

By email:  
debtconsultations@ofgem.gov.uk

06 February 2025

**Ref: Resetting the energy debt landscape: the case for a debt relief scheme consultation**

Dear Ofgem,

This response is from SP Energy Networks (SPEN). SPEN owns and operates the electricity distribution networks in the Central Belt and South of Scotland (SP Distribution plc) which serves two million customers, and North Wales, Merseyside, Cheshire and North Shropshire (SP Manweb plc) which serves one and a half million customers. We also own and maintain the electricity transmission network in Central and South Scotland (SP Transmission plc).

We welcome the opportunity to contribute to Ofgem's consultation, focusing on whether to introduce a debt relief scheme for customers. In preparing our response we have worked closely with other network companies through the ENA. The ENA has provided a response<sup>1</sup> on behalf of all members setting out our concerns in summary which we explore in more detail below.

In summary:

- We recognise the negative impact on customers and supply companies resulting from the cost of energy crisis. We are therefore supportive of Ofgem and government seeking to identify viable interventions to address these issues and considering the option of using a debt relief scheme.
- However, affordability is not a one-off issue and as such must be addressed for the long-term. A debt support scheme as set out in the consultation isn't a sustainable solution as it represents a reactionary short-term sticking plaster to the wider structural issues that exist within the retail market.
- The published consultation fails to recognise consideration of a solution funded by government and we consider this should be explored as a priority as the preferred solution to ensure that the correct support is given to consumers (either directly or via a social tariff)
- Failing this we believe that the supplier led delivery option would be best placed to deliver the objectives Ofgem have set out in the consultation while providing Ofgem the opportunity to remedy the structural issues that currently exist within the wider price control cap bad debt methodology.
- We do not believe that a networks delivery option is the right course of action as this would increase contagion risk at a point where investability/financeability in networks has never been more of a priority and would be inconsistent with the current regulatory and legal ring-fencing framework.

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<sup>1</sup> ENA Response – Debt Relief Scheme 060224

- If Ofgem does push on with a networks option this must be on a PAYG approach, with all network companies contributing equally and all consumers providing equal contributions regardless of their location or fuel type.
- We are disappointed that Ofgem's consultation and impact assessment fails to include a wider suite of viable options as the first hurdle for any proposed scheme is that it must be better than any reasonable alternative interventions, not just the baseline.

### **Case for Change/ Considerations and Objectives**

We fully recognise the negative impact on consumers and supply companies resulting from the cost of energy crisis; creating material bad debts which continue to escalate outside of what could be considered acceptable levels. We fully support Ofgem and government seeking to identify viable interventions to address this. However, we are concerned that a solution involving networks financing this debt write-off, and subsequently recovering the amounts through network charges, is not a viable option due to the adverse risk to network operators (NWO's) financeability and cost of capital as well as the legality of such a scheme.

Furthermore, we believe that Ofgem must consider the proposed debt relief scheme in the context of general levels of affordability for consumers as one cannot be remedied without the other in our opinion. Affordability to pay is a wider societal problem reflecting today's need to properly help those in poverty – and for those people, energy bills are only one cost that they are struggling to meet. As such, it is a problem that the welfare system needs to address. To the extent that it is Ofgem's problem to resolve itself, the best tool it has at its disposal is a social tariff.

Solving the problems via the introduction of a social tariff would lead to additional benefits that would impact the wider energy system. For example, when considering the need to sanction a modest increase in network costs to fund significant increases in investment that will enable decarbonisation, stimulate economic growth and drive overall energy costs down in the long-term, Ofgem would be free to make the right choice for the system as a whole, without any need to contemplate distorting the outcome in an attempt to manage the impact on those customers it considers would find it difficult to afford even a modest increase in network charges.

This demonstrates that affordability is a longer-term problem and needs to be addressed in such a way that it is sustainable. The absence of a long-term approach risks creating a barrier to unlock the investment needed to deliver net zero. Otherwise, we believe that implementation of an inadequate solution such as the debt relief scheme in isolation would only act as a reactionary short-term sticking plaster to the wider structural issues that exist within the retail market.

We are sceptical of Ofgem's view that the current debt and arrears issue has stabilised as we continue to see energy bills remain stubbornly higher than the pre-crisis equivalent. As such if the proposed scheme only looks to tackle debt accumulated during the energy crisis, we are not of the view that it will lead to lasting improvements to the current level of indebtedness within the wider retail market (i.e. if energy prices increase or fail to reduce to previous levels).

## **Funding Options**

We are disappointed that Ofgem's consultation and impact assessment fails to include a wider suite of viable options as the first hurdle for any proposed scheme is that it must be better than any reasonable alternative interventions, not just the baseline.

### Government Solution

In particular, we believe a well-designed government funded solution would best fit the short-term timescales identified by Ofgem while also providing an enduring fix to wider energy market issues (i.e. affordability) and as such should be explored as a priority as the preferred solution. If the principal objective of the scheme is to alleviate household debt, this could be achieved and funded through general taxation with relief dispersed by government directly to those in need as demonstrated through recent government interventions. This would achieve the aims set out by Ofgem for such a scheme which is to ensure cost neutrality while socialising the cost of debt to fund the debt support while also providing longer-term, targeted support, in a more cost-effective way. We believe this represents a cheaper, more cost-effective solution than the alternatives included within Ofgem's initial impact assessment.

### Supplier Funded Solution

Failing this, a Supplier funded solution would also meet the enduring criteria but may require longer timescales to fully implement as it should look to also fix the wider structural issues present within the retail market. If this solution was to be implemented, it is paramount that customers do not pay twice where suppliers have already been funded for written-off debt.

Ofgem already has an existing mechanism within the retail regime that could be used to implement such as scheme via the debt allowance element of the retail energy price cap (and by extension a process to undertake reconciliation payments between suppliers). For example, a supplier pool funded as an extension to the existing price cap mechanism via a new and separate DRSS cap solution with additional money raised through customer bills and subsequently used to directly fund the supplier pool.

Such an approach would also provide additional benefits as it would allow for correcting failures in the existing regressive price cap mechanism which involves debt allowance payments provided on an untargeted basis as, in accordance with statutory requirements for the price cap, all suppliers receive the same allowance regardless of the level of consumer debt in their portfolio and differences in the effectiveness of their own debt recovery processes. While this incentivises debt recovery by suppliers, the existing design of the price cap-based approach does not account for the varying levels of debt in customer bases of different suppliers and as such would benefit from being recalibrated as part of the proposed wider intervention.

There are significant drawbacks to the current approach to bad debt allowances in the cap, primarily that it does not directly help those in debt (i.e. this does not directly translate to customer relief). Debt related costs are not paid for by all consumers equally, rather these differ, particularly according to payment type. Levelling the debt related costs of Standard Credit (SC) customers by socialising prices across payment types (levelisation) was an Ofgem initiative (paused earlier this year) aimed to address this issue. A supplier led DRSS

would allow Ofgem to pursue this initiative and achieve more fairness for general consumers.

Ofgem within the consultation has highlighted that some suppliers have argued that further intervention on debt is not needed and instead suppliers need to be better at managing debt. This further points to wider failings of the current mechanism within the retail market and as such is a direct reason as to why a networks solution is not viable as this would transfer stress between each sectors balance sheets (contagion risk), at a time when all available network resources should be concentrated on the generational challenge of getting the network ready for net zero.

If this option is chosen it would be important to provide transparency to consumers about the levels of funding being provided through the price cap methodology (and ideally make this visible on consumer bills). This would also be important for the networks funded solution where this cost should be made visible and not hidden within wider networks charges. This would help promote the stated objectives of a debt relief scheme which is to repair damaged broader trust in the sector at a time when the market needs to focus on significant reform and transition towards net zero objectives while providing an opportunity to build relationships between consumers and their suppliers.

#### Network Funded Solution Issues

NWO's should not be exposed to risks in the retail supply market. If Ofgem is to further consider exposing networks to these risks, it must first:

- Set out clearly why it is the best option;
- Explain how such a scheme is lawful; and
- Mitigate contagion risk as far as possible – NWO's must be cashflow neutral.

We are concerned there are viable arguments that the proposed networks scheme could be contrary to Article 18(1) of Regulation (EU) 2019/943 (retained EU legislation), which states:

*“Charges applied by network operators for access to networks, including charges for connection to the networks, charges for use of networks, and, where applicable, charges for related network reinforcements, shall be cost-reflective, transparent, take into account the need for network security and flexibility and reflect actual costs incurred insofar as they correspond to those of an efficient and structurally comparable network operator and are applied in a non-discriminatory manner. Those charges shall not include unrelated costs supporting unrelated policy objectives.”*

We also have concerns that the proposals could be contrary to section 7(3A) of the Electricity Act 1989 which places restrictions on the types of conditions Ofgem can included in licences. In addition, the proposal could also risk unwinding the ring-fencing of network and supply company balance sheets, as introduced by the Utilities Act 2000. Further, we have concerns that the payments to be made by networks to suppliers under the proposed DRSS could amount to a cross-subsidy or may otherwise result in market distortion contrary to competition law. Network and supplier risks have been kept separate for good reason and Ofgem should not contravene this fundamental cornerstone of the regulatory framework. If Ofgem does not believe there to be any legal barriers despite the points raised above, we would ask that the reasoning be clearly set out.

The statutory regime recognises that network tariffs are not an appropriate mechanism for raising funds to shore up suppliers or bolster household finances, and legislation explicitly prohibits network tariffs being used for unrelated policy objectives such as this. A debt relief scheme would represent unrelated costs supporting an unrelated policy objective. The debt in question exists between a customer and an energy supplier via the retail energy market.

The separation of networks from suppliers has been a cornerstone of the regime since 2001. It facilitates materially lower financing costs for networks and correspondingly lower bills for customers. Exposing networks, indirectly, to supply market risk undermines that separation and unnecessarily increases overall network costs (“contagion risk”).

A network funded solution risks adversely affecting NWO’s financeability and future cost of capital – at a time when maintaining NWO’s financial strength is critical, given their key role in facilitating the transition to net zero and supporting wider economic growth. There is a risk that some capital providers see this as contagion from the retail market impacting NWO’s lower cost of capital given the materiality of the proposed scheme, and long term investability in the sector is an issue that cannot be discounted if debt relief is to be part or fully funded via NWO’s balance sheets. Any incremental increases to networks WACC due to contagion risk can result in a very large impact to end consumers given the current RAV base across each NWO, even before the increase due to unprecedented investment in relation to net zero delivery are accounted for.

#### Network Funded Solution Criteria

We are opposed to any networks solution that requires NWO’s to provide funding up front, which is subsequently collected over a period in excess of one year. If such a scheme was to be enacted, the key factor would be to ensure that amounts paid and recovered are simultaneous – to ensure revenue and cashflow neutrality. (i.e. the scheme should be conducted on a Pay As You Go (PAYG) basis). However, we acknowledge that a PAYG solution can be spread over several years to smooth the impact on bills and still be on a cash neutral basis but to do so would also impact the effectiveness of the scheme to support suppliers and customers in the short term (i.e. speed of payments).

There is a repeating need for intervention, where Ofgem continues to rely on a short-term approach to regulating energy supply companies, with network companies increasingly relied upon to prop-up the competitive retail supply market. It appears very likely that the materiality of a debt relief scheme will be at a similar level to the response required as part of the previous peak SOLR amounts following an unprecedented level of supplier failures in 2021 which in itself was hailed as a one-off intervention in the face of exceptional circumstances brought about in part due to the cost of energy crisis.

Ofgem references that a NWO’s funded option could follow a similar approach to that used under the SOLR process. However, this process was designed and implemented at a specific period of time due to prevailing market conditions. The subsequent design of the SOLR scheme in response to the 2021 failures (i.e. PAYG) may have reduced any concerns networks, and their auditors and investors, had around financeability and/or adding retail market related cashflow risk to the NWO’s balance sheet at that time however this is not necessarily the case in today’s environment especially given the increases in funding (and

associated credit risk) that delivery of net zero investment will require inevitably leading to consumer detriment through higher cost of capital implications for future price controls.

Any solution financed by NWO's should be distributed equitably, i.e. amongst all electricity and gas transmission and distribution networks, ensuring it has the same nature of impact on all contributing parties. The terms need to be consistent with the lowest common denominator; as such principles should not be bound by standard industry arrangements (e.g. tariff related notice periods).

Furthermore, there must be equal contribution from consumers as part of any proposed scheme i.e. no post code lottery based on where a customer is located, and payments should not vary by fuel type. We do recognise that this creates practical issues within any networks funded scheme which would need to be overcome. There are options to mitigate this such as a flat network charge i.e. divorced from the amount of finance provided, and supplemented with payments between licensees to ensure neutrality however this increases complexity and overall costs which must be considered in the context of the wider suite of options.

We would argue that at present a full and complete impact assessment has not been undertaken and published alongside the current consultation as key options have not been included to allow for a meaningful debate about the merits of each proposal. This also extends to the need for Ofgem and or Government to make an early decision on the involvement of third-party financing which may affect how much consumers pay overall, how amounts are allocated to the 'recovery parties', and the payment and recovery profile.

There is also the wider issue in relation to Ofgem's timescales. They have identified that they would like payments to be made in Winter 2025 however to achieve this while maintaining the cashflow neutrality as applied in the 2021 SOLR mechanism would require a mid-year tariff change (regardless of which sectors tariffs are chosen for recovery). While this is not impossible to overcome, it would lead to a large amount of market disruption which we believe is not in both consumers' & suppliers' best interests further degrading the arguments for a networks led solution. Consideration would also need to be given to the impact of individual NWO's reporting period (i.e. calendar year ends) as part of any proposed PAYG scheme (i.e. if recovery/neutrality was based over a tariff setting year).

### **Scheme Administration and Eligibility Options**

For any scheme to be successful we believe that a time-limited period to assess and determine the support needed is necessary as this would remove the risk of accumulation of avoidable costs. The type and level of support available under a debt relief scheme should ensure as a minimum that customers do not pay twice where suppliers have already been funded for written-off debt as part of the existing price cap methodology

As a result, we believe that the proposal of Ofgem administering and auditing the scheme is appropriate to minimise costs to customers. However, the proposed administration and delivery process, and current uncertainty around levels of payment or targets of relief would suggest a government funded scheme or simultaneous payment (cash neutrality) would be required.

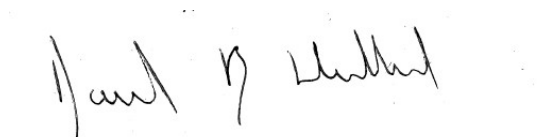
In relation to eligibility and conditionality options, we agree with the need for clear and prescriptive eligibility criteria to promote consistency and the targeting of appropriate customers. As noted, we believe Ofgem's attempt to ring-fence debt incurred during a certain period will not deliver sustainable change. Bills remain high, and a customer's ability and/or willingness to pay is not necessarily isolated to the "energy crisis" period. Ofgem has rightly identified the significant risk of moral hazard associated with a debt relief scheme, however prioritising simplicity to achieve a desired speed of delivery risks failing to mitigate these risks as far as reasonably possible; and does at increased contagion risk.

### **Next Steps**

We welcome the positive engagements with Ofgem to date and are committed to continuing the dialogue to help identify the optimum solution that addresses the issues outlined, providing debt relief to those customers that need it most.

Please do not hesitate to contact us should you wish to discuss any of the points raised in this letter in more detail.

Yours sincerely,



**David Holland**

Head of Licence & Revenue