 introduction of licence conditions to obligate the provision of ASCs. Consequently, the data used to set this allowance is unreflective of the actual amount of ASC given to customers.
- The CMA's estimate of the PPM-DD *"had not allowed for the possibility of a PP customer incurring bad debt in its own right."*⁵ Given the limitation of the debt-related allowances for PPM in the price cap, we believe that the CMA did not envisage the growth of supplier-issued ASCs and therefore would not have included the associated bad debt in the price cap. This could indicate that a baseline should be close to zero.
- The headroom allowance is overused by Ofgem and it is unlikely that it could cover ASC bad debt for PPM customers. We have also not seen evidence that implies that ASC bad debt was considered part of the headroom allowance when introduced.

In addition, using the 2021/22 data as a baseline would overestimate any 'ASC baseline'. For these reasons, we do not consider that Ofgem should have introduced a baseline level of ASC bad debt costs. Or, if a baseline is introduced, then that the baseline should have been close to zero to reflect the fact that there is currently no allowance in the price cap for ASCs. This should be considered in any true-up process.

2. A true-up mechanism

Given the continuing need for ASC payments and the increase in associated bad debt, we consider that it is important for Ofgem to include a true-up of the current ASC allowance when moving to the new approach to bad debt, expected in April 2025. The true up exercise would calculate the difference between actual ASC-related bad debt costs and the value of the allowance over the period October 2023 to March 2025, and introduce an additional true-up (or true-down) allowance from October 2025 as appropriate. This would allow six months, between April and September 2025, for Ofgem to issue an RFI and set the level of the true-up. This true-up process would be vital to ensure that suppliers are able to recover their efficient costs.

Different suppliers with different customer bases are likely to incur different amounts of ASC debt, for example, due to differing levels of deprivation. In addition, the proportion of a supplier's PPM customer base that is repaying an existing debt, impacts on the recovery of the ASC allowance. Therefore, we would support including a levelisation/reconciliation mechanism as part of the true-up process to avoid competitive distortions as a result of the 'one size fits all' price cap.

The levelisation/reconciliation mechanism could work in a similar way to current standing charge levelisation. The mechanism could use supplier specific total value of ASCs issued and apply an Ofgem specified provision rate as it has done in some of its debt consultations

³ We have attached our previous response in full for clarity.


⁴ Appendix 6, Operating Costs, p.10

⁵ Para 116 CMA Appendix 9.8: Analysis of indirect costs by payment method

to calculate the associated bad debt. The levelisation/reconciliation process could then work as it currently does for standing charges.

If this is not done, suppliers with a customer base that has a higher proportion of vulnerable PPM customers may be relatively disadvantaged by the ASC allowance, leading to competitive distortions. As such, we propose a tailored true-up mechanism that balances cost recovery to support vulnerable customers and ensure fairness and competitiveness in the industry. This approach will foster a more resilient and equitable energy market.

Yours sincerely,

A handwritten signature in black ink, appearing to read "Derm Baran".

pp **Richard Sweet**
Director of Regulatory Policy