

Ofgem
10 South Colonnade
London
E14 4PU

06/02/2025

Dear Price Protection Team,

We are responding to Ofgem's consultation on the energy price cap operating cost and debt allowances.

Key points:

- Energy UK welcomes Ofgem's move from a lower quartile to a weighted average benchmark on operating and debt costs, and the rationale for seeking to ensure adequate supplier recovery of their efficient costs.
- Energy UK also agrees that the indexing of costs to CPIH will help support the adequacy of allowances but this does not remove the need to account for additional upward cost pressures. The retail energy policy and regulatory landscape continues to evolve, with wide-ranging and complex changes likely to occur in the short to medium term.
- Limited information on future costs of new policies and regulations does not mean that there will not be additional and material increases in operating costs. Ofgem should clearly signpost the route to reviews to ensure the adequacy of the allowance.
- Energy UK broadly supports the position reached on the debt allowance, including that it remains under review based on the systematic and material test.

Core operating costs

It is welcome that suppliers' operational efficiency improvements are recognised by Ofgem. They are a testament to hard work and innovation. However, there is insufficient evidence of sustained cost over-recovery, given the complex allocation of costs and the broader context of £4 billion of supplier losses under the cap between 2019 and 2023¹. There is also insufficient certainty about future costs to be confident in reducing the operating cost allowance.

¹ [Times \(2023\) Ofgem boss Jonathan Brearley: We'll clamp down on energy firms making excess profit](#)

Using a 2023 baseline and a weighted average benchmark for operational costs represents an imperfect but broadly fair compromise of a stabilising market as a basis for costs. Suppliers likely faced costs above their historical average operational costs in 2023 due to the impacts of the energy crisis, including customer bad debt and arrears growing by around 50% (£1 billion). However, the ongoing pressures caused by the crisis and the sector's efforts to raise standards mean elevated costs will continue over the medium-term.

Further, the benchmark does not reflect the impact of upcoming costs that may be disproportionate to CPIH, such as the increase in National Insurance Contributions and National Living Wage.

The plan to only increase the operating cost allowance by CPIH inflation risks cost under-recovery in the future. Energy UK supports Ofgem's intent to deliver a more stable allowance and agrees that indexing allowances will support its adequacy to meet an industry average impact of inflation. However, this does not remove the need to account for additional upward cost pressures. As a result, the current proposal is at odds with the high level of uncertainty about suppliers' specific future costs and obligations.

There is a dramatic pipeline of policy and regulatory change that may impact operational capability requirements, including: DESNZ and Ofgem proposed changes to the role of the price cap and default tariffs; the implementation of a debt relief support scheme; debt standards reform; warm home schemes; metering complexities on RTS and 4G; and possible regulatory framework changes for smart metering and the market-wide half-hourly settlement programme.

Given the complexity of some of these policies and regulations, such as debt reduction and price cap reform, it is difficult to see how Ofgem can have confidence that the ongoing cost of delivering high-quality customer service will not rise faster than the indexed 2023 baseline.

The diverse range of regulatory and evidence development for changes to the price cap themselves increase operational demand, with the number of annual RFIs rising from the tens in previous years to several hundred in 2024. Even before delivering changes, building the evidence for change is impacting supplier confidence in regulatory continuity. This was experienced under the previous operating costs allowance and would be felt more sharply under the proposed allowance, given the existing implementation tasks faced by suppliers and those to be planned for.

Anticipating the future recovery of what constitutes efficient operating and debt costs of energy suppliers is complex when what constitutes an efficient supplier operation is changing so frequently. Suppliers must consider recent changes working through their systems, anticipated upcoming changes and the cumulative impact of multiple potential changes, all while trying to find the resources for product and tariff innovation for their customers, in line with their specific business models. The high

level of uncertainty about efficient future supplier core operating costs means that Energy UK would expect Ofgem to keep the allowance under regular review.

Reviewing efficient operating costs

Ensuring that the core operating cost allowance remains adequate while still representing efficient costs for consumers requires planning for reviews and updates of the allowance to be as predictable and prompt as possible.

The ascertained additional costs adjudged through individual impact assessments of significant changes to the cap should be straightforward for suppliers to recover. Ofgem should consider setting materiality parameters such that when an upcoming policy or regulation (or combination of multiple policies and regulations) meet a cost threshold, the core operating cost allowance is adjusted accordingly.

This should be as mechanistic as possible to support supplier cashflow and speed of response to policy and regulatory change. This process should account for cumulative impacts, where implementation of one change incurs cost, which may not be material on its own, but taken with other changes within the same period, does amount to material cost that triggers an adjustment.

If you have any questions or considerations that it would be helpful to discuss then we would welcome the opportunity to discuss further.

Kind regards

Ed Rees

Head of Retail Policy, Energy UK