Appendix 2: Debt-related costs

Contents

Ар	pendix 2: Debt-related costs	1
1.	Introduction	3
	Purpose of this paper	3
	Summary of our decisions	3
	Structure of this Appendix	4
2.	Background	5
	Context	5
	Previous approach to setting debt allowances	7
	How the allowance has been updated over time	8
	Case for reviewing and setting a distinct debt-related costs allowance	10
	Context	10
	Decision	12
	Stakeholder response summary	12
3.	Data, sampling and selection of cost components	. 14
	Selection of cost components	14
	Context	14
	Decision	14
	Stakeholder response summary	14
	Considerations	15
	Selection of data source and measurement of costs	16
	Context	16
	Decision	16
	Stakeholder response summary	17
	Considerations	17
	Sampling	18
	Context	18
	Decision	18
	Stakeholder response summary	18
	Considerations	18
4.	Benchmarking approach	. 19
	Context	19
	Baseline period options	20
	Context	20
	Decision	21
	Stakeholder response	22
	Considerations	23
	Benchmark metric	25

Context	. 25
Decision	. 26
Stakeholder response	. 26
Considerations	. 27
Benchmark across parameters	. 27
Context	. 27
Decision	. 28
Stakeholder response	. 28
Considerations	. 28
Allocating costs across customer groups	30
Payment type	. 30
Context	. 30
Decision	. 32
Stakeholder responses	. 33
Considerations	. 34
Fuel type	. 50
Context	. 50
Decision	. 50
Stakeholder response	. 51
Considerations	. 51
Tariff Type	. 52
Context	. 52
Decision	. 53
Stakeholder response	. 53
Considerations	53
	. 55
Consumption and Meter types	. 55
Consumption and Meter types Implementation and update mechanism	. 55 . 55 57
Consumption and Meter types Implementation and update mechanism Implementation in the cap	. 55 . 55 57 . 57
Consumption and Meter types Implementation and update mechanism Implementation in the cap Context.	. 55 57 . 57 . 57
Consumption and Meter types Implementation and update mechanism Implementation in the cap Context. Decision	. 55 57 . 57 . 57 . 57
Consumption and Meter types Implementation and update mechanism Implementation in the cap Context Decision Considerations	. 55 57 . 57 . 57 . 58 . 58
Consumption and Meter types Implementation and update mechanism Implementation in the cap Context Decision Considerations Updating the allowances	. 55 57 . 57 . 57 . 58 . 58 . 58 . 60
Consumption and Meter types Implementation and update mechanism Implementation in the cap Context Decision Considerations Updating the allowances Context	. 55 . 55 . 57 . 57 . 58 . 58 . 60 . 60
Consumption and Meter types Implementation and update mechanism Implementation in the cap Context. Decision Considerations Updating the allowances Context. Decision.	. 55 57 . 57 . 57 . 58 . 58 . 60 . 60 . 61
Consumption and Meter types Implementation and update mechanism Implementation in the cap Context. Decision Considerations Updating the allowances Context. Decision Stakeholder response.	. 55 . 57 . 57 . 57 . 58 . 58 . 60 . 60 . 61 . 61
Consumption and Meter types Implementation and update mechanism Implementation in the cap Context. Decision Considerations Updating the allowances Context. Decision Stakeholder response. Considerations	. 55 57 . 57 . 57 . 58 . 60 . 60 . 61 . 61 . 61
Consumption and Meter types Implementation and update mechanism Implementation in the cap Context Decision Considerations Updating the allowances Context Decision Stakeholder response Considerations Other considerations	. 55 57 . 57 . 57 . 58 . 60 . 60 . 61 . 61 . 61 . 62 64
Consumption and Meter types Implementation and update mechanism Implementation in the cap Context Decision Considerations Updating the allowances Context Decision Stakeholder response Considerations Other considerations Treatment of working capital	.55 57 .57 .57 .58 .60 .60 .61 .61 .61 .62 64 .64
Consumption and Meter types Implementation and update mechanism Implementation in the cap Context Decision Updating the allowances Context Decision Stakeholder response Considerations Other considerations Treatment of working capital Interactions with EBIT allowance	.55 57 .57 .57 .58 .60 .60 .61 .61 .61 .61 .62 .64
Consumption and Meter types	.55 57 .57 .57 .58 .60 .61 .61 .61 .61 .62 64 .64 .64
	Decision Stakeholder response Considerations Benchmark across parameters Context. Decision Stakeholder response Considerations Allocating costs across customer groups Payment type Context. Decision Stakeholder responses Considerations Fuel type. Context. Decision Stakeholder response Considerations Fuel type. Context. Decision Stakeholder response Considerations Tariff Type. Context. Decision Stakeholder response Considerations

1.Introduction

Section summary

This section introduces the purpose of this appendix within the wider context of our work on debt. We set out the summary of our decisions and a breakdown of the appendix structure.

Purpose of this paper

- 1.1 Debt-related costs describe a selection of costs incurred by suppliers that are associated with non-payment of bills, known as bad debt, the administration of debt and costs associated with working capital. The price cap ('the cap') currently allows for debt-related costs within several different allowances. Debt-related costs are part of the wider basket of operating costs that a supplier incurs.
- 1.2 In our December 2024 statutory consultation, we discussed our proposal to set a separate debt-related cost allowance, distinct from other elements of the operating cost allowance. We set out our proposals for which costs to include and how to include them, how we could benchmark costs across suppliers and how we could allocate costs across different groups of customers. We also set out how we proposed to set the allowance and update it over time.
- 1.3 In this appendix, we set out our decisions on these areas, having considered the feedback received in response to our December 2024 consultation.

Summary of our decisions

- 1.4 We have decided to:
 - set a distinct ex-ante allowance for debt-related costs within the wider basket of operating costs. This allowance will be set using the three components of debt-related costs.
 - set a weighted average benchmark for debt-related costs. In terms of baseline period, we use a combination of data from 2023 and 2024. We have updated our proposed range with the most recent industry data and have taken into consideration stakeholder comments to set the debt allowance at the new mid-point of the range.
 - allocate debt-related costs across payment methods based on the current payment method differential present in the cap. We have decided to allocate costs between fuel types proportionately to cap levels. We have decided on equal allocation across electricity meters and tariff types.

- update the allowance over time similar to the status quo. This means updating bad debt costs and debt-related working capital costs (henceforth referred to as working capital costs) to scale in line with bill changes, and debt administration costs in line with inflation (measured using CPIH). Working capital costs will also align with the cost of capital we use in Earnings Before Interest and Tax (EBIT) Allowance.
- monitor the evolution of debt-related costs through the DRC Request for Information (RFI) which will help us monitor any material or systematic changes in costs over time. As with any allowance in the cap, we have the ability to review and make changes to the debt allowance.

Structure of this Appendix

- 1.5 The structure of the remaining sections is set out below:
 - i) Section 2 Background. In this section we set out the current approach of how debt-related costs are allowed for through the existing price cap methodology. We also set out our decision for setting a separate debt-related cost allowance.
 - ii) Section 3 Data Sampling and selection of cost components. In this section we set out our decisions on data sources used to measure debt-related costs and the sampling approach taken to set the allowance.
 - iii) Section 4 Benchmarking approach. In this section we set out our decision on the selection of baseline year and how we benchmark industry costs.
 - iv) Section 5 Allocating costs across customer groups. In this section we set out our decision for how we allocate costs across different parameters such as customer payment type and fuel type.
 - v) Section 6 Update mechanism. In this section we set out our decision for how we update the debt related costs allowance over time.
 - vi) Section 7 Other considerations. In this section we discuss other considerations such as how working capital interacts with the cap, and our decisions on wider true-up and monitoring.
 - vii) Annex A Phase 1 levelisation review. This additional section communicates the latest position on phase 1 levelisation review. To note, this is separate to the wider operating costs review work.

2.Background

Section summary

In this section we provide an overview of what supplier debt-related costs are and how they are accounted for in the current price cap methodology. We also set out our analysis of the latest debt-related costs across industry. We then explain our decision for setting a separate debt-related cost allowance in the cap.

Context

2.1 Many consumers continue to struggle with paying their energy bills. Latest data shows current levels of debt and arrears across the market have continued to increase since 2022, and are now standing at £3.85bn, which is an increase of nearly £2bn in that period.



Figure 1.1: Debt & Arrears over time

Accessibility format: The graph shows the total amount of debt and arrears owed by domestic customers greater than 91 days. This data comes from the Social Obligations Reporting RFI, and can be found in our debt and arrears indicators data portal.¹

¹ Ofgem (2024) Ofgem indicators data portal <u>https://www.ofgem.gov.uk/publications/debt-and-arrears-indicators</u>

- 2.2 Some energy bills are paid late or not paid at all and therefore have to be ultimately written off by energy suppliers. This is referred to as bad debt and all energy suppliers accumulate some bad debt. It is usual for businesses in many industries, not just energy, to make a provision for bad debt in their accounts and to cover this cost through the broader pricing of their goods and services. The cap therefore provides for an allowance to account for these efficient costs. This means all default tariff customers pay for the cost of bad debt incurred by customers who do not pay.
- 2.3 Suppliers incur debt-related costs as part of their operating expenses, and we divide these into three components.
 - **Bad debt costs**: These are costs of write-offs and provisions in suppliers' accounts from customers' energy bills that are never paid.
 - **Debt-related administrative costs:** These are costs associated with suppliers' activities when dealing with customers in debt. These activities include (but are not limited to) sending out payment reminders, setting up repayment plans and, where appropriate and within tightly prescribed rules, carrying out warrant activity.
 - Working capital costs: These are costs associated with suppliers raising capital for day-to-day operations and funding both customers making scheduled payments in arrears (eg quarterly payments on receipt bills) and delayed payments.
- 2.4 The following illustrates how a supplier may typically incur these costs: a customer incurs debt when they stop paying for the energy consumed. When debt starts accumulating, suppliers incur debt-related administrative costs when they try to recover the debt. In parallel, suppliers will also incur short-term working capital costs to finance consumer debt. The amount of debt that is not eventually recovered is ultimately considered bad debt and is the largest element of debt-related costs.
- 2.5 The cost of bad debt is reflected in suppliers' accounts through the bad debt charge, which is an entry in the income statement. Suppliers make estimates (known as provisions) for the amount which will never be paid. They then adjust these estimates over time and eventually finalise them through write-offs. Write-offs can take some time to crystalise as suppliers attempt to recover the debt.
- 2.6 Different customer types tend to have different costs to serve. The majority of debt-related costs are associated with Standard Credit customers. However, this does not mean all Standard Credit customers have high debt-related costs, nor

that suppliers with greater numbers of Standard Credit customers necessarily have greater debt costs.

- 2.7 In recent years, we have observed an increase in total energy debt and arrears, as well as the number of customers who are in debt. We recognise the impact this has on consumers and we have launched a package of reviews to ensure our efforts support customers. However, through the cap we also recognise that debt-related costs are a cost to suppliers which are at least in part outside their control. Under the Domestic Gas and Electricity (Tariff Cap) Act 2018 ('the Act'), we must protect the interests of existing and future customers on default and standard variable tariffs whilst having regard to a number of matters including the need to ensure that suppliers who operate efficiently are able to finance activities authorised by the licence.
- 2.8 This appendix sets out our decision to introduce a new forward-looking allowance for debt-related costs within the price cap methodology. It is worth noting that this decision is separate to our decision to extend the additional debt-related costs adjustment allowance ('float'), published on 25 February 2025.²

Previous approach to setting debt allowances

- 2.9 Debt related costs are generally accounted for in existing cap allowances through three inter-related components:
 - **The Operating cost allowance:** This captures the debt-related costs (bad debt costs and debt-related administrative costs) associated with the Direct Debit payment method and is applied as a baseline for other payment methods.
 - Earnings Before Interest and Tax (EBIT) Allowance: This captures the working capital cost associated with customers paying in arrears. These costs are not differentiated by payment method but instead are set using a common methodology across all payment methods.
 - Payment method uplift (PMU): This allowance captures the additional costs associated with other payment methods, such as debt-related costs when compared with the Direct Debit baseline. For bad debt and debt-related administrative costs, the additional costs associated with serving Standard Credit customers are captured here. Furthermore, it adjusts the working

² Ofgem (2025), Additional debt related costs extension decision <u>https://www.ofgem.gov.uk/sites/default/files/2025-02/Energy-price-cap-additional-debt-related-costs-extension-decision.pdf</u>

capital allowance set in the EBIT allowance to reflect the cost differences between payment methods.

- 2.10 When we set the previous allowance for debt-related costs as part of our 2018 decision,³ we used data that we collected through our 2018 RFI. We calculated the bad debt cost using the bad debt charge, and we calculated the working capital cost by using the working capital requirement and applying the cost of capital from the 2018 EBIT decision. To estimate the allowance, we calculated the additional costs to serve a Standard Credit customer relative to a Direct Debit customer. We combined these costs across fuels and took a lower quartile benchmark.
- 2.11 To set the allowance across payment methods, we then allocated the additional costs between Standard Credit and Direct Debit payment methods. For example, while we allocated additional working capital fully to Standard Credit customers, we allocated 52% of the additional bad debt costs and debt-related administrative costs to Standard Credit and Direct Debit customers.
- 2.12 We set the allowances for bad debt costs and working capital cost as a percentage which is applied to the rest of the cap 'core cost' components. We set the allowance for the additional administrative costs as 'pounds per customer value'.

How the allowance has been updated over time

2.13 Generally, the debt-related cost allowances are linearly scaled with the overall cap level, with the exception of the part of debt-related costs which is included within the core operating costs baseline and the fixed element of the payment method uplift, both of which are indexed to inflation (CPIH). We have observed an increase in the debt-related costs allowance in the cap, primarily due to scaling effects driven by increasing wholesale costs.

³ Ofgem (2018), Default tariff cap: decision - overview <u>https://www.ofgem.gov.uk/decision/default-tariff-cap-decision-overview</u>

		*Cap 14a allowance *Cap 14a allowance	
		(exl AA)	(inc AA)
Debt-related cost	Direct Debit	26	57
allowances			
Debt-related cost	Standard	130	161
allowances	Credit		
Debt-related cost	РРМ	11	19
allowances			
Price cap level	Direct Debit	1,752	1,752
Price can level	Standard	1,871	1,871
	Credit		
Price cap level	РРМ	1,743	1,743
Debt allowance as % of	Direct Debit	1.5%	3.3%
total price cap			
Debt allowance as % of	Standard	7.0%	8.6%
total price cap	Credit		
Debt allowance as % of	РРМ	0.6%	1.1%
total price cap			

Table 1.1: Cap 14a debt-related cost allowance (annualised, \pounds per dual fuel customer at benchmark consumption)

Notes: *Additional adjustment allowances (AA) are in place in cap 14a. This table shows what the allowance would be with and without the AA in place. See below for explanation of the AA. Cap 14a is the period between April to May 2025. Price cap levels are pre-levelisation and excluding VAT.

2.14 In April 2024, we implemented an additional adjustment allowance in the cap, as part of our decision on the additional debt costs review.⁴ We set an additional debt adjustment allowance ('float allowance') of £31 per customer per year for a period of 12 months. In October 2023, we also implemented an adjustment allowance of £9 per customer per year for the costs associated with Additional

⁴ Ofgem (2024), Additional debt costs review decision <u>https://www.ofgem.gov.uk/decision/energy-price-cap-additional-debt-costs-review-decision</u>

Support Credit (ASC) bad debt.⁵ Both of these will roll off the cap when this decision is implemented on 1 July 2025.

Case for reviewing and setting a distinct debt-related costs allowance

Context

- 2.15 With the wider cost of living crisis putting pressure on household finances and increasing levels of debt and arrears, this in turn means greater proportions of outstanding bills may never be repaid. This increased non-payment leads to increased costs to suppliers.
- 2.16 We recognise the impact debt has on consumers. The wider debt strategy work is a pathway for consumer focussed solutions,⁶ while the operating costs allowance is the primary route through which we assess and capture the costs suppliers incur to manage debt efficiently.
- 2.17 We considered that reviewing debt-related costs in the cap was appropriate for the following reasons:
 - **External events** there have been a number of economic events, such as the recent wholesale gas prices crisis and the subsequent cost of living crisis, that have impacted household finances and have led to increasing debt and arrears. This has increased costs for suppliers.
 - **Market structure** since 2017, there has been significant consolidation of the market structure, with large scale mergers and acquisitions. There have also been a number of supplier exits leading to further consolidation, through the supplier of last resort process. This means that the makeup of the data used along with the suppliers in the sample would likely be different to what would have been set previously.
 - Debt costs diverging as part of the additional debt-related cost review, our analysis indicated that debt-related costs have diverged materially and systematically from the permanent cap allowances over the period April 2022 to March 2024.
- 2.18 Since the introduction of the cap, we have made several adjustments to the debtrelated cost allowance in the form of a 'float and true up' approach. At first this

 ⁵ Ofgem (2023), Allowance for additional support credit bad debt costs. <u>https://www.ofgem.gov.uk/decision/allowance-additional-support-credit-bad-debt-costs</u>
 ⁶ Ofgem (2024), Debt strategy: a reset and reform customers in debt. <u>https://www.ofgem.gov.uk/publications/debt-strategy-reset-and-reform-customers-debt</u>

was related to additional costs incurred by suppliers due to the COVID-19 pandemic and then, more recently, the increase in debt-related costs following the gas crisis.

- 2.19 In light of these reviews, we consider it appropriate to isolate debt-related costs from the total operating cost allowances. This is due to several reasons which are outlined below:
 - Variability in debt-related costs: While other operating cost components are likely to be broadly stable over time, we consider debt-related costs to depend on consumer behaviour, economic circumstances and bill sizes, making them more likely to change as a result of external circumstances.
 - Impacted by supplier assumptions: Suppliers may have various approaches to how they provision for bad debt that may impact reported costs. For instance, these may relate to distinct policies regarding how they manage debt built up over time, or how long they chase up bad debt before writing it off.
 - **Flexibility to adjust:** If we are required to make any adjustments to the debt-related costs allowance in the future, setting a separate allowance helps make these adjustments easier.



Figure 1.2: Total industry debt-related costs

Accessibility format: The graph shows the debt-related costs for all tariff types and payment methods from the latest debt-related cost RFI. The grey areas represent winter seasons.

- 2.20 Figure 1.2 indicates the volatile nature of supplier debt-related costs over time. These costs have increased significantly since 2022, peaking in summer 2023 at well over twice the level seen in the previous year. This peak was mainly driven by wider cost of living pressures, putting pressure on households' ability to pay their bills. This increased level of debt and arrears can lead to increased levels of non-payment, which comes at a cost to suppliers. This variability due to external factors is one reason why we consider it appropriate to treat debt-related costs separately to core operating costs.
- 2.21 As communicated in our December 2024 consultation, a falling trend has been seen across the first three quarters of 2024. Since then we have received data for Q4 2024, which can be seen represented in Figure 1.2 above. This indicates that recent debt-related costs have returned to levels similar to those seen in Q2 2024. However, these costs are still lower than the equivalent quarter in the previous year.
- 2.22 The increase in Q4 2024 has been driven by an increase in reported costs for bad debt charge. While there may be an element of seasonality influencing this increase, it is also worth noting the data for this quarter has incorporated changes in provisioning methodologies, meaning a somewhat reduced confidence in the comparable nature of the bad debt charge reported costs for Q4 2024. It is also worth noting that these are the gross costs, not taking into account the allowances received through the cap that suppliers can recover from consumers.

Decision

- 2.23 Given the above, we have carried out a review of the debt-related costs in the cap and have made the decision to adopt a new allowance. We have decided to isolate these debt related costs from the other operating costs allowances.
- 2.24 We have decided to implement a distinct debt related allowance that will come into effect in July 2025 as part of the wider operating costs review.

Stakeholder response summary

2.25 Seven suppliers and one industry body supported the case for change, stating general comments of concern around increasing levels of debt in industry. For example, one supplier said energy costs had plateaued at 50% above pre-crisis levels. They said that this had resulted in customer debt at high levels, and noted 75% of debt was not currently managed via a repayment plan. They said, despite major investment in efficiency, their total billed debt has nearly doubled since 2020, with a resultant increase in the bad debt charge.

- 2.26 Seven suppliers and one industry body supported the implementation of a distinct debt-related cost allowance. For example, one supplier said a new distinct debt-related cost allowance is reasonable to facilitate different indexing approaches, more easily allow for review as well as providing stakeholders with more transparency.
- 2.27 Another supplier agreed with simplifying the various debt-related allowances into a distinct allowance, noting the challenge of estimating the current debt-related allowances in the cap. They state transparency is key and stakeholders should have clear visibility of the debt allowances contained in the cap.

3.Data, sampling and selection of cost components

Section summary

In this section we set out our decision on the data sources, the selection of cost components and the sampling approach taken when measuring debt-related costs to set the allowance.

Selection of cost components

Context

- 3.1 Before implementing our benchmarking methodology for the new allowance, we needed to select which debt-related cost components we would assess to set the allowance. In our May 2024 consultation,⁷ we considered the correlation between the cost components, the definition of these costs, and their flexibility in the update mechanism of the cap.
- 3.2 In our December 2024 consultation, we proposed setting the allowance based on maintaining the current approach of including all three debt-related cost components (bad debt charge, debt-related administrative costs and working capital costs).

Decision

3.3 We have decided to maintain our consulted-on approach to include the three debt-related cost components when setting the allowance.

Stakeholder response summary

- 3.4 One supplier agreed with our proposal, stating that maintaining the inclusion of these cost components will ensure the correct treatment of debt-related working capital costs and reflect the higher working capital cost of Standard Credit customers within the allowance.
- 3.5 One supplier disagreed with our proposal and suggested setting separate allowances for bad debt costs and debt-related administrative costs, and to assess the working capital costs through the EBIT allowance. In addition, in case

⁷ Ofgem (2024), Operating cost allowances review.

https://www.ofgem.gov.uk/consultation/energy-price-cap-operating-cost-allowancesreview

we continue with our consulted-on position, this supplier requested we publish the value of all three debt allowances in each price cap update.

Considerations

Correlation between cost components

- 3.6 We acknowledge the possibility that different debt-related cost components may have different drivers. However, in our consulted-on position we considered that these cost components are strongly correlated and should be assessed together. Treating them individually would risk setting an unachievable benchmark for suppliers.
- 3.7 The supplier that disagreed with our proposal stated that treating bad debt costs and debt-related administrative costs separately would help assess the efficient number of customers in debt and the efficient debt-related administrative cost. However, we consider that such an approach would not account for the correlation across the three costs components. For instance, suppliers who invest more on debt-related administrative costs could have low levels of bad debt cost relative to other suppliers. This means that these cost components are inversely correlated and should be treated together.
- 3.8 Treating these cost components individually risks setting an unachievable benchmark. Consequently, this would make it challenging for suppliers to recover efficient costs, and in turn could impact their financeability, which would not be in the best interest of current and future customers.

Publication of the debt-related allowance

3.9 One supplier asked for us to publish a breakdown of the allowances by each component. We will publish the default tariff cap (DTC) model with the baseline values of the three debt-related cost components used to calculate the allowance. From this, it is possible for stakeholders to isolate each of the three debt-related cost components from the allowance. We discuss our approach to implementation and updating allowances further in section 6.

Selection of working capital costs

3.10 We maintain our consulted-on position to include working capital costs to set the debt-related cost allowance. We consider that working capital costs generally vary by payment method, for example, the average Standard Credit customer has higher working capital costs due to the nature of their payment method. We intend to reallocate the existing allowance for debt-related working capital costs (within the EBIT allowance) to reflect, as accurately as possible, the differences

between payment methods. The EBIT allowance does not vary by payment method. See section 7 for more discussion on the relevant interactions with working capital costs.

Selection of data source and measurement of costs

Context

- 3.11 In our December 2024 consultation, we stated our intention to ensure the robustness of the data used to set the allowance. To address this, we conducted a data reconciliation exercise between the debt-related data sources used across our workstreams, against the data quality dimensions set out in the Government's Data Quality Framework.⁸
- 3.12 The reconciliation exercise reviewed the following RFIs: Debt-Related Cost Review (DRC RFI); the RFI for Stress Testing for Financial Resilience (FRC RFI); and the Operating Cost Review (Opex RFI).
- 3.13 Along with the three dimensions set out in the Government's Data Quality Framework, we also reviewed the measurement and definitions of each cost component across the data sources.

Decision

- 3.14 We have decided to maintain the approach proposed in the December 2024 consultation to use the DRC RFI and continue to use the following measurements for each cost component:
 - Bad debt costs Option A.2: Profit and loss charge incurred. Costs include write-offs and recoveries, movements in provisions and credit balance recognition⁹.
 - Debt-related administrative costs Option Hybrid: include the external and internal collection, warrant costs and active charge categories, as well as any other debt-related administrative costs.
 - Working capital costs Option C.1: Net accounts receivable approach that uses supplier net accounts receivable (ie accounts receivable minus accounts payable) and applying the most recent cost of capital (from the EBIT decision)

⁸ Government Data Quality Hub (2020), The Government Data Quality Framework, Data quality dimensions – how to measure your data quality. <u>https://www.gov.uk/government/publications/the-government-data-guality-</u>

framework/the-government-data-quality-framework#Data-quality-dimensions

⁹ Accounting standards (International Financial Reporting Standards (IFRS 9)) require entities to classify and measure financial liabilities and assets in their balance sheets.

to estimate working capital costs. Using the EBIT cost of working capital assumes working capital requirements are financed fully (100%) through equity.

- 3.15 The DRC RFI measures the cost components in line with the proposed measures mentioned above and provides the most consistency in the data for each cost component.
- 3.16 Furthermore, the DRC RFI holds a longer time series of data than other RFIs. It is also submitted on a quarterly basis and the granularity of its data helps us in the assessment of the cost components. This data source has allowed us to review different options across the aggregation of the cost components, reviewing their trends and testing different benchmark approaches.

Stakeholder response summary

3.17 We did not received any responses regarding the selection of the data source used in the benchmarking of the debt-related cost allowances. However, one supplier agreed with our proposals on the measurement of individual cost components in our benchmark methodology.

Considerations

- 3.18 This respondent agreed with our three options proposed. They mentioned that as Option A.2 follows accounting standards, the data is audited and from their perspective is subject to stringent control. However, they recognise that bad debt provisions, which are accounting judgements, can be corrected over time. With respect to working capital costs, they also agreed with our assessment of only including customer working capital costs as customer balances will include billed debt, unbilled debt, and customer credits.
- 3.19 As set out in our December 2024 consultation, using Option A.2 allows us to use reported data that has undergone an audit process and enables us to validate supplier data against other sources. We however acknowledge that there will always be a degree of accounting judgement in the use of profit and loss account data. We consider there are other limits on the risks of using supplier provisioning. Over time provisions will likely converge as revisions to previous provisions are made. The use of a longer timeframe in our calculation of baseline period would further mitigate the impact (see section 4) along with our proposal to use a weighted average benchmark.

Sampling

Context

- 3.20 We selected a core sample of suppliers' data to estimate the debt-related costs, in order to set the allowance.
- 3.21 For this, in our December 2024 consultation we proposed to use the Government Quality Framework data quality dimensions of completeness and accuracy as the inclusion criteria for determining which suppliers' data to use to estimate the debt-related costs.
- 3.22 Therefore, our consulted-on approach was to exclude three of the eleven suppliers that submitted data in the DRC RFI. We considered that these suppliers did not meet the data quality dimensions of completeness and accuracy.

Decision

3.23 We have decided to maintain our consulted-on approach and continue excluding the three suppliers from our core sample based on our sampling criteria.

Stakeholder response summary

3.24 We received one response from a supplier, who agreed with our sampling criteria.

Considerations

- 3.25 With the latest data submitted through the DRC RFI, we continue to observe that the three excluded suppliers still do not meet our data quality dimensions because:
 - all three suppliers did not provide complete data for all three debt-related cost components; and
 - one of the suppliers did not meet the data quality dimension of accuracy as they operate a multi-utility model which makes it challenging for them to accurately split their retail energy related costs from other costs.

4. Benchmarking approach

Section summary

In this section we set out our decision on the baseline period sample, benchmark metric and benchmark level used to set the debt-related allowance. We discuss the rationale and stakeholder responses that we have considered in our decision.

Context

- 4.1 We aim to set the allowance based on an efficient benchmark, such that an efficient notional supplier could recover their costs, comply with their obligations, and deliver a good standard of service.
- 4.2 We consider that the overall level of stringency depends on three factors: the baseline period; the choice of benchmark metric; and the benchmark level.
 - **Baseline period:** as we are setting an ex-ante allowance for the debtrelated costs in the cap, we aim to select a baseline period that we consider representative of expected future supplier costs. If the baseline period was affected by specific factors which were not expected to reoccur in future, then this could unduly affect the stringency of the allowance.
 - **Benchmark metric:** the choice of benchmark metric directly affects the level of the allowance. For example, a weighted average benchmark metric is less stringent than a lower quartile.
 - **Benchmark level:** once we determine which benchmark metric to use, we need to consider how we set allowances for different customer groups. We need to consider whether we benchmark debt-related costs at the parameter level (eg payment method) or benchmark at an aggregate level (ie benchmark at total costs) and then allocate separately. This choice could affect stringency in particular under a lower quartile benchmark. This is because the sum of lower quartile benchmarks for individual parameters could be lower than an aggregate lower quartile, if different suppliers set the lower quartile for each parameter.
- 4.3 When assessing the selection of the baseline period, we consider the latest data submitted by suppliers. The latest data available shows an increase in levels of debt-related costs incurred by suppliers relative to historical levels, with these costs potentially reaching their peak across 2023. Also, we have seen relatively lower levels of costs throughout 2024 compared to this potential peak.

- 4.4 Given that not all customers have the same propensity to incur debt, we consider how to set different allowances for different consumer groups. One option for setting different allowances is to set different benchmark approaches across different parameters. As we mentioned in our December 2024 consultation, we focus on payment methods, as they are a likely driver of debt-related costs.
- 4.5 In this section we explain our considerations for benchmarking debt-related costs based on the factors outlined. Through our review, we evaluated our benchmarking approach with reference to the Act, which requires us to protect customers and have regard to, amongst other things, the need to ensure that suppliers who operate efficiently are able to finance licensed activities and incentivise suppliers to operate efficiently.

Baseline period options

Context

- 4.6 As set out in the previous section, we are using the DRC RFI as the source for the industry data on debt-related costs. This allows us to set the allowance by benchmarking industry costs using the latest data available. This data source includes quarterly data, which allows us to consider options for which baseline period to use when benchmarking costs.
- 4.7 A key consideration when selecting the baseline period is whether the period is representative of expected future supplier costs. As previously discussed, the latest data suggests that 2023 showed record levels of debt-related costs. This could have been due to a combination of a reaction to the wholesale price shock, the end of universal government energy bill support and the moratorium on involuntary PPM installations; likely leading to rapid changes in provisioning policies and large additions to the bad debt charge.
- 4.8 With the latest debt-related cost data submitted for the year 2024 being lower than in 2023, it is likely that we are seeing these impacts ease off, even though costs remain elevated compared to historical norms. We consider using the year 2023 as a baseline period is unlikely to be the most appropriate representation of expected supplier costs going forwards.
- 4.9 At the time of setting out proposals for our December 2024 consultation, the latest data available to us covered debt-related costs up to Q3 2024. Therefore, for the purpose of the consultation, the last four quarters was defined as Q3 2023 to Q3 2024. We recognised that we would receive industry data in 2025 with the latest quarter of debt-related costs (Q4 2024).

- 4.10 Given recent volatility in debt and uncertainty about future developments, we consider it important to ensure we are using the latest available evidence to inform our decision on how to set the ongoing allowances. We proposed in the consultation to take into consideration the latest quarter's data at the decision stage. In doing so, we recognised that any debt allowance figures proposed in our December 2024 consultation were indicative and, as explained in the consultation, could change at the decision stage after including the latest data.
- 4.11 Given this uncertainty, we proposed to examine different baseline options to set a range which the debt allowance could fall within. We defined this range within two baseline options, both based on data from the most recent two years. We acknowledged the sensitivity the range had to the incorporation of the latest data, which could mean moving within the range, or indeed the range itself could change.
- 4.12 We proposed that the lower end of the range would use a baseline period made up of the most recent four quarters of data, and the upper end of the range would use a baseline period made up of the most recent eight quarters of data.
- 4.13 We also showed how the two approaches could be combined. In our December 2024 consultation, we showed the combination of the last four and the last eight quarters of our baseline period using an average of the ends of the range. This resulted in weighting the latest four quarters and the preceding four quarters with a 3:1 ratio. The latest four quarters had a greater weighting because they formed part of both the last four quarters and the last eight quarters. This meant the last four quarters (Q4 2023 Q3 2024) composed 75% of our baseline period and the first four quarters (Q4 2022 Q3 2023) the remaining 25%.

Decision

- 4.14 Having considered the latest data from the DRC RFI, we have decided to set the allowance at the bottom of the range we consulted on, made up of the period Q1 2023 to Q4 2024. This results in an allowance of £71 per dual fuel customer per year, considering debt-related costs were lower in 2024 than in 2023.
- 4.15 Selecting this value involves adjusting the weighting between the latest four quarters and the previous four quarters used in our consulted-on approach. We still consider that it is appropriate to place more weight on the latest four quarters than the previous four quarters, reflecting that this is more recent data. However, reducing the weight placed on the latest four quarters (relative to our consultation position) acknowledges that costs in any one year may be affected

by revisions to estimated costs from previous periods and changes to suppliers' provisioning methodologies.

4.16 We discuss our rationale in more detail in the considerations sections below.

Table 4.1: Baseline period options at aggregate debt-related costs level (\pounds per dual fuel customer per year) based on our benchmark metric option

Options	Period	Debt Allowance
Option A.1	Last 4 quarters Consultation Quarter 4 2023 – Quarter 3 2024	£71
Option A.1	Last 4 quarters Decision Quarter 1 2024 – Quarter 4 2024	£61
Option A.2	Last 8 quarters Consultation Quarter 4 2022 – Quarter 3 2024	£76
Option A.2	Last 8 quarters Decision Quarter 1 2023 – Quarter 4 2024	£74
Option A.3	Combination: last 4 and last 8 quarters Consultation Quarter 4 2022 – Quarter 3 2024	£73
Option A.3	Combination: last 4 and last 8 quarters Decision Quarter 1 2023 – Quarter 4 2024	£71

Notes: Values are presented at benchmark consumption (Electricity 3,100 kWh and Gas 12,000 kWh). The Consultation position values are based on the DRC RFI data available up to Q3 2024 and are in June 2024 prices. The Decision position values are based on the DRC RFI data available up to Q4 2024 and are in December 2024 prices.

Stakeholder response

- 4.17 We received responses from four stakeholders on our baseline period proposals, ie three responses from suppliers and one from an advisor. Three of these stakeholders disagreed with our selection of baseline period.
- 4.18 One supplier stated that it is likely that the first four quarters (Q4 2022 Q3 2023) of our proposed baseline overstated underlying bad debt costs because of provisioning assumptions reflecting their pessimistic sentiment towards the market at that time, while the last four quarters (Q4 2023 Q3 2024) understated their underlying bad debt costs. Therefore, they suggested two options for the baseline period: testing different weights between the last four quarters and the last eight quarters of our baseline period (for example, a 1.5:1 or 2:1 ratio) or extending the baseline period to the last 10 quarters.

- 4.19 Another supplier and the advisor disagreed with our proposal and suggested that using solely the last eight quarters would be a better option as it mitigates fluctuations in the data.
- 4.20 While another supplier did not have strong views on the selection of baseline period, it mentioned their preference to use an option that is most indicative of the long-term future conditions for energy debt-related costs.

Considerations

Considering whether to incorporate the latest data

- 4.21 Debt-related costs vary over time. As we now have data for Q4 2024, we consider that we should incorporate it in our analysis, so that we are making use of the most recent information and reflecting market conditions. This will support the accuracy of the baseline.
- 4.22 In response to the consultation, stakeholders did not suggest that we should disregard the Q4 2024 data. They did however make comments about factors which may have impacted this data, namely corrections to suppliers' bad debt provisions and changes to their provisioning methodologies. We take these into account when considering the weight to place on different periods of data.

Considering the impact of the latest data

- 4.23 Our latest data shows that aggregated debt-related costs (bad debt charge, debtrelated administrative costs and associated working capital costs) were lower throughout 2024 compared to the equivalent quarters in the previous year. While we have seen an increase in bad debt costs in Q4 2024 compared to Q3 2024, we do not consider that this is significant given usual seasonal patterns of consumption. Any individual quarter may also be impacted by factors such as changes to provisioning methodologies.
- 4.24 In our December 2024 consultation, we said that new data could be used to update the range we consulted on, and that new data would be likely to change the range. We also said that new data and evidence could mean moving within the range.¹⁰
- 4.25 As set out in Figure 3 in section 2, while Q4 2024 data indicates a quarterly increase, it is still in keeping with the general downward trend in debt-related

¹⁰ Ofgem (2024), Energy price cap operating cost and debt allowances consultation. Appendix 2: Debt-related costs, paragraphs 4.22 to 4.24. <u>https://www.ofgem.gov.uk/consultation/energy-price-cap-operating-cost-and-debt-allowances-consultation</u>

costs across industry. It is also well below the peak experienced in Q3 2023, which it replaces in our analysis for the last 4 quarters. This means the latest quarter has reduced both the lower and upper limits of the range, which in turn has reduced the mid-point of the range from $\pounds73$ to $\pounds68$.

Range scenarios	Last 4 quarters	Last 8 quarters	Combination of last 4 and 8 quarters
Range as per December 2024 consultation	£71	£76	£73
Latest range with Q4 2024 data	£61	£74	£68
Latest range with Q4 2024 data and adjustment for weighting	£61	£74	£71*

Table 4.2: Baseline period range scenarios in £ per dual fuel customer per year

Notes: This table sets out the change to the range given the inclusion of the latest data for Q4 2024. It also shows the impact on the baseline (*) after taking into consideration stakeholder feedback to adjust for uncertainty in the most recent data. Range as per December 2024 consultation is in June 2024 price base.

4.26 Incorporating the Q4 2024 data to update the range while maintaining a midpoint would therefore mean that we would observe a £5 decrease in the debt allowance figure compared to the December 2024 consultation position.

Considering selecting a value within the range

- 4.27 We are setting a baseline for the purpose of determining an allowance for debtrelated costs in future periods. While we are not seeking to forecast future debtrelated costs, we need to consider how best to use historical data to set this baseline.
- 4.28 Recent data (eg the last 4 quarters) would have been informed by recent energy prices and customer payment behaviour. As this data is closer in time to future periods, it would in principle therefore be a better reflection of expected future costs (compared to older data).
- 4.29 However, the largest debt-related cost is the bad debt charge, which has measurement challenges. First, the bad debt charge includes both provisions in relation to current consumption and changes to provisions made in relation to previous consumption. As provisions are refined over time, the bad debt charge in

any period does not necessarily reflect expected costs in relation to consumption in that period. For example, we note one supplier's comment that it made high provisions in 2023, leading to a subsequent downward correction in 2024. Second, suppliers' provisioning methodologies can change over time. In the latest data, we took note that some suppliers have made updates or changes to provisioning methodologies.

- 4.30 If we were measuring a metric which was broadly stable over time, we could mitigate these measurement challenges by averaging data over a longer time period (eg using the last 8 quarters, or even the last 10 quarters). However, debt-related costs have varied over time, eg due to changes in energy prices.
- 4.31 We therefore consider that it is appropriate to place more weight on more recent data. However, we recognise that there are risks in placing too much weight on the latest four quarters.
- 4.32 We have therefore decided to set the baseline at £71 per dual fuel customer. This is equal to the bottom of the range we consulted on, and is £3 per dual fuel customer higher than if we had maintained a midpoint approach. It is however still £2 per dual fuel customer lower than our December 2024 consultation position, reflecting that we have incorporated new data.
- 4.33 In weighting terms, our December 2024 consultation placed a 75% weight on the latest four quarters. We have explained above why we would want to place more than a 50% weight on the latest four quarters. Setting the allowance at £71 per dual fuel customer would imply a 62% weight on the latest four quarters. This demonstrates how we are taking a judgement to balance recognising more recent data and avoiding placing too much reliance on a single year of data.

Benchmark metric

Context

- 4.34 In our December 2024 consultation we aimed to strike a balance between four key considerations: (i) the role of efficiency and non-efficiency factors; (ii) the level of customer protection; (iii) the level of uncertainty; and (iv) supplier provisioning methodologies. We evaluated the following benchmark metric options:
 - Option B.1: lower quartile benchmark the cost of the supplier that is at the 25th percentile in the sample applied to the three debt-related costs together.

- Option B.2: weighted average benchmark the average cost across suppliers weighted by the number of customers in their portfolio across the three debt-related costs together.
- Option B.3: hybrid benchmark setting different benchmark metrics for different debt-related costs. We could, for instance, set the bad debt component using a weighted average and the working capital and debtrelated administrative costs using a lower quartile benchmark.

Decision

4.35 We have decided to maintain our consulted-on position of adopting option B.2: weighted average benchmark to set the debt-related cost allowance.

Stakeholder response

- 4.36 We received seven responses to our choice of benchmark metric, with five suppliers and one advisor in agreement with our approach, and one supplier disagreeing with it.
- 4.37 One supplier and the advisor mentioned that, under a weighted average benchmark approach, suppliers will still have an incentive to improve their efficiency, as this will enable them to increase their profits. Besides the methodology, this supplier proposed to use revenues for weighting debt-related costs, rather than customer numbers, as they considered that it is a better reflection of the underlying driver of debt-related costs. Also, this supplier suggested that in considering non-efficiency factors, we should exclude from our sample suppliers who are atypical in terms of non-efficiency factors.
- 4.38 Another supplier mentioned that a weighted average approach allows greater scope for companies to maintain a degree of tailored services for individual customer groups, including vulnerable and low-income customers.
- 4.39 One supplier that agreed with our benchmark approach raised concerns that the combined impact of a number of methodological choices made in arriving at the final allowance effectively results in stringency, such as the treatment of the EBIT allowance in the cap (which we discuss below in section 7).
- 4.40 The supplier that disagreed with our benchmark approach stated that debtrelated cost allowances could be benchmarked at a more stringent level that drives suppliers to be better at recovering debt. They said that supplier performance plays a significant role in determining whether customers keep on top of their energy bills or fall into debt and arrears. They said that we should not

view debt as an exogenous variable which is simply a feature of a supplier's customer base.

Considerations

- 4.41 We consider that our selection of a weighted average metric balances the four key considerations mentioned above in this section. A weighted average accounts for suppliers with different customer bases. For a supplier with a higher-cost customer base, relative to a lower quartile benchmark, a weighted average benchmark reduces the likelihood and extent of shortfalls in recovering their efficient costs, helping them to provide the appropriate service level to their customers. For suppliers with a lower-cost customer base, or with a higher level of efficiency, we consider a weighted average benchmark would enable them to provide a wider range of support going beyond their licence obligation. However, we still expect all suppliers to exert control over their debt-related costs where possible, applying best practice.
- 4.42 In selecting a weighted average over a lower quartile approach, we consider the variation between suppliers' costs driven by factors other than efficiency. As mentioned in our December 2024 consultation, it is a general challenge to identify and potentially quantify non-efficiency factors when benchmarking costs. It is particularly important to consider non-efficiency factors when selecting a lower quartile approach, as they could affect whether the benchmark is achievable. Moreover, in the circumstances of the present decision for an enduring debt allowance, selecting a lower quartile benchmark would raise the level of risk to the financeability of a notionally efficient supplier with a higher-cost customer base, which we do not consider would be in the best interests of current and future customers. Therefore, by applying a weighted average approach we aim to mitigate the impact of customer base characteristics.
- 4.43 We do not consider that there is a clear reason to prefer weighting by revenue rather than customer numbers. A supplier's debt-related costs will likely depend on a variety of factors. In addition, part of a supplier's debt-related costs are administrative costs, which we would not expect to scale with revenue.

Benchmark across parameters

Context

4.44 We set the price cap at different parameter levels (eg payment method and fuel type). Through the DRC RFI we have collected suppliers' debt-related costs broken down by some of these parameters. This helps us to carry out analysis of

suppliers' data and the reporting methodologies they use, to understand the drivers behind how these costs vary across parameters.

- 4.45 In our December 2024 consultation we considered whether we benchmark debtrelated costs by each payment method or at an aggregate level across them. Splitting the costs by payment method would mean setting three separate benchmarks, and we would therefore rely on suppliers' allocation of costs for this parameter. In contrast, by aggregating costs across payment methods our benchmark would not rely on suppliers' allocation methodologies.
- 4.46 To determine the benchmarking approach at parameter levels a key consideration we take into account is how confident we are in suppliers' cost allocation methods and whether they are comparable across suppliers.

Decision

4.47 We have decided to maintain our minded-to position to set our benchmark approach at an aggregate level.

Stakeholder response

- 4.48 We received five responses to our proposal for benchmarking across parameters. Two suppliers agreed with our approach, while one stakeholder disagreed with it, and two suppliers did not hold a position towards our choice.
- 4.49 One of the two suppliers that did not hold a position towards our approach said we should consider the correlation between costs when determining the appropriate level of aggregation at which to benchmark.
- 4.50 One supplier agreed with our benchmark at aggregate level, as there may be differences in how suppliers have allocated costs in the absence of a standardised methodology. Another supplier agreed with our choice as this approach is less subject to information asymmetry around suppliers' allocation methodologies.
- 4.51 The stakeholder who did not agree with our approach suggested a benchmark methodology by payment method because it is simpler, more transparent, and cost reflective. They said that under that methodology, suppliers could recover their efficient costs with reduced distortion to incentives in a competitive market.

Considerations

4.52 There would be particular considerations about whether to benchmark at aggregate or parameter level, if we intended to use a lower quartile benchmark. This reflects that the sum of separate parameter-level lower quartile benchmarks might be less than an aggregate lower quartile benchmark, eg if there were inconsistencies in allocation approaches between suppliers.

- 4.53 Given our decision to use a weighted average benchmark, the choice between an aggregate and a parameter level benchmark is less significant. There would not be a reason in principle to expect that one benchmark approach would be more likely to lead to a lower total allowance.
- 4.54 However, as noted by two suppliers, there could be allocation differences between suppliers. A parameter level benchmark is more directly impacted by suppliers' allocation decisions, whereas an aggregate benchmark allows us to consider the appropriate approach to allocation separately from benchmarking.
- 4.55 We discuss our considerations about allocation in more detail in section 5. At this stage, we note that there is judgement involved in allocating debt-related costs between payment methods. This reflects, for example, that customers can move between payment methods when they get into payment difficulties. Suppliers will have had to make their own judgements when allocating costs between payment methods, so we do not consider that we should use their allocations automatically or uncritically. We therefore do not agree that parameter benchmarks would be a cost-reflective approach.
- 4.56 We also do not agree that parameter level benchmarks should be used on the basis of perceived simplicity or transparency our priority is to set an appropriate set of allowances. We consider that our assessment in section 5 provides sufficient transparency on our allocation approach.

5. Allocating costs across customer groups

Section summary

In this section we set out our decision on the allocation of the debt-related allowances across payment methods, tariff types, fuels and meter types. We discuss the rationale and stakeholder responses we have considered in our decision.

Payment type

Context

- 5.1 In section 4 we discussed our decision to benchmark the debt-related costs at the aggregate level. This means that once the costs are benchmarked at the aggregate level, we must then decide on how to allocate costs across parameters. The allocation approach taken does not affect the total level of costs recovered through the cap, but rather the way in which the costs are recovered through the different parameters.
- 5.2 The first parameter we must consider is how to allocate the benchmarked costs across payment methods. This will determine the portion of debt-related costs allocated across the Standard Credit, Direct Debit and Prepayment Meter (PPM) payment methods within the cap.

General principles

- 5.3 In making decisions on cost allocation within the price cap, Ofgem must consider its overarching objective to protect existing and future default tariff customers and in doing so, must 'have regard to' the five other matters specified under the Domestic Gas and Electricity (Tariff Cap) Act 2018. This requirement to have regard to these five matters does not mean that we must achieve all of them but in setting the cap and reaching decisions on particular aspects of the cap with a view to protecting existing and future default tariff customers, the weight to be given to each of these considerations is a matter of judgement. Often a balance must be struck between competing considerations. Ofgem must also have regard to wider duties, which include the Public Sector Equality Duty.
- 5.4 Historically, the cap has broadly followed the principle of cost reflectivity when allocating costs between allowances. This is done so that consumers can face prices that reflect the cost to serve and so that an efficient supplier can recover its costs. The principle of cost-reflectivity has generally provided benefits to customers, as it means that the price cap tariffs are broadly comparable with non-capped tariffs with equivalent characteristics. This then allows customers to

choose between the cap and open market tariffs in a comparable way. If efficient suppliers cannot earn normal returns from a group of customers due to unrecoverable cost differences, this can result in sub-optimal incentives to acquire these customers or to provide good service to them.

- 5.5 However, it is not always clear what a cost-reflective position is in practice. It is not possible to recover the costs of non-payment from the customers who do not pay. These costs instead need to be paid for by other customers. This limits the degree to which the costs of non-payment can be considered in a cost-reflective way ultimately we need to make an allocation decision. For example, at a group level, we have historically found that Standard Credit customers are generally more costly to serve. However, on an individual level many Standard Credit customers are not (e.g. those who pay promptly) and therefore it would not be cost reflective to charge those Standard Credit customers.
- 5.6 Further, before the introduction of the price cap in 2019, the price differences in the market between payment methods were generally set based on the costs to serve these customers, although these were not always reflected in full. We found that no supplier had a Standard Credit to Direct Debit price differential that reflected the full additional average cost to serve that was reported through the cost data collected from suppliers. This meant that most suppliers were already spreading costs over a broader customer base through a market price-setting mechanism. This highlights that suppliers' reported costs may differ to the pricing which would be observed in open market dynamics.

Options in our December 2024 consultation

- 5.7 In our December 2024 consultation we developed options for allocating debt costs. This allowed us to narrow down the allocation approach to three options:
 - Option 1 (minded-to option): current differential this approach allocates the debt costs in a way that would maintain the current differentials in the price cap across payment methods. This does not mean that the differentials will be fixed over time to the current differentials in the price cap in absolute terms, as debt allowances are scaled to the prevailing bill size.
 - Option 2: reported costs allocation this approach would allocate the benchmarked debt allowances in a way that would reflect the average costs per customer reported across the sample of suppliers for each payment method.

- Option 3: equal cost allocation this approach allocates the benchmarked debt allowances equally across all payment methods.
- 5.8 We outlined our view that option 1 was the most appropriate, as debt by definition is a cost associated with one set of customers (non-paying) that is socialised across another (paying). Therefore, those costs should be spread as broadly across customers as possible, while reflecting some differential based on the inherent properties of the payment type they choose (ie that Direct Debit customers have a lower propensity to incur debt and Standard Credit a higher propensity) due to their approach to payment.
- 5.9 In our December 2024 consultation¹¹, we confirmed that we do not propose to proceed with levelisation of debt costs at this time. This was for a number of reasons, including the case for change and significant feasibility barriers which we are not confident can be completely overcome.
- 5.10 Alongside the consultation, we published our Debt strategy¹² which, alongside broader actions, raised the possibility of a debt relief scheme. Depending on implementation this would allow suppliers to make claims to write off eligible customer debt in line with need driven by their customer portfolios.

Decision

5.11 We have maintained our minded-to proposal of allocating benchmarked debtrelated costs across payment methods using a current differential approach (option 1). This allows the allocation to maintain a premium that reflects the higher direct cost and risk of serving a Standard Credit customer (and lower for PPM) whilst protecting individual consumers that are particularly vulnerable from disproportionately shouldering the cost of debt of other customers. We therefore consider it appropriately balances relative debt risks associated with a payment method against protecting paying customers who use that method.

¹¹ Ofgem (2024), Energy price cap operating cost and debt allowances consultation: overview, paragraphs 2.52 – 2.55.

https://www.ofgem.gov.uk/consultation/energy-price-cap-operating-cost-and-debtallowances-consultation

¹² Ofgem (2024), Debt Strategy: a 'reset' and 'reform' for customers in debt. <u>https://www.ofgem.gov.uk/publications/debt-strategy-reset-and-reform-customers-debt</u>

Debt allocation (£/dual fuel customer)	Final decision
Direct Debit	57
Standard Credit	160
РРМ	19

Table 5.1: Debt allocation in £ per dual fuel customer for each payment method

Stakeholder responses

- 5.12 We received eight stakeholder responses regarding our cost allocation approach. Six stakeholders disagreed with the current differential approach, while two stakeholders agreed with the approach.
- 5.13 Six stakeholders expressed concerns about cost recovery for the current differential approach, stating that it would lead to financial difficulties and competitive distortion for suppliers that have large numbers of Standard Credit customers.
- 5.14 Six stakeholders disagreed with the implementation of a current differential on the basis that it was not cost reflective and called for the implementation of the supplier-reported allocation.
- 5.15 Three stakeholders disagreed with the implementation of a current differential approach and called for Ofgem to establish a reconciliation mechanism alongside a current differential approach to mitigate against financeability issues. They also called for Ofgem to implement Phase 2 debt levelisation as described in our February 2024 decision.¹³
- 5.16 One stakeholder recognised the challenge of the cost of debt on Standard Credit customers, and the differential these customers pay versus a Direct Debit customer. They stated that if the allocation proposal reduces that differentiation, that can only work in those customers' interests.
- 5.17 One stakeholder stated that the differential between Standard Credit and Direct Debit should be driven down further. They stated that this can be done by ensuring suppliers become better at managing Direct Debit customers as there is little difference between cost to serve between Standard Credit and Direct Debit customers. However, in comparison to the reported cost allocation, they agreed

¹³ Ofgem (2024), Decision on adjusting standing charges for prepayment customers. <u>https://www.ofgem.gov.uk/decision/decision-adjusting-standing-charges-prepayment-customers</u>

adopting the current differential approach is the right course of action to keep Standard Credit costs down.

Considerations

Cost recovery

- 5.18 Out of the six stakeholders that disagreed with adopting the current-differential approach, three of these stakeholders submitted their own cost-recovery analysis. This stated the following key points:
- 5.19 <u>Allocation will lead to material winners and losers</u> stakeholders said that the current differential approach will create material over-recovery and under-recovery across suppliers. Estimates for over and under-recovery ranged from +£38/-£16 per customer account annually, and therefore stakeholders said that the current differential approach leads to a significant variation in the costs that individual suppliers could recover.
- 5.20 One stakeholder compared the amount that each supplier will recover through the current differential approach to the industry average cost to serve for each payment method, which was represented by the reported cost allocation. They state that this shows four suppliers are set to significantly over recover against the industry average cost to serve. They said that this means that the current differential is representing a material competitive distortion, rather than over-and under-recoveries being a reflection of relative efficiency (given that the analysis uses the same cost to serve across suppliers for each payment method). They said that this implies the current differential does not incentivise efficiency.
- 5.21 One stakeholder used a benchmarking by payment method approach to set an alternative allowance. They state that this alternative allowance would match industry costs more closely than the current differential. They state that allocation methodologies that make use of suppliers' reported cost allocation reduce variation in cost recovery, and result in lower revenues overall, which would benefit consumers.
- 5.22 <u>Allocation favours Direct-Debit heavy suppliers</u> stakeholders said that overrecovery will primarily benefit Direct Debit heavy suppliers, with under-recovery primarily affecting Standard Credit heavy suppliers. This makes the current differential approach sensitive to differences in payment mix across suppliers. They argue this represents a material competitive distortion created by the allowance as suppliers with a higher Standard Credit customer base will be at a competitive disadvantage given the windfalls created by the allowance for Direct-Debit heavy suppliers. This will not incentivise Direct-Debit heavy suppliers to

improve their efficiency, creating a two-tier market where suppliers start to compete for low cost to serve customers. Consequently, they said that disengaged, vulnerable Standard Credit customers will see their bills increase.

5.23 <u>Switching Direct-Debit customers makes cost recovery difficult for Standard</u> <u>Credit suppliers</u> – stakeholders said that Standard Credit heavy suppliers carry an additional risk pertaining to cost recovery, as movements of Direct Debit customers to fixed tariffs results in a lower opportunity to recover the socialised debt costs. They argue that the allowance exacerbates this risk as it allows for Direct Debit heavy suppliers to use the windfall revenues provided by the current differential approach to provide cheaper fixed tariffs that Standard Credit heavy suppliers cannot compete with.

Ofgem's sensitivity analysis for cost recovery

- 5.24 The cost recovery analysis submitted by stakeholders took methodological approaches that were not consistent with how we calculate the allowance allocation¹⁴ and did not use the latest data. We have carried out our own cost recovery sensitivity analysis that is consistent methodologically to test the positions detailed above.
- 5.25 It is important to note that the purpose of this analysis is not to forecast cost recovery across the industry, as this would need to account for parameters such as consumer incomes, consumption and external economic factors that are out of scope for the purpose of setting allowances within the price cap framework. The sole purpose of the analysis is to use a simple approach to indicate cost recovery across a snapshot of time. It assumes benchmark consumption for revenue and compares it to costs based on the average cost per customer accounts for each supplier during the baseline period (see section 4). We retained benchmark consumption, as the average consumption reported in our data for suppliers was above TDCV. This is so that we can assess the impacts of different allocation options in isolation.
- 5.26 We consider that it is an acceptable approximation to use a single consumption figure when calculating revenue, given that we are interested in how different allowance options would change the distribution of outcomes (rather than assessing the total amount of over/under-recovery).

¹⁴ Methodological inconsistencies included not applying the working capital cost adjustment correctly, using default and fixed tariff customer numbers and multiplying allowances on a dual fuel basis.

- 5.27 This analysis presents three scenarios in which the differential between Direct Debit and Standard Credit allowance is increased by increments of £50 from the current differential approach (minded-to position). This is done to assess how cost recovery impacts behave as the allowances approach a supplier-reported cost allocation, which allocates a larger Standard Credit allowance.
- 5.28 We report under or over-recovery for the eight suppliers in the benchmarked supplier sample discussed in section 3. This involves comparing their revenue under each option against their own actual debt costs over the previous 2 years as discussed in section 4.
- 5.29 We present the analysis in a scatter graph and address each position below.

Figure 5.1: Suppliers' annual net-cost recovery for Standard Variable Tariffs (SVT) customers in \pounds per customer account for 8 suppliers



Accessibility format: A scatter graph displaying suppliers' annual net-cost recovery for SVT customer accounts (in \pounds per customer), under three scenarios. Each scenario includes eight data points representing the different suppliers and showing the distribution of suppliers' net-recovery for each scenario.

- 5.30 We calculated the statistical range and standard deviation for each scenario modelled. We have used these metrics as two different measures of variation to allow us to assess the different aspects of stakeholders' concerns.
- 5.31 The range measures the difference between the largest over-recovery and the largest under-recovery in pounds per customer for each scenario. This indicates how increasing the differential between Direct Debit and Standard Credit can change the maximum variation in outcomes across the market.
- 5.32 The standard deviation measures how far net-cost recovery deviates from the industry average net cost recovery for each scenario in pounds per customer. This indicates how increasing the differential between Direct Debit and Standard Credit can affect how net cost recovery varies from the industry average.
- 5.33 We find that the statistical range for decision position, scenario 1 and scenario 2 are £25.4/customer, £25.2/customer and £26/customer respectively.
- 5.34 We find that the standard deviation for decision position, scenario 1 and scenario2 are £8.2/customer, £8.1/customer and £8.3/customer respectively.

Assessing whether allocation will lead to material winners and losers

- 5.35 While there are suppliers whose cost recovery changes between scenarios, the range does not change materially across the scenarios (ie between the current differential and an allocation that approaches a reported cost allocation). This suggests that there will always be a degree of under and over-recovery no matter what cost allocation is adopted and that allocating a greater amount of cost to Standard Credit (whether accompanied by a levelisation and reconciliation or not) would not materially change that outcome (although it may change which suppliers are affected).
- 5.36 We consider that these results are partly due to the price cap having one allowance that covers all suppliers (as required by legislation). Therefore, it is not designed to ensure exact cost recovery across the market as that would require a tailored supplier-specific approach. However, this phenomenon is also not restricted to regulated markets where price caps are used. Over-recovery at the cost of under-recovery of other suppliers would also exist in unregulated markets as that is the nature of demand and supply dynamics and suppliers are to some extent price takers.
- 5.37 Additionally, in our analysis we find that over-recovery could mostly occur for suppliers with a higher proportion of Standard Credit customers across all scenarios. Generally, we recognise that suppliers who over-recover will be able to make commercial choices about how to use this potential additional revenue (though we note the cap is a ceiling on prices, not a floor). However, given the analysis above, we do not consider that our allocation decision creates an avoidable impact on competition.
- 5.38 We note that although the range is not materially changing, as we increase the differential between Direct Debit and Standard Credit, the graph exhibits an upward shift in the net-cost recovery. We find that this upward shift is a result of the limitations of the methodology.

- 5.39 We use different sources of customer numbers when setting the allowance and within the cost recovery analysis. For the cost recovery analysis, we use supplier reported customers from our Tariff and Customer Account RFI. This allows us to calculate cost recovery across all the allocation decisions we have taken. There is a slight discrepancy between these two sources of customer numbers that results in the cost recovery analysis using a slightly higher ratio of Direct Debit to Standard Credit customers than what we use to set the allowance. This leads to a slight over-estimate of cost recovery across the sample of suppliers.
- 5.40 More fundamentally, increasing the differential between Direct Debit and Standard Credit would lead to increasing the allowance due from non-paying Standard Credit customers. Given that non-paying Standard Credit customers are a significant proportion of the Standard Credit customer base, this would constrain the amount of costs that can be recovered in practice. This would also increase the risk of non-paying Standard Credit customers falling into higher levels of debt, ultimately increasing the debt burden and under-recovery on suppliers. Therefore, this would limit overall cost recovery, and we would not except to see a rise in overall cost recovery across scenarios.
- 5.41 We consider that allocations that result in a rise in the overall level of cost recovery is not an outcome that can be materialised without disbenefits to both consumers and suppliers. When assessing what allocation improves cost recovery outcomes across the market, our primary concern is how the spread of the distribution of the cost recovery changes. We assess this using the next metric of standard deviation.
- 5.42 We find that the standard deviation across scenarios does not materially change. This demonstrates that the reported cost allocation does not narrow the spread of the cost recovery and therefore cannot be considered to prove a better reflection of the typical situation across suppliers. We note that our analysis uses suppliers' actual costs, as opposed to the analysis from one stakeholder which used industry average costs on each payment method. We therefore consider that our analysis is a better reflection of the likely spread of under and over-recoveries.
- 5.43 Additionally, this corroborates that there is a weak correlation between suppliers' costs and their payment method mix. It demonstrates what we see in our commercially sensitive data (which we cannot show in this decision). We find that the number of Standard Credit customers is only weakly correlated with the bad debt charge and debt-administrative cost per customer, and that suppliers with low numbers of Standard Credit customers have a higher proportion of those customers indebted. This in turn drives their reported costs to be higher, but this

does not mean that these reported costs per customer are an accurate indication of the average costs per Standard Credit customer for suppliers with higher quantities of such customers. We therefore consider that increasing Standard Credit allowances to establish a more 'cost reflective' approach would not make a significant difference to the accuracy of the net-cost recovery across the market as a whole.

- 5.44 We discuss correlations between debt costs, payment method and other parameters such as Priority Services Register (PSR) and Warm Home Discount (WHD) further below.
- 5.45 We modelled the use of benchmarking by payment method as an alternative cost allocation approach and find that it leads to an increase in Standard Credit allowances that is above the £100 increment modelled in our cost recovery analysis. It will therefore only provide a distribution of cost-recovery that is similar to scenario three modelled in Figure 5.1 above, at the cost of an even higher Standard Credit allowance.
- 5.1 We do not consider that benchmarking by payment method would mitigate against the potential impacts of increasing Standard Credit allowances on vulnerable customers. Currently, disabled, chronically sick and low-income customers form a higher proportion of Standard Credit customers than Direct Debit (See 'Appendix 5: Impact Assessment'). However, due to a greater number of customers that are on Direct Debit, the number of vulnerable customers on Direct Debit are greater in absolute terms. While we therefore recognise that there are vulnerable customers on each payment method, the scale of the impact on certain vulnerable customers would be greater if we allocated more costs to Standard Credit. We consider it preferable to try and avoid large negative impacts at an individual customer level, given that the consequences (both financial consequences like debt and non-financial consequences like self-rationing) may be more significant when impacts are larger. Put another way, we are not simply concerned about the average impact across vulnerable customers, but also the distribution of impacts.

Assessing whether allocation favours Direct-Debit heavy suppliers

5.2 Our cost sensitivity analysis does not suggest that the current differential allocation approach favours, or skews cost recovery towards suppliers that are Direct Debit heavy. If this was the case, then we would expect a narrower distribution for at least one of the other options, reflecting an erosion of any

benefit to Direct Debit heavy suppliers. As the standard deviation does not change across scenarios, this is not what we observe in our analysis.

5.3 Additionally, our analysis suggests that over-recovery could occur mostly for suppliers that have higher Standard Credit customers across all scenarios, and therefore do not consider that the current differential skews recovery toward Direct Debit heavy suppliers.

Assessing switching between default and fixed tariffs

- 5.4 In considering the risk of Direct Debit customers switching between default and fixed tariffs, we first assessed the current trends in switching between tariff types. We then adjusted the customer numbers in our cost recovery sensitivity analysis for the current differential approach to reflect the evolution of switching trends observed in historical data. This modelled the high (cap 13a) and low levels (cap 8) of SVT customers that were observed in the DRC RFI data. This was out carried to indicate the level and range of cost-recovery impacts that could occur with different switching patterns, with the current situation with a high proportion of SVT customers or a return to a proportion of Fixed Term Contracts (FTC) customers previously observed.
- 5.5 We observe that the rate at which default tariff Direct Debit customers are switching to fixed tariffs is higher across suppliers with a high proportion of Direct Debit customers, as opposed to suppliers that have more Standard Credit customers. This suggests that the Direct Debit customers are relatively more engaged for suppliers with a higher proportion of Direct Debit customers. It is therefore not likely that suppliers with a higher proportion of Standard Credit customers will be at a significant competitive disadvantage.
- 5.6 Additionally, when modelling the dynamics of switching in our cost-recovery analysis, we find that Standard Credit and Direct Debit heavy suppliers which had a positive net-recovery would stay in this position across the range of switching rates modelled. The net-recovery of Direct Debit heavy suppliers would reduce faster than the one from Standard Credit heavy suppliers. There would be no change to PPM specialist suppliers' position. We therefore do not consider that switching between tariff types warrants a change in allocation approach.
- 5.7 We also note that to some extent suppliers retain the ability to set their own fixed tariff prices, so switching to a fixed tariff does not automatically mean that a supplier will be unable to recover debt-related costs from these customers. Fixed tariff pricing is subject to competitive pressure, but suppliers must also consider

how to price sustainably, including consideration of their shared costs such as the cost of non-payment.

Reported cost allocation

5.8 Six stakeholders disagreed with the current differential approach and stated that the supplier-reported cost allocation is the appropriate allocation to adopt. They provided a number of reasons for this. Primarily, they stated that the current differential approach is not cost-reflective and disagreed with our consultation position that the reported cost allocation would provide perverse incentives. Additionally, one stakeholder stated that the "misallocation" of costs would make it more difficult for suppliers to reach their Capital Adequacy Target. We address each of the stakeholder responses below.

The appropriateness of using reported cost allocation

- 5.9 Two stakeholders disagreed that the reported allocation should not be adopted on the basis that there is a weak correlation between payment method mix and supplier debt costs. One stakeholder provided their own analysis showing a positive correlation between the debt costs and the share of Standard Credit customers for suppliers.
- 5.10 One stakeholder stated that the weighted average reported cost per supplier for each payment method can be considered as a reasonable estimation of the actual costs that suppliers face.
- 5.11 Two stakeholders stated that in comparison to the reported cost allocation, the current differential approach is markedly below industry average costs per Standard Credit customer, and markedly above the industry average for Direct Debit customers.
- 5.12 We acknowledge that there is some positive correlation between the proportion of Standard Credit customers and average debt costs per customer. However, we do not consider that this demonstrates that the proportion of Standard Credit customers is the main cause of suppliers' debt costs. Customers can move between payment methods when they get into debt, so debt risk is not solely sat with Standard Credit customers. Additionally, debt costs will reflect suppliers' own provisioning rates at the time of billing as opposed to at the point of consumption. These provisioning rates will change periodically by suppliers as well as vary across suppliers. We consider that the nature of customer movement and debt provisioning make it difficult to define the true cost-to-serve of each payment method using reported costs.

- 5.13 We have considered stakeholders' own correlation analysis between debt costs and the proportion of Standard Credit customers that suggests a positive correlation. We find that stakeholders have included working capital costs in their correlation analysis. The current differential maintains the position taken when we first introduced the price cap in 2019. This was to allocate all additional working capital costs to Standard Credit, reflecting that they are an inherent characteristic of the payment method. However, when assessing the correlation between the proportion of customers on Standard Credit and the sum of the bad debt charge and debt-related administrative costs, this is where we find the correlation to be weak. We observe that correlation becomes particularly weak when we control for suppliers' changes in provisioning methodologies,¹⁵ as well as when we update the analysis with latest DRC RFI data. We also find that the strength and direction of the correlation becomes sensitive to what baseline period is assumed.
- 5.14 Alternatively, we looked at the relationship between other customer base factors, such as PSR and WHD, and the sum of bad debt and debt-related administrative costs. In our December 2024 consultation, we observed that there was likely to be positive correlation between suppliers' debt and arrears and the proportion of PSR or WHD.¹⁶ This was based on data we collect from our Affordability RFI. We have tested the correlation between: 1) the sum of the bad debt charge and debt-related administrative costs; and 2) PSR or WHD using our latest data. We find that there is also a weak correlation with PSR and WHD levels, and that similarly to payment method, the correlation is sensitive to the baseline period and suppliers' changes in provisioning methodologies. Additionally, a supplier's proportion of customers on PSR may partly depend on how effective they are at identifying PSR customers, rather than only differences in their customer base.
- 5.15 We identified that the main determinant of a positive net cost-recovery was the level of costs reported by supplier, but those could not be correlated to non-efficiency factors mentioned by suppliers apart from working capital costs. The above steps considered the impact of different cost allocations for the debt allowances to make them more reflective without improving significantly the accuracy of the cost recovery. We unsuccessfully tried to find a relationship between the characteristics of suppliers which are considered as non-efficiency

¹⁵ We did this by excluding suppliers with recent significant adjustments in their debt provisioning from our analysis.

¹⁶ Ofgem (2024), Energy price cap operating cost and debt allowances consultation: appendix 2, paragraph 4.29. <u>https://www.ofgem.gov.uk/consultation/energy-price-cap-operating-cost-and-debt-allowances-consultation</u>

factors and their debt costs; the proportion of Standard Credit customers, the proportion of PSR or WHD customers.

5.16 We therefore do not consider that the reported cost allocation gives a reasonable estimate of how suppliers' costs vary based on their payment method mix. Further, due to the weak correlation, using reported costs to allocate allowances would not reduce the risk of under- or over-recovery of debt costs across the market. This is likely because suppliers with large legacy Standard Credit customer bases have a lower debt-per-SC-customer than suppliers with low numbers of Standard Credit customers who are likely only on Standard Credit because they have fallen behind on their bills.

The current differential allocation is not cost reflective

- 5.17 One stakeholder stated that the current differential approach is based on obsolete data based on what was used when the price cap was introduced. They stated that this could underestimate the efficient difference in costs between Standard Credit and Direct Debit as it embeds efficiency assumptions about the sector that are unlikely to hold in current data.
- 5.18 One stakeholder stated that when the price cap was introduced, the additional debt costs of serving Standard Credit customers were not entirely allocated to Standard Credit and therefore was not set cost-reflectively. Another stakeholder stated that the current differential is not consistent with the principle of a bottom-up cost assessment, which is the basis for determining the price cap. They stated that although the existing cap allowances are not also fully cost reflective, they did reflect Ofgem's estimate of the existing large supplier price differential at the time.
- 5.19 Costs relating to non-payment inherently involve paying customers bearing the costs of those who do not pay. This means that charges for these costs can never be cost-reflective at an individual customer level. This would be true with or without a cap.
- 5.20 We therefore unavoidably have a choice about how to allocate the costs of nonpayment between customers, including those on different payment methods.
- 5.21 The choices associated with the period used for data, and the benchmarking metric only impact how the total allowance is set, and not the allocation decisions. Given that we have used the latest DRC RFI data and the weighted average approach to estimate the total allowance, it reflects the latest view of efficiency assumptions that hold in the market as well as accounting for non-efficiency factors.

- 5.22 In 2018, we did not allocate all additional costs to serve Standard Credit customers as it would have resulted in a differential between Direct Debit and Standard Credit that exceeded the differential observed in the market before the price cap was introduced.¹⁷ This implied that suppliers were allocating the additional costs to serve with Standard Credit across the other payment methods as prior industry practice. We therefore considered the following principles in allocating the additional costs of serving Standard Credit customers:
 - Additional working capital costs we allocated 100% of these costs to Standard Credit as we recognised that in general, Standard Credit customers cause additional working capital costs as they pay a higher proportion of their bills in arrears. We considered that additional working capital costs were an inherent feature of the Standard Credit payment method.¹⁸
 - Additional bad debt costs and administrative costs we allocated 52% of additional bad debt and administrative costs to Standard Credit customers, with the remaining additional cost to serve across all other customers. This was because we did not consider that there was a strong case that only credit customers should be required to carry all of the additional costs.¹⁹ Full allocation would mean that Standard Credit customers who have paid their bills are treated as responsible for covering the cost of Standard Credit customers who have not paid their bills. We did not consider that sharing a payment method makes Standard Credit customers any more responsible for that debt, than a Direct Debit customer is. This would have undermined the meaning of cost-reflectivity for paying Standard Credit customers.²⁰

¹⁹ Ofgem (2024), Default tariff cap: decision – appendix 8 payment method uplift, paragraph 2.39, <u>https://www.ofgem.gov.uk/decision/default-tariff-cap-</u> decisionoverview#:~:text=On%206%20November%202018%20we,to%20reflect%20un derlying%20cost%20changes.

²⁰ Ofgem (2024), Default tariff cap: policy consultation – appendix 12, <u>https://www.ofgem.gov.uk/sites/default/files/docs/2018/05/appendix 12 – payment method uplift.pdf</u>

¹⁷ Ofgem (2024), Default tariff cap: decision – appendix 8 payment method uplift, paragraph 2.39, <u>https://www.ofgem.gov.uk/decision/default-tariff-cap-</u> <u>decisionoverview#:~:text=On%206%20November%202018%20we,to%20reflect%20un</u> derlying%20cost%20changes.

¹⁸ Ofgem (2024), Default tariff cap: decision – appendix 8 payment method uplift, paragraph 2.40, <u>https://www.ofgem.gov.uk/decision/default-tariff-cap-</u> <u>decisionoverview#:~:text=On%206%20November%202018%20we,to%20reflect%20un</u> <u>derlying%20cost%20changes.</u>

5.23 For the forward-looking debt allowance, we consider that the principles above still hold for the market today and therefore have maintained the current differentials in the price cap as the best approach to allocate costs.

Current differential embeds non-cost reflective allocation of the float allowance

- 5.24 One stakeholder stated that the current differential bakes in the non-cost reflective allocation of the float allowance. They said that as the float allowance is a temporary allowance that is subject to further review, this undermines its suitability as a reference point for the allocation of a forward-looking allowance. They recommended that in adopting the current differential approach, a cost reflective allocation of the float allowance should be assumed. Another stakeholder stated that the true-up of the float allowance should be allocated in line with the methodology applied in the forward-looking allowance.
- 5.25 We recognise that the float allowance was introduced as a temporary allowance. The allocation we used for the temporary float allowance reflected a judgement that the additional debt-related costs (above the historical proportions) should be shared evenly across credit customers. Avoiding the allocation of an undue fraction of these additional costs to Standard Credit customers is still a relevant consideration.
- 5.26 We outline the considerations that will be taken for the true-up of the float allowance further in section 7.

Current differential does not consider higher than average proportions of Standard Credit customers

- 5.27 One stakeholder disagreed with our statement in the December 2024 consultation that given there is no supplier with a predominantly Standard Credit base in the market, this provides mitigation against the allocation choices in the proposed methodology. They stated that the risk here is whether suppliers have more Standard Credit customers than the market average. Another stakeholder stated that the current differential puts suppliers who are efficient but have a greater proportion of Standard Credit customers (compared to Direct Debit customers) at a disadvantage, and that such suppliers will be unable to finance their activities.
- 5.28 The price cap has historically allowed for recovery of the additional costs to serve Standard Credit customers based on an average proportion of Standard Credit customers. We have recognised that there may be suppliers in the market that have higher costs than the average due to having a higher proportion of Standard Credit customers, as well as other characteristics. However, within the price cap framework, there are limitations in how far variations from average metrics can

be accommodated without substantially increasing charges to customers. We consider that these variations fall under the residual uncertainty present in our modelling that is recognised by the headroom allowance.

5.29 Additionally, we have carried out sensitivity analysis to test the cost recovery impacts of the current differential approach. We do not find that Standard Credit heavy suppliers are put at a disadvantage relative to other suppliers from the current differential approach, or that a further allocation of costs to Standard Credit and away from Direct Debit would result in materially less under- and over-recovery across the market. Rather, it would change the balance of which suppliers under- or over-recovered.

Current differential keeps absolute difference between payment methods constant

- 5.30 One stakeholder stated that the current differential keeps the absolute difference between payment methods constant. This means that Ofgem is effectively adopting an equal allocation approach for future increases in the allowance. They said that this will lead to an approach that disproportionately allocates increases in the allowance to PPM and Direct Debit customers. They recommended that relative differentials are maintained, as this would automatically adjust with cap levels, which would be more cost reflective as revenue levels change.
- 5.31 The current differential does not keep the absolute difference between payment methods constant. Through our update mechanism approach (see section 6), we have maintained the approach of scaling the current differentials in the price cap with the bill size going forward. We will do this by applying a percentage allowance for bad debt and working capital. This means that, for a given cap level increase, the absolute increase in the allowance would be greater for a payment method with a higher percentage allowance (ie Standard Credit). We consider that this approach reflects a degree of cost reflectivity and therefore do not consider that it will disproportionately allocate increases in debt-related costs to PPM and Direct Debit customers.

Reported cost allocation would not lead to perverse incentives

5.32 One stakeholder disagreed that the reported cost allocation would result in perverse incentives for customers and suppliers, specifically the perverse incentive for suppliers to keep paying Standard Credit customers on that payment method due to their profitability. They said that this is not consistent with suppliers' licence conditions, as they are required to offer a variety of payment methods to customers, and therefore suppliers are bound by licence conditions to aid their customers in selecting the most advantageous payment methods.

- 5.33 Additionally, they state that suppliers attempting to retain customers on expensive Standard Credit tariffs face the risk of competitors undercutting their offer and attracting customers to switch away from them. This means that competitive pressure in the market would make suppliers' strategy of profiting from their paying Standard Credit customers untenable.
- 5.34 The price cap was introduced due to concerns that price competition was not effective in preventing the overcharging of disengaged customers, including those on Standard Credit. We therefore do not consider that competition would prevent suppliers from making additional revenue as a result of disengagement.
- 5.35 Similarly, while suppliers must provide customers with information about tariff options, this does not mitigate harm if customers do not engage with these prompts.
- 5.36 Additionally, in our latest consumer survey, we found that pricing was not the only reason why customers select their payment method of choice, rather convenience and payment control are other reasons. This constrains the benefits that customers could achieve from pricing signals created by larger price differentials through reported cost allocation and increases the incentives for suppliers to benefit from paying Standard Credit customers that remain due to factors other than pricing signals. We therefore consider that there is still a case for incentives for both customers and suppliers to encourage switching to efficient modes of payment, whilst maintaining a price differential that allows suppliers to cover their costs for Standard Credit customers. We consider the current differential best balances these incentives.

Current allocation undermines the ability to achieve Capital Adequacy targets

- 5.37 One stakeholder stated that the current differential allocation embeds misallocation of costs that have been in place since the implementation of the cap and which have been acknowledged by Ofgem. They refer to the Competition Market Authority (CMA)'s decision in the Financial Resilience Appeal and cite the CMA's statement that the ability for a supplier to earn a return is dependent on the appropriateness of the set price caps it faces given the characteristics of its customer base, including payment types. They state that by the current differential approach perpetuating the misallocation of costs, it makes it more difficult for suppliers to reach their Capital Adequacy target.
- 5.38 Given the principles outlined for the Payment Method Uplift allocation above, and that we observed it was industry practice to follow similar principles, we do not

consider that the current differential embeds a misallocation of costs since the implementation of the cap.

- 5.39 In our EBIT impacts analysis (see 'Appendix 5: Impact Assessment'), we find that the current differential and an allocation that increases the Standard Credit allowance both lead to a reduction in EBIT as a proportion of total revenue. However, for the current differential these reductions are due to a reduction in core operating allowances, as opposed to being driven by our allocation decision for debt-related costs. Diverging from the allocation methodologies led to negative outcomes for suppliers' with a high Direct Debit EBIT. Additionally, we are not providing an allowance for working capital costs through the forward-looking allowance. The Capital Adequacy target is a minimum capital requirement, and as such has been set below the total level of capital assumed in the EBIT allowance. We therefore do not consider that maintaining the current differential will fundamentally impact this. We discuss our treatment of working capital costs in section 7 further.
- Phase 2 levelisation and Debt Relief Scheme
- 5.40 Three stakeholders called for Ofgem to re-consider its position on Phase 2 levelisation, and to expedite the delivery of Phase 2 levelisation along with the reconciliation mechanism. As stated in our consultation, the decision to pause Phase 2 levelisation was due to a number of reasons, including feasibility barriers.²¹
- 5.41 As part of a separate piece of work we are considering a new policy intervention to address historical debt accumulated due to the extraordinary circumstances which arose during the energy crisis. As set out in our Debt Relief Scheme policy consultation, this is because without addressing the build-up of unsustainable debt, suppliers will continue to pursue indebted customers for the historical unpaid bills and the costs will be met by all customers who pay their bills. The price cap debt allowance is a single allowance that is set across all suppliers. The debt relief scheme is a potential one-off, backward-looking intervention targeted solely at debt accumulated during the energy crisis and at eligible customers. We therefore consider that the Debt Relief Scheme could complement existing

²¹ Ofgem (2024), Energy price cap operating cost and debt allowances consultation: overview, paragraph 2.52 - 2.54.

https://www.ofgem.gov.uk/consultation/energy-price-cap-operating-cost-and-debtallowances-consultation

allowances provided to suppliers by targeting support to clear historical debt accrued during the energy crisis.

5.42 Further, while we consider that a broad socialisation of debt costs is appropriate and in consumer's interests we continue to see the case for a premium paid by Standard Credit customers over Direct Debit due to a) the increased capital requirements; and b) the higher propensity to non-payment inherent in the payment method. While we consider these factors justify a differential, we do not consider these would justify further increases in the differential.

Phase 2 Reconciliation mechanism and the debt-related allowance

- 5.43 Two stakeholders stated that in the absence of Phase 2 levelisation, Ofgem has adopted an allocation method that proposes the 'levelising'²² of costs between payment methods. They said that this has been conducted without considering the market implications of not undertaking reconciliation or the impact it has on suppliers and customers. They stated that without a supplier reconciliation mechanism, the current differential approach puts some suppliers at a material disadvantage. Therefore, they called for a reconciliation mechanism to be introduced along with the current-differential allocation approach, so that distortive impacts on suppliers are mitigated.
- 5.44 In our May 2024 consultation, we stated that in the absence of Phase 2 levelisation, we would consider a consumer-led perspective in deciding which allocation approach to adopt.²³ However, this does not mean that we would seek to, or consider it appropriate to, replicate the objectives, or the scope of Phase 2 levelisation.
- 5.45 In our February 2024 decision on levelisation of PPM/Direct Debit standing charges, we assessed our approach for potential Phase 2 debt levelisation against the following aims:
 - All customers that have the ability to build debt should contribute equally to debt-related costs. This aim sought to spread debt-related cost allowances between Direct debit and Standard Credit customers, with no costs spread across PPM customers.

²² 'Levelising' refers to making costs between payment methods more equal or equitable (but less cost-reflective).

²³ Ofgem (2024), Energy Price Cap: Operating cost allowances review, paragraph 4.106. <u>https://www.ofgem.gov.uk/consultation/energy-price-cap-operating-cost-allowances-review</u>

- The Standard Credit premium should be reduced but maintained to incentivise efficient payment methods. This aim sought to reduce the differential between Standard Credit and Direct Debit customers.
- 5.46 We have not assessed the current differential approach against the above aims. The current-differential approach does not aim for all customers that can build debt should contribute equally to debt-related costs. Neither does it rule out spreading debt-related costs across PPM customers. It also does not aim to reduce the differential between Standard Credit and Direct Debit customers.
- 5.47 Phase 2 levelisation could have resulted in moving away from the current differentials present within the cap. This is not the approach we have taken to set the forward looking allowance and we therefore do not consider that the current-differential approach levelises allowances. Additionally, through our cost recovery analysis, we find that current differential does not skew against some suppliers. Therefore, we do not consider a reconciliation mechanism is required when adopting (or continuing with) a current differential approach for the debt-related allowance.

Fuel type

Context

- 5.48 In our December 2024 policy consultation, we discussed the following options to allocate costs between fuel types:
 - Option A.1: equal allocation this would lead to equal allocation between electricity and gas.
 - Option A.2 (minded-to option): allocate based on bill size (using supplier-reported revenue) this would lead to a 67% and 33% split between electricity and gas.
- 5.49 We stated that, although our minded-to option used supplier-reported revenue as the source of bill size data, we could consider using other options such as the cap levels at benchmark consumption. Using cap levels as the source of the bill size would be less sensitive to fluctuations in actual consumption across historical periods. This would be relevant to gas consumption as it is sensitive to weather changes.

Decision

5.50 We have maintained our minded-to position to allocate the allowance across fuel types based on bill size. However, after taking into consideration stakeholder feedback, we have decided to use cap levels, instead of supplier-reported

revenue, as the source of the bill size to split revenues across fuel types. This leads to a 53% and 47% allowance split between electricity and gas, on a per customer basis.

Stakeholder response

5.51 One supplier disagreed with our proposal and called for the use of cap levels as the source of bill size. They also identified other factors to consider. Two suppliers agreed to our proposal of allocating costs between fuel types based on supplierreported revenue.

Considerations

- 5.52 One supplier stated that supplier revenues by fuel will reflect temporary weather conditions. They said this will bias supplier-reported revenues when used to determine fuel type splits. They stated that supplier revenues by fuel should reflect cap levels, Typical Domestic Consumption Values (TDCV), and customer numbers, and therefore called for allocating costs across fuel types based on these factors.
- 5.53 We have considered the factors of bill size, consumption and customer numbers in reaching our decision. We consider that debt-related costs tend to scale with a customer's bill size. Bill size for a customer will be driven by two factors the consumption patterns for each fuel and the rates charged for each fuel. Notwithstanding other key factors²⁴, as a customer's consumption increases, so will their bill size and therefore the impact if they fall into debt. Similarly, as the rates charged for each fuel increase, this will also impact debt levels. We therefore recognise that although fuel types do not directly drive debt-related costs, the amount customers consume of each fuel and the fuel rates they are charged can impact how debt costs are incurred.
- 5.54 We observe that although gas is cheaper than electricity on a £/kWh basis, on average, customers consume more gas than electricity, and therefore a customer's bill size is split broadly equally between gas and electricity.²⁵ This means, that on average, debt-related costs are likely to be incurred in the same proportions to the split between gas and electricity. The cap levels within the price cap (assessed at benchmark consumption) give us a good estimate of the broadly equal split of 53% and 47% for electricity and gas respectively. It also

 ²⁴ Factors such as affordability and vulnerability of consumers.
 ²⁵ DESNZ, (2024), National energy efficiency data-framework.
 <u>https://assets.publishing.service.gov.uk/media/66e0203ad65d5c23df086710/NEED-report-june-2024.pdf</u>

aligns with the underlying ratio of debt-related costs when comparing to the latest Social Obligations Reporting data²⁶.

- 5.55 Along with consumption levels, customer numbers will drive suppliers' revenues. We observe that, on average, suppliers have a greater number of customers on electricity than gas. Suppliers' historical revenue splits (in the most recent four quarters before our statutory consultation) between fuel types result in a split of 67% and 33% for electricity and gas respectively. This is due to a combination of the specific consumption pattern during this period of historical data (eg influenced by weather) and the ongoing differences in customer numbers between fuels. This means that if we were to allocate debt-related costs using this split, the average customer would be paying 67% of debt costs through their electricity bill even though only 53% of their expected bill (for a dual fuel customer at benchmark consumption) was due to electricity-heavy or single electricity fuel customers, as they would end up paying a greater proportion of their bill as debt-related costs than a typical customer.
- 5.56 Additionally, when we multiply customer numbers with the debt allowances using a 53% and 47% split between electricity and gas, we find that it maintains the characteristic from supplier-reported revenue of having most of debt being covered through electricity. Implementing this broadly equal split between fuel types results in 62.5% of debt revenue being recovered through electricity. We therefore consider that using cap levels as the bill size to be more appropriate in reflecting a customer's bill size, as well as maintaining the supplier-reported trend of having most debt revenue recovered through electricity.
- 5.57 We consider that using cap levels as the source of bill size will also be less sensitive to weather conditions than the use of supplier-reported revenue. We therefore consider that this approach mitigates against any disproportionate skew within the fuel type allocation as a result of weather conditions within any single year.

Tariff Type

Context

5.58 In our December 2024 consultation we presented two options in allocating debtrelated costs between tariff types:

²⁶ We have considered the average debt and arrears for each fuel that we multiplied by the number of customers in debt and arrears. We considered data up to Q3 2024.

- Option B.1: equal allocation.
- Option B.2: allocate all costs to default tariff customers.
- 5.59 Our minded-to proposal was to allocate debt-related costs equally between tariff types as we did not have complete data for tariff type splits.

Decision

5.60 We have maintained our minded-to position of Option B.1, and allocated costs equally between tariff types.

Stakeholder response

5.61 Two stakeholders disagreed with the equal allocation across tariff types. One stakeholder stated that assuming a zero differential between tariff types would be the incorrect conclusion as debt-related costs are higher for SVT customers. Both stakeholders stated that an equal allocation between tariff types would impact cost recovery due to SVT numbers reducing. They recommended that the methodology implemented in our COVID-19 temporary debt allowance for tariff types should be adopted.

Considerations

Zero differential between tariff types

- 5.62 One stakeholder stated that assuming a zero differential between tariff types is incorrect as there are a number of reasons why debt-related costs are higher for default SVT customers. They gave examples of a greater level of customer engagement and financial adeptness in the fixed tariff market, and stated that in part this is why suppliers can offer Fixed Term Contracts (FTCs) at a discount to the cap.
- 5.63 The principle we have used in allocating debt-related costs is based on the recognition that costs due to non-payment are inherently socialised from non-paying to paying customers. We have also recognised that additional working capital costs are an inherent feature of the Standard Credit payment method and therefore allocated these costs to be fully borne by customers on Standard Credit.
- 5.64 However, if we assumed a higher allocation of debt-related costs to SVT than for FTC customers, then this would be equivalent to transferring responsibility for bearing this shared cost from engaged customers on FTCs to less engaged customers on SVTs. We do not consider that this would be appropriate, because this is the dynamic that the cap was set up to prevent. We therefore have maintained the assumption of an equal allocation across tariff types.

5.65 Fundamentally, FTC pricing is outside the scope of the cap, and suppliers remain responsible for their own FTC pricing decisions.

Cost recovery impacts

- 5.66 Two stakeholders stated that assuming an equal allocation would impact cost recovery as customers move away from default tariffs. One stakeholder stated that setting the allowance based on total costs and recovering only over SVT customers would impact cost recovery, as more engaged, paying customers will likely move onto FTCs and this would result in higher bad debt costs per customer for SVT. One stakeholder disagreed that suppliers improving their efficiency could mitigate against under-recovery.
- 5.67 We recognise that customers will move between tariff types over time. However, as set out above, we do not consider it appropriate for SVT customers alone to bear the costs of non-payment.
- 5.68 Suppliers retain the ability to determine the pricing of their FTCs. We recognise that FTC pricing will be affected by competitive pressures, and that different suppliers will have different levels of debt-related costs. This may allow some suppliers to set their FTCs at a lower level than others. However, suppliers still need to price their FTCs responsibly.

Methodology for COVID-19 allowance

- 5.69 Two stakeholders recommended that the methodology adopted for the COVID-19 temporary debt allowance should be used for controlling for the difference between SVT and FTC customers. One stakeholder disagreed with the reason of not adopting the approach due to its low materiality.
- 5.70 The approach taken for our decision on the COVID-19 temporary debt allowance used revenue to control for SVT customers. We recognise that unit revenue will be lower on fixed tariffs than on SVTs, and that this may lead to revenue per customer being lower on FTCs. However, in light of our position that debt-related costs should be shared across customers, the choice of whether to adjust for revenue differences simply becomes a judgement about how these costs should be shared between FTC and SVT customers.
- 5.71 Adjusting for revenue would mean that average customers on different tariff types would pay the same proportion of their bill towards debt-related costs, whereas not adjusting for revenue would mean that customers (at benchmark consumption) would pay the same amount in pounds. For a forward-looking allowance, we do not consider that one approach would be clearly more

appropriate. Additionally, suppliers were unable to split revenue by tariff type consistently, and therefore we have limited confidence in the data provided. We therefore have maintained the approach of not adjusting.

Consumption and Meter types

5.72 We discuss below our decision for allocation across consumption and meter types. We have maintained the proposals set out in our December 2024 consultation for both allocations. We did not receive stakeholder responses regarding our proposals.

Consumption level

- 5.73 We have maintained our allocation proposal between the standing charge and unit rate set out in our December 2024 consultation. This allocates costs between the standing charge and unit rate using the following approach:
 - Credit bad debt cost allowances and all payment method debt-related working capital cost allowances are allocated using the current Payment Adjustment Percentage (PAP) allocation. This means the percentage allowance would not vary at the typical and nil consumption levels.
 - PPM bad debt cost allowance is fully allocated to the standing charge, similar to the ASC allowance. This means that the allowance will be calculated by applying the percentage allowance to the typical consumption level, and then also using the same value to set the allowance at nil consumption.
 - All payment method debt-related administrative costs allowances are allocated using the current allocation of the operating costs allowance. These allocations vary between gas and electricity.
- 5.74 We have maintained this approach as it would be complex to strictly follow the status quo allocation for the forward-looking debt allowance across the unit rate and standing charge. This is because the status quo in the price cap recognises debt-related costs across different operating cost allowances with different allocations across the unit rate and standing charge. We would have to estimate the exact proportion of each debt cost component that is captured within each allowance and consumption level, then apply these proportions to the forward-looking allowances. This would introduce additional complexity to the allocation at the risk of additional error.
- 5.75 We consider it is more reasonable to allocate the forward-looking allowance based on the allocation currently used for the allowance where the majority of each cost

component sits for a given payment method, as opposed to exact measures. This allows us to maintain the status quo as closely as possible whilst mitigating against unnecessary complexity that could lead to substantial error and unintended policy intentions.

Meter type

- 5.76 We have maintained our proposal of equally allocating debt-related costs at benchmark consumption between single-rate and multi-rate meters. We will set the same percentage values for bad debt and working capital for each meter type. We will set the same absolute value for debt-related administrative costs at typical consumption.²⁷ Given our decision on the update mechanism (see section 6), this means that the per-customer allowance for each meter type would scale with usage.
- 5.77 We have maintained this approach due to the lack of evidence that debt-related costs vary between meter types, beyond the variation in consumption. We consider that creating a differential unit rate between meter types will likely be complex and may lead to inaccuracies given the uncertainty in the evidence. Therefore, we consider it appropriate to adopt a simple approach by setting the allowances for bad debt and working capital in percentage terms equally across electricity meter types.

²⁷ As a consequence of our decision above to maintain the current operating cost allocation between nil and typical consumption for debt-related administrative costs, the allowances at nil consumption will differ slightly between single-rate and multi-register meters.

6.Implementation and update mechanism

Section summary

In this section we set out our decision on how we will implement the debt-related allowances in the cap and how the allowances will be updated over time. We discuss the stakeholder responses to our December 2024 consultation.

Implementation in the cap

Context

- 6.1 In previous sections we have discussed the decisions made to appropriately benchmark debt-related costs, using the latest data we received from industry. This sets an allowance at an aggregate level. We then set out how we have decided to allocate this aggregate level allowance to different customer types, such as across the various payment methods.
- 6.2 The price cap is comprised of various allowances that are calculated at a component level in the various annex models²⁸. The outputs from these models are entered into the DTC model which then calculates the relevant cap levels. As part of our December 2024 consultation, we shared a version of the DTC model²⁹.
- 6.3 When we implement an allowance in the cap, suppliers will eventually receive the allowance in pounds per customer. Some allowances in the cap are set in pounds per customer (eg network costs, core operating cost), while other allowances are indexed to other cap components (eg EBIT and headroom).
- 6.4 Setting a pounds per customer allowance may be a simpler approach and would make the allowance less volatile; for example, during the energy crisis, we saw an increase in the debt allowance. However, we consider that a rise in bills has an impact on bad debt costs, and vice versa, so setting a flat allowance may risk deviations between efficient costs and allowances.
- 6.5 We considered the method by which the allowance is updated would dictate how we would implement the allowance in the cap. For example, to update the allowance in line with the bill size, we need to set the allowance as a percentage

 ²⁸ Ofgem (2024). Energy price cap (default tariff) levels. https://www.ofgem.gov.uk/energy-policy-and-regulation/policy-and-regulatoryprogrammes/energy-price-cap-default-tariff-policy/energy-price-cap-default-tariff-levels
 ²⁹ Ofgem, 2024 Draft version of the Default tariff cap model (v1.24.1) https://www.ofgem.gov.uk/sites/default/files/2024-12/Draft Default tariff cap level v1.24.1.xlsx of revenue. Therefore, in our December 2024 consultation we proposed the following options:

- Option 1: Bill size Under this option we would index the allowance to other core cost components in the cap (ie wholesale costs, operating costs, policy costs and network costs). This means we would set the allowance as a percentage of revenue.
- Option 2: External indicators Under this option, we would use one or several indicators to update the allowance. As an example, we could update debt-related administrative costs with CPIH, while updating other debt-related costs with another indicator. Under this option, we could set the allowance as a percentage with respect to the indicator or as a pounds per customer.
- Option 3: Regular reviews Under this option, we would periodically review the allowance to consider whether it remains appropriate by recollecting supplier data and recalculating the ex-ante allowance. For avoidance of doubt, this option does not include ex post adjustments for under and over allowances between periods. Under this option, we could set the allowance as a percentage of revenue or as a £ per customer.
- Option 4: A combination of options 1 and 2 For example, we could scale the appropriate costs by bill size and link it to an external indicator. Under this option, we could set the allowance as a percentage of revenue or as a pounds per customer.

Decision

6.6 We have decided to select Option 4 from our December 2024 consultation. Under this combination, we would index the bad debt costs and working capital costs to other core cost components in the cap (ie wholesale costs, core operating costs, policy costs and network costs). To achieve this, after allocating bad debt costs and working capital costs across payment methods on a pounds per customer account basis, we will convert these two costs to percentages. Debt-related administrative costs will be set on a pounds per customer basis.

Considerations

Converting the allowances into percentages

6.7 When setting the debt-related cost allowance we consider how costs are incurred and how they may change relative to the bill size. For example, we consider that bad debt and working capital costs scale with the bill level, because if a customer who either does not pay or pays in arrears has a higher bill, we expect they would incur a higher debt or a larger payment in arrears. In these cases, we calculate the allowance as a percentage of other costs. In contrast, we do not expect debt administrative costs to be linked to the level of bill a customer pays, because we expect that costs are driven by the actions a supplier takes to pursue debt. We therefore calculate it as a flat cost in pounds per customer account.

- 6.8 To achieve this, we convert the bad debt costs and working capital costs allowances into percentages. In our December 2024 consultation we set out the methodological steps taken to do this³⁰.
- 6.9 To convert the allowances to a percentage, we divide them by the core cap allowances (wholesale costs, network costs, policy costs and operating costs), evaluated at benchmark consumption. We use these allowances because these are the ones we will apply the percentages to when calculating the allowances for bad debt and working capital post-implementation.
- 6.10 We adjust the operating cost allowance so that it is equivalent to the situation after implementation of the operating cost review. This reflects that we will apply the percentages to post-review allowances to set the future allowances for bad debt and working capital.
- 6.11 In the same way, we also exclude the adjustment allowance. While the adjustment allowance will remain by the time we implement the debt allowance, we exclude it to avoid overestimation, as it currently holds the extension of the float additional allowance for debt-related costs and the extension to the ASC bad debt cost allowance. As we mentioned in our December 2024 consultation, we set out to replace these existing debt allowances with the ex-ante enduring debt-related cost allowance from this decision.
- 6.12 For the denominator when calculating the percentage, we estimate the annual value using allowances based on the last full calendar year of data. This reflects that we want to ensure that the estimated denominator is not dependent on a single cap period but rather reflects the level of allowances observed over the last full calendar year of data. We therefore calculate the demand-weighted average annual cap level over 2024 (cap periods 11b 13a) for each payment method, fuel type, and electricity meter type.

³⁰ Ofgem (2024), Energy price cap operating cost and debt allowances consultation, Appendix 2, paragraphs 7.21 to 7.23.

https://www.ofgem.gov.uk/consultation/energy-price-cap-operating-cost-and-debtallowances-consultation

- 6.13 To calculate the demand-weighted average, we use the latest estimated demand shares for each quarter of the year as used to calculate the cap in cap period 13a. We consider that these estimated demand shares across the year, on a quarterly basis, are appropriate as they are sourced from the last period of the latest full calendar year of data. In the case of electricity consumption, we estimated the annual weighted average by customer numbers with single-register and multiregister electricity meter observed in cap 13a in the SVT market.
- 6.14 These conversion steps are not required for debt-related administrative costs, as these costs are not linked to the level of bill a customer pays. It will be implemented as a pounds per customer amount. Further details on how each cost component will be updated over time are set out below.
- 6.15 When the percentage conversion has been carried out, the three debt-related cost components are inputted into the DTC model as the baseline values. These baseline values will be used for cap updates over time, the details of which are set out below.

Updating the allowances

Context

- 6.16 In addition to setting the baseline allowance, we need to consider how to update it over time to best reflect changes in costs.
- 6.17 In our December 2024 consultation we evaluated the options mentioned in the context section of section 6 under the following criteria: (i) accuracy, (ii) feasibility, and (iii) independence of supplier behaviour. We also considered other criteria: (iv) future changes in costs, and (v) consistency across cost components.
- 6.18 When updating the debt-related cost allowance we intend to implement the most appropriate update approach to ensure that it leads to a reasonable approximation of future costs. This will ensure customer protection while allowing efficient cost recovery.

We acknowledge that debt-related costs are driven by various factors, such as bill size, inflation, changes in the regulatory landscape, and wider macroeconomic conditions. However, setting an ex-ante allowance to accurately capture the change in efficient costs over time is inherently challenging, particularly when external factors influence these costs. While the update mechanism of this allowance may not be able to account for all the possible external factors, we aimed to develop a mechanism that would allow the debt-related allowance to change over time, broadly reflecting the efficient costs of a notional supplier over time.

Decision

- 6.19 We consider the method by which the allowance is updated would dictate how we would implement the allowance in the cap. For example, to update the allowance in line with the bill size, we need to set the allowance as a percentage of revenue.
- 6.20 We have decided to maintain our minded-to position and implement the following options to update the debt-related cost allowance:
 - To update the bad debt and working capital costs using Option 1: Bill size.
 This is similar to the status quo, where most of these costs are updated using bill size.
 - In addition, to update the working capital cost allowance to align with changes to the EBIT cost of capital. This is to maintain consistency with the EBIT allowance. This is because we intend to reallocate the working capital allowance already provided in the EBIT allowance across payment methods.
 - To update the debt-related administrative costs in line with CPIH, similar to the status quo. This is because our analysis suggests that debt administrative costs tend to align with inflation.

Stakeholder response

- 6.21 We received seven responses from suppliers to our proposed mechanism for updating the debt-related cost allowances. Broadly, the seven suppliers were in favour of our proposals and highlighted the greater transparency of this update mechanism.
- 6.22 Debt-related costs are particularly influenced by external factors and suppliers that agreed with our proposals made some suggestions to ensure the allowance remains adequate in an economic context which remains uncertain. Several suppliers proposed to keep the debt-related cost allowance under close regular review in response to the uncertain context.
- 6.23 Other suppliers said that the relationship might not remain the same between bad debt costs and energy costs and we should monitor this relationship moving forward.
- 6.24 Some suppliers said that debt costs are more prone to sudden upsets because of external factors, which might require reviews and ex-post adjustment mechanisms. Suppliers asked for clarity on the timing of these reviews and processes.
- 6.25 Two suppliers said that while they are not opposed to the proposed update mechanism. Also, they said that they have been unable to review how the pounds

per customer allowance produced by the disclosed debt model will be applied in practice.

Considerations

- 6.26 Section 4 discusses the baseline period we have used to benchmark industry costs when setting the updated debt-related cost allowances. The latest data available shows an increase in levels of debt-related costs incurred by suppliers relative to historical levels, with these costs potentially reaching their peak across 2023. Relatively lower levels of costs have been seen throughout 2024 compared to this potential peak. We consider the primary driver of debt-related costs to be customer affordability, and we acknowledged that many customers are still facing financial challenges with likely high debt costs. We therefore used the latest data available to select a baseline period that we consider the most appropriate reflection of future costs.
- 6.27 By looking at the way energy costs and the different components of the debt costs fluctuated during the cost-of-living crisis, we found that the principle of the proposed update mechanism remained adequate. Our analysis found that energy costs were correlated to the bad debt cost and working capital costs, while debt-related administrative costs were correlated to CPIH.
- 6.28 We will monitor the evolution of debt-related cost through the DRC RFI which will help us monitor any material or systematic changes in costs over time. The Domestic Gas and Electricity (Tariff Cap) Act 2018, which underpins the energy price cap, provides us with the ability to review and adjust the components of the cap, including debt cost allowances. We have already demonstrated this capability through this review of operating cost allowances as well as the implementation of the float additional allowance for debt-related cost.
- 6.29 Given that we consider that our baseline is appropriate, we consider that monitoring is an adequate approach to determining if, and when further reviews are required.
- 6.30 We are mindful that further scheduled in-depth regular reviews would also be resource intensive for all stakeholders involved. The operating cost review has taken two years to complete, and involved in depth participation from stakeholders. During this time, many stakeholders have responded in detail to each review phase along with the regular monitoring of industry costs based on suppliers' data submissions. We do not consider it to be beneficial to repeat this in-depth process on a frequent basis, which reflects our aim to set a stable and enduring allowance.

- 6.31 As for the core operating costs, we may consider an overarching review if the cap is in place for a longer period (eg similar in time to the difference between the introduction of the cap and this operating cost review).
- 6.32 We consider this approach, alongside the remainder of our approach to setting the core operating cost allowance, to account for foreseeable uncertainties, promote efficiency improvements over time, and increase regulatory stability.

7. Other considerations

Section summary

In this section we aim to give more transparency on how working capital interacts with the debt allowance. We also use this section to communicate our potential approach to a 'True-up' review and ongoing monitoring of debt-related costs.

Treatment of working capital

7.1 Stakeholders raised concerns about the transparency of how we proposed to estimate working capital costs, and how this interacts with the EBIT allowance, and the Float allowance. We address these concerns in the following sections.

Interactions with EBIT allowance

Separation of working capital costs between EBIT and Debt-related allowances

7.2 One stakeholder stated that it was unclear whether Ofgem intended to maintain debt-related working capital costs as part of the EBIT allowance or move these costs under the new ex-ante debt-related cost allowance in the future. They said that, in practice, suppliers' recovery of working capital costs is not dependent on the debt-related cost allowances, but on the EBIT allowance that Ofgem has not updated in this process. Another stakeholder stated that working capital costs should be addressed through the EBIT allowance.

Considerations

- 7.3 We have historically addressed working capital costs in the price cap across three allowances that carry out three mechanisms:
 - A mechanism that provides a rate of return on capital employed this is done through the EBIT allowance. Since the introduction of the cap in 2019, the EBIT allowance has assumed a level of working capital that covers notional suppliers' business as whole, with no differential between payment methods applied. In our August 2023 decision for amending the EBIT allowance,³¹ we stated that the risk of additional bad debt costs (ie beyond normal levels), including related working capital costs, is omitted from the working capital

³¹ Ofgem (2023), Amending price cap methodology for Earnings Before Interest and Tax (EBIT) allowance decision, paragraph 4.45.

https://www.ofgem.gov.uk/decision/amending-price-cap-methodology-earningsinterest-and-tax-ebit-allowance-decision

estimations assumed in the EBIT allowance. We considered that if such risks materialised, they would be covered by separate allowances in the cap.

- A mechanism that adjusts the price cap allocation to account for working capital differences across payment methods - this is currently done by the Payment Method Uplift. Since the introduction of the cap in 2019, we recognised that on average, relative to direct debit, suppliers can incur additional working capital costs required for Standard Credit customers, who pay in arrears. We therefore decided to allocate the additional working capital costs to Standard Credit through the Payment Method Uplift. In effect, this adjusted the assumption of no differentials in working capital costs across payment methods in the EBIT allowance.
- A mechanism that introduces a new allowance that provides for changes in debt-related costs. In February 2024, we introduced a temporary float allowance to the cap to allow for the increase in debt-related costs over existing cap allowances. This increase was driven by an increase in bad debt costs. Our benchmarking indicated that working capital costs had reduced.³² The float therefore did not provide any additional allowance for working capital in fact, the contribution of working capital was negative.
- 7.4 As outlined in our Overview, we have decided to restructure the operating cost allowances to provide greater transparency of where various types of costs are captured. Through this, we have sought to create a like-for-like comparison of existing allowances to the new structure. The Debt-related cost allowance absorbs the mechanism that accounts for working capital differences between payment methods (ie the second mechanism above). Given that we have adopted the current differential approach for allocation between payment methods, this means that we have maintained the allocation approach adopted in the Payment Method Uplift and allocated all working capital costs to Standard Credit .
- 7.5 The debt-related cost allowance does not provide an additional allowance for working capital costs, but only adjusts for the differential in costs between direct debit and standard credit that is not considered within the EBIT allowance. We have therefore maintained the historical separation across allowances in the treatment of working capital costs.

³² Ofgem (2024), Energy price cap: additional debt costs review decision, Table 5.3. <u>https://www.ofgem.gov.uk/decision/energy-price-cap-additional-debt-costs-review-decision</u>

Alignment of working capital estimates between EBIT and Debt-related allowances

7.6 One stakeholder said that we had likely significantly overstated the element of the EBIT allowance that is related to debt-related working capital costs. They said that if actual working capital costs exceed those assumed in the EBIT allowance, there is a risk of undercompensating suppliers. They recommended that we calculate the overlap with EBIT more precisely to ensure that the full working capital costs are included in the price cap. They said that this would involve inferring the quantity of debt-related working capital costs from the EBIT methodology or estimating debt-related working capital costs using the same period (Oct 2020 – Sept 2022 RFI) used to estimate working capital in the EBIT allowance.

Considerations

- 7.7 As outlined above, there has always been an overlap between the overall working capital assumed in the EBIT allowance, and the adjustment for working capital differences between payment methods in the Payment Method Uplift. When we set the cap originally, we included an adjustment through the Payment Method Uplift to mitigate against double counting, but this did not involve a precise calculation of the amount of working capital included in the EBIT allowance. Therefore historically, we have not considered that exact alignment is required between the debt-related working capital costs assumed in the EBIT allowance and the mechanism by which we adjust working capital differentials between payment methods.
- 7.8 Since our update of the EBIT methodology in August 2023, the EBIT allowance is based on a modelled approach. The working capital required was based on a model that estimates the notional efficient supplier's capital employed requirements using simplifying assumptions. The model aggregates the working capital costs across a supplier's business and models the average level of working capital that a notional supplier would need to maintain to remain financeable across a range of wholesale price scenarios. It does not seek to isolate working capital related to customer payments (payment in arrears and bad debt) from working capital costs as a whole. We therefore cannot reasonably use the working capital model for the purpose of estimating debt-related working capital costs in isolation.
- 7.9 As stated above, the level of working capital assumed in the EBIT allowance is a modelled estimate and not derived from historical data on suppliers' working

capital. We therefore do not consider it appropriate to align the time period of the historical data used to calculate debt-related working capital with the input data used for modelling the EBIT allowance. Nonetheless, for completeness we have estimated debt-related working capital costs across October 2020-September 2022 as a sensitivity check using the DRC RFI.

- 7.10 We do not observe a material difference between the estimate used across our selected baseline period [£11.2/customer] and that of October 2020-Sepetember 2022 [£12.3/customer].³³ Therefore, we do not consider that our approach in estimating the debt-related working capital costs significantly overstates the corresponding element of the EBIT allowance.
- 7.11 Additionally, we have used the latest DRC RFI to estimate the proportion of debtrelated working capital costs and consider this gives the best view costs across the period of time where customer debt levels have been increasing. Therefore, we consider that the proportion of debt-related working capital costs that we have allocated to Standard Credit payment method is broadly representative.

Verification of working capital estimates in Debt-related allowance

7.12 One stakeholder stated that the lack of transparency in our approach has not allowed them to verify whether we have correctly adjusted the debt-related cost allowance for the debt-related working capital cost covered by the EBIT allowance.

Considerations

- 7.13 We provided the methodological steps used to estimate the cost per customer and benchmark costs in our December 2024 consultation. This included how the annual net working capital cost per customer account per supplier is estimated and benchmarked. We provide a summary of the steps below:
 - From the DRC RFI, we calculate the average of each of account receivables and account payables by taking the average of the beginning of the respective period and at the end of the respective period across the baseline period.
 - We multiply the average of account receivables and account payables by the cost of capital assumption used for working capital of 12.8%. We also multiplied it by the fraction of the year covered by the periods considered in our baseline.

³³ Estimates for SVT tariffs. We found no material difference in working capitals between tariffs.

- We then calculate the net working capital cost by subtracting the gross account receivables from the gross account payables. This gives the net account receivables for each supplier.
- We divide the net working capital cost by the respective average number of SVT customer accounts. This gives the annual working capital cost per customer across the baseline period for each supplier.
- We take the weighted average of the annual working capital cost per customer across the sample of suppliers selected. This gives us the benchmarked £22/customer estimate for debt-related working capital costs.

Interactions with Float allowance

7.14 One stakeholder stated that non-customer working capital should not be included in the calculation of debt-related working capital for the operating cost review. Additionally, it said that we should provide a fuller explanation when it comes to the final true-up exercise (for the float allowance) for how working capital costs are estimated.

Considerations

- 7.15 Non-customer working capital is not factored into the calculations for estimating debt-related working capital costs for the operating cost review.
- 7.16 For the float allowance, non-customer working capital is factored into the calculations. This is because the float involves a comparison between suppliers' costs and the existing EBIT allowance. The EBIT allowance covers working capital costs as a whole (customer and non-customer). Therefore, to isolate the net additional working capital costs required for the float allowance from what is already provided for through the EBIT allowance, we consider all customer and non-customer related working capital in the calculations.

Debt true-up & ongoing monitoring

- 7.17 In our December 2024 consultation, we discussed the wider picture of debt within the domestic energy market, informed by our monitoring of both consumer debt and arrears, and also debt-related costs data that we gather direct from industry.
- 7.18 As set out in section 2 of this document, consumers are continuing to see high levels of debt and arrears. A separate area of work is looking at how the issue of historical debt and arrears accrued during the gas crisis can be addressed,

potentially targeting funds at alleviating the debt accumulated during the crisis by customers with the most severe affordability challenges.³⁴

- 7.19 In terms of additional costs that suppliers have incurred, since 2022 there has been a material and systematic change in these costs compared to the permanent cap allowances. This led to us introducing a temporary float allowance for the efficient additional debt-related costs incurred between April 2022 and March 2024.
- 7.20 This allowance was backward looking (ex post) and was initially recovered from bills between April 2024 to March 2025. In our December 2024 consultation we consulted on extending this temporary float allowance and have since published a decision in February 2025 to extend it until the operating cost review is implemented.³⁵
- 7.21 We also discussed in the December 2024 consultation the emerging evidence of further under-recovery of debt-related costs since Q2 2024 ('allowance gap'), which may continue until the forward-looking allowance for debt-related costs is implemented. The extension of the temporary float allowance is intended to bridge the gap until the implementation of the operating costs review, as suppliers continue to incur efficient costs above what is allowed for by the permanent debt-related costs allowance.
- 7.22 We have previously signalled our intention to carry out a 'true-up' review of the temporary float allowance. In our December 2024 consultation we proposed to delay and extend the true-up exercise, given the need to observe a longer period of actual data following our extension of the float, and the need to account for any interaction between any potential debt relief scheme and the cap.
- 7.23 There are multiple factors it may be appropriate to take into consideration as part of any extended future debt-related costs true-up exercise. We are not aiming to define the full scope of a true-up at this stage, until we have more clarity. However, the below may serve as an indication of some of the considerations we may aim to view in the round:

³⁴ Ofgem (2024), Resetting the energy debt landscape: the case for a debt relief scheme <u>https://www.ofgem.gov.uk/consultation/resetting-energy-debt-landscape-case-debt-relief-scheme</u>

³⁵ Ofgem (2025), Additional debt-related costs adjustment allowance extension decision <u>https://www.ofgem.gov.uk/sites/default/files/2025-02/Energy-price-cap-additional-debt-related-costs-extension-decision.pdf</u>

- Allowance gap: Suppliers have been continuing to incur additional debtrelated costs. As set out in our December 2024 consultation suppliers have incurred around £195m additional debt-related costs from April 2024 to September 2024.
- Float allowance extension: Extending the float will help to bridge the gap until implementation of the operating costs review, avoiding a step down in allowances and allowing suppliers to recover additionally incurred costs.
- Analysis of initial 'float' allowance: As set out in our December 2024 consultation, based on the actual data observed, we consider that the £31 per customer per year temporary float allowance set in the cap was broadly appropriate. However, we noted that it has allowed suppliers to over-recover costs by around £2.50 per customer per year. We may also consider wider feedback received through the consultation and disclosure process.
- **Debt relief scheme**: The implementation of any such scheme may have interactions with the debt allowances in the cap, which may likely be appropriate to take into account as part of any true-up.
- 7.24 We acknowledge stakeholder responses to our December 2024 consultation which commented on the methodological approach used for the float allowance. As set out in our February 2025 decision on extending the float allowance, we still consider the current methodological approach taken for the float allowance to be appropriate for the purposes of a temporary adjustment to the existing allowance for debt-related costs.
- 7.25 We do not consider it appropriate at this stage to review the float allowance methodology, either for the extension period or on a backward looking basis. Any true-up review, which could include a review of the float methodology, requires careful balancing. Uncertainty remains over the eventual scale of debt-related costs, along with a basket of factors such as the ones set out above, that may be viewed in the round.
- 7.26 We may also take into consideration feedback received through the wider consultation process. For example, as part of the disclosure process, feedback resulted in the highlighting of an issue with the modelling that may have impacted the float allowance, with initial assessment indicating a benefit to industry.
- 7.27 So, while industry may be incurring additional debt-related costs currently, it is worth noting that any true-up would likely take into account factors that have also been benefitting industry. This means that any true-up review carried out

could indicate either an upward or downward adjustment to allowances. If there is evidence of a material and systematic departure between the costs and the allowances for the period assessed, then we may consider implementing a trueup adjustment.

- 7.28 Given the uncertainty over how industry debt-related costs will progress, we intend to continue to monitor this data over time, along with the wider debt and arrears indicators. We intend to use the latest appropriate data to inform any true-up review. The timing of any true-up will likely be dependent on when this data becomes available. For example, we will not know the scale of any allowance gap until later this summer. Also, the timing of any true-up may need to align with when the interactions with the debt relief scheme are more fully understood.
- 7.29 Any true-up exercise would look to true-up over a period from April 2022 and we will establish an end-date in due course, once we have the information needed to form a more settled view on the interventions that we would be looking to collectively true-up.

Annex A: Phase 1 Levelisation Review

In our February 2024 decision to 'levelise' standing charges between PPM and Direct Debit consumers (Phase 1), we committed to reviewing the 'impact and operation' of this policy within a year of implementation (Review).³⁶ In December 2024, we consulted on the proposed scope, evaluation framework, and a draft Request for Information (RfI) for the Review (December 2024 publications.)³⁷

We received six responses from stakeholders and welcome the technical feedback on the proposed evaluation questions, metrics, and design of the RfI. We note that some respondents set out broader concerns regarding the sequencing, timing, and proposed scope of the Review. One respondent called on Ofgem to pause the Review and reconsider our position on Phase 2 levelisation. We also note one respondent expressed a view that the proposed Review scope did not sufficiently consider a counterfactual in which Phase 1 was not introduced. Two respondents suggested that a retrospective Review focused on the first year of implementation risked failing to capture the enduring benefits or unintended consequences of Phase 1 respectively.

Having considered this feedback and our Phase 1 policy aims, we are pausing the Review until next Winter at the earliest. In our February 2024 decision, we set out our policy aim that Phase 1 should be 'enduring and responsive to policy changes'. In our December 2024 publications, we proposed this aim would be a key metric by which we evaluate the effectiveness of Phase 1. Importantly, there are currently multiple reviews and policies in development by Ofgem which may impact our approach to evaluating Phase 1:

 We have recently consulted on introducing a zero standing charge price cap variant, and are now considering running a trial before any implementation.
 We will consider how this policy would interact with Phase 1 and whether a price cap variant should be levelised.³⁸

³⁶ Ofgem (2024), Decision on adjusting standing charges for Prepayment Customers. <u>https://www.ofgem.gov.uk/decision/decision-adjusting-standing-charges-prepayment-customers</u>

³⁷ Ofgem (2024), Levelisation phase 1 review: next steps.

https://www.ofgem.gov.uk/call-for-input/levelisation-phase-1-review-next-steps ³⁸ Ofgem (2025), Introducing a zero standing charge energy price cap variant. https://consult.ofgem.gov.uk/energy-supply/introducing-zero-standing-charge-variant/
- We have launched a cost allocation and recovery review to consider fairer, more efficient, and simpler ways of recovering costs in the energy system.³⁹
- We have recently consulted on the introduction of a Debt Relief Scheme to support eligible consumers who accumulated debt during the energy crisis.⁴⁰

We consider it will provide stakeholders with more clarity to conduct the Review after we have progressed these policy areas further and considered how these workstreams may impact Phase 1 in the future. Furthermore, we consider increasing our observation period for the Review will allow for a more thorough assessment of the impact on Phase 1 on consumers and competition. This will allow us to better assess the potential enduring impacts of levelisation than through a retrospective Review focused on the first year of implementation.

³⁹ Ofgem (2025), Recovering the costs of energy infrastructure investment from customers. <u>https://www.ofgem.gov.uk/blog/recovering-costs-energy-infrastructure-investment-customers</u>

⁴⁰ Ofgem (2024), Resetting the energy debt landscape: the case for a debt relief scheme. <u>https://www.ofgem.gov.uk/consultation/resetting-energy-debt-landscape-case-debt-relief-scheme</u>