Decision

Energy price cap: review of historical debt related costs

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This document sets out our decision not to introduce any further adjustment to the price cap for debt-related costs incurred between 1 April 2022 and 30 June 2025. This confirms our minded-to position set out in our March 2026 consultation. Our assessment indicates that price cap customers have already contributed their proportionate share of these historical costs, and we do not consider it appropriate to require them to contribute further.

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Executive summary

The default tariff cap ('the price cap') protects households on standard variable and default tariffs by ensuring they pay a fair price for their energy that reflects the efficient underlying cost of supply. It includes allowances for debt-related costs: unpaid bills that suppliers do not expect to recover, the administration of customer debt, and the cost of working capital needed to fund day-to-day operations and customers paying in arrears.

These debt-related costs, like in many sectors are ultimately borne by other customers. To an extent, this is necessary to ensure the market can support customers in payment difficulty. Our Energy Debt Circuit Breaker, published in conjunction with the Government in October 2026, has outlined our approach to reducing these costs over time while ensuring customers are well supported. This includes a commitment to a Debt Relief Scheme in 2027 targeted at customers most in need.

The gas price crisis and wider cost-of-living pressures led to a significant increase in these debt-related costs which started in 2022 and has continued since. In April 2024, we introduced a temporary additional allowance for these additional costs, known as the 'float', while committing to review costs once more complete evidence became available. The float was initially set for 12 months and was subsequently extended to June 2025, ahead of the introduction of a new enduring debt-related costs allowance in July 2025.

This decision concludes our review of historical debt-related costs incurred between 1 April 2022 and 30 June 2025. Following consideration of consultation responses, updated analysis and the evidence available, we have decided not to make a further adjustment to the price cap. This confirms the position proposed in our March 2026 consultation. We judge that, while having due regard to our duties under the Tariff Cap Act, requiring price cap customers to contribute further to historical debt-related costs would not appropriately protect their interests.

Our assessment

We have compared suppliers' reported debt-related costs with the revenues provided for by the relevant price cap allowances, including the float. We considered a number of methodological approaches to assessing costs and revenues. Our preferred methodology finds that price cap customers have contributed slightly over their pro rata share of debt costs across the review period as a whole. This is a market-level assessment using modelled revenues, not a finding that every supplier recovered its costs or that equivalent revenues were necessarily recovered through historical non-price cap tariffs.

We have maintained the main methodological positions proposed at consultation. These include using a customer-weighted average benchmark of total net debt-related

costs, assessing costs and revenues across payment methods and tariff types, and including both customer and non-customer working capital.

The weighted average benchmark replaces the more stringent combination of benchmarks used to set the float. This reflects part of our in-the-round judgement on a preferred methodology. We consider that differences in reported costs can arise from supplier efficiency as well as customer characteristics or other circumstances outside suppliers' control. We note that a lower quartile approach to benchmarking, combined with an approach to placing a greater burden of debt costs onto SVT customers would lead to a similar outcome. We have decided not to benchmark separately by payment method. Customers can move between payment methods and suppliers use different approaches to allocating costs between them. Reported differences therefore do not reliably identify the underlying cost of serving otherwise similar customers. Reflecting these differences through separate adjustments could also impose substantial additional charges on standard credit and prepayment customers, without reliably directing revenue towards suppliers with the greatest historical under-recovery.

Including customers outside the price cap

Most supplier respondents opposed including non-price cap customers, such as those on fixed-term contracts. They argued that this changed the approach after historical pricing decisions had been made and overstated the revenues they could have recovered. We recognise there are some contractual and competitive constraints suppliers face and acknowledge that equal recovery across tariff types may not necessarily occur.

However, the costs of unpaid bills are inherently shared between suppliers and paying customers rather than the customers who create them. Tariff type is not, in our judgement, an inherent driver of these costs. Customers move between tariffs, and the tariff recorded when a debt cost is recognised does not necessarily identify where that debt arose. We do not consider that price cap customers should bear a disproportionate share of these costs because they remain on default tariffs while customers who make an active tariff choice avoid making similar contributions.

Our methodology therefore includes costs across both price cap and non-price cap customers and models equivalent debt-related revenues using price cap allowances. This gives effect to our judgement about the contribution it is appropriate for price cap customers to make. It does not assume that suppliers necessarily achieved equal recovery in practice. Making these judgements is inherent in setting the price cap according to our duties outlined in the Domestic Gas and Electricity (Tariff Cap) Act 2018. By nature both the setting of the float and the associated true-up were backwards-looking, but we have always been clear that the true-up would require judgements about allowable costs and revenues.

Including non-customer working capital

We have maintained our approach of including non-customer working capital, consistent with the approach used to set the float. This captures funding associated with other day-to-day business activities, rather than customer payment timing alone. Suppliers' reported non-customer working capital generally provides a financing benefit that offsets customer working capital costs.

Although non-customer working capital is not driven by customer non-payment, the relevant price cap allowances cover working capital more broadly. Including both elements enables a broadly like-for-like comparison of costs and allowances. We do not consider the proposed alternative methods sufficiently robust to isolate and remove the non-customer element from allowances. Removing the reported financing benefit without a corresponding adjustment to allowances would not provide a fair comparison. Nor would it be in customers' interests to consider only areas of potential under-recovery while excluding closely related benefits within the allowances under review.

Our overall judgement

We recognise that suppliers' recovery positions vary and that making no adjustment will not affect every supplier in the same way. We have considered the implications for financeability, competition and efficiency alongside the protection of existing and future price cap customers. In exercising our regulatory judgement, we have given greater weight to preventing price cap customers from making a disproportionate contribution to shared historical costs than to seeking to ensure that all reported debt-related costs are fully recoverable.

Our methodological choices have their own justifications, and we have also considered their combined effect. The less stringent weighted average benchmark helps mitigate risks to suppliers' ability to finance their activities and recover efficient costs. Taken together, we judge that making no further adjustment appropriately balances our duties under the Domestic Gas and Electricity (Tariff Cap) Act 2018. This decision concerns historical costs only. We will continue to monitor debt-related costs and consider reviewing the level or allocation of the enduring allowance if the evidence indicates a clear reason to do so.

1. Introduction

In this chapter, we provide an overview of our key decisions and an introduction to other related work.

Context

1.1 Some energy bills go unpaid and cannot be recovered. This is referred to as bad debt, and all energy suppliers accumulate bad debt. It is usual for businesses in many industries, not just energy, to make a provision for bad debt and to cover this through the broader pricing of their goods and services. The default tariff cap (the 'price cap') includes an allowance to account for an efficient level of **bad debt costs**.

1.2 The cap also includes allowances for two other associated costs:

- **debt-related administration costs** – costs involved in managing customers in debt (e.g. payment plans, collections activity, warrants); and
- **working capital costs** - the cost to suppliers of raising capital for day-to-day operations and funding customers paying in arrears.

1.3 Collectively **bad debt costs**, **debt-related administration costs** and **working capital costs** are referred to as **debt-related costs**.

1.4 Allowances, such as those for debt-related costs, are generally set ahead of time (ex-ante). However, we can make after the fact (ex-post) adjustments to allowances as well, where we identify that in previous cap periods there was a material and systematic difference between allowances and efficient costs.

1.5 To minimise the lag between costs being incurred and revenue received ex-post adjustments can sometimes be made in two phases:

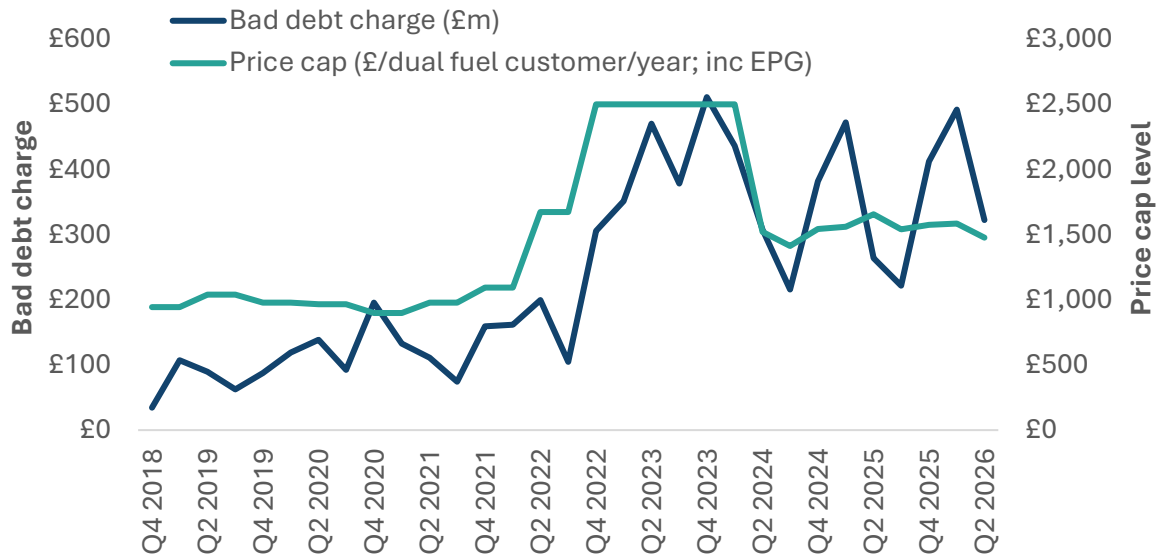
1. **Initial adjustment ("float")** – a temporary adjustment reflecting our best assessment or forecast of a divergence between allowances and efficient costs using the information available at the time.
2. **Revising adjustment ("true-up")** – a review of the initial "float" to decide whether it was in retrospect, and in light of newer data, set at the right level and in the right way and therefore whether a further adjustment is needed.

1.6 In the case of debt-related costs a float and true-up approach can be beneficial as there is an inherent lag between rising non-payment and costs being recognised in accounts. Customer arrears will only show up as part of the bad debt charge once they have been assessed as unlikely to be repaid; this can take months. A float and true-up approach is therefore particularly useful in helping reduce the gap between when costs are incurred and revenue recovered. This also enables a smoother profile of costs for consumers.

1.7 A float and true-up approach also enables a quicker response to fast paced and exceptional market events. The gas price crisis is an example of such an event. Figure 1.1 shows that the rise in energy bills coincided with a sharp rise in supplier reported bad debt costs, risking a divergence between costs and allowances. Motivated primarily by this observation we began consulting on the case for an increase to the cap for additional debt-related costs in early 2023.

1.8 In the price cap period beginning 1 April 2024 we introduced a temporary initial allowance of £28 per dual fuel customer for additional debt costs incurred by suppliers between 1 April 2022 and 31 March 2024 ("the float"). This allowance was initially expected to be in place for 12 months but was extended for a further 3 months to align with the introduction of a new higher enduring debt-related costs allowance.

Figure 1.1 – Bad debt charge and price cap level over time



Notes: Bad debt charge data from Ofgem debt-related costs data publication

1.9 In March 2026 we consulted on our approach to reviewing whether, given data on actual additional debt costs and after review our assessment methodology, the float was in retrospect set at an appropriate level and whether a further adjustment, a true-up, was required. This looked at debt-related costs incurred between 1 April 2022 and 30 June 2025 and compared them against the total level of allowance provided for these costs (i.e. the underlying allowances plus the temporary float allowance and previous temporary allowance for Additional Support Credit costs).

1.10 We assessed that, on a weighted average basis, suppliers had under recovered their debt-related costs across price cap customers only. However, we also judged that contributions made towards debt-related costs should be equal across all paying customers (i.e. those on the price cap and those not). After adjusting for this we concluded that the float had resulted in price cap customers

making an appropriate contribution to these shared costs and therefore no further adjustment to the price cap was justified.

Purpose and structure of this document

1.11 This decision document seeks to present the evidence, analysis and policy rationale that has led us to decide to maintain our consultation position and make no further adjustment to the cap for historical debt-related costs. In doing so we set out stakeholder views provided via the consultation process.

1.12 We have carefully considered all stakeholder views and material provided via the consultation, whether or not we specifically address them in this document. In coming our decision, we had regard to our statutory duties as set out in S1(6) of the Domestic Gas and Electricity (Tariff Cap) Act 2018 ("Tariff Cap Act 2018").

1.13 This document is structured as follows:

- **Chapter 2: Net cost calculation approach**
  - A summary of the method by which we calculate an individual supplier's net debt-related costs.
  - Impact of corrections and adjustments to our modelling since the consultation.
- **Chapter 3: Benchmarking**
  - Choice of benchmark and consideration of stakeholder views.
- **Chapter 4: Inclusion of non-price cap customers**
  - Consideration of the impact of including costs and revenues of non-default tariff customers and response to stakeholder views on this topic.
- **Chapter 5: Inclusion of non-customer working capital**
  - Consideration of the impact of including non-customer working capital costs and revenues and response to stakeholder views on this topic.

1.14 Chapters 2, 3, 4 and 5, and subsections within, are structured around four headings:

1. **Context:** setting out the relevant ideas and history related to the topic of the chapter or section.
2. **Decisions:** a summary of the decisions we have come to.
3. **Stakeholder responses:** a summary of what stakeholders told us in their consultation responses.
4. **Considerations:** our response to the points raised via consultation responses.

Our decision-making process

Publications and stakeholder engagement

1.15 Throughout this float and true-up exercise we have sought stakeholders' feedback, both when setting the float and when assessing the need for a true-up. This has taken the form of calls for input, consultations and the disclosure of the data and calculations underlying our true-up assessment.

1.16 Table 1.1 below summarises each key stage of this float and true-up process. Any non-confidential responses received to our publications have been published on the relevant consultation page, include those submitted to our true-up consultation.

Table 1.1: Decision-making stages

Date	Stage description
April 2023	Initial call for input (CFI) on whether an adjustment to the debt-related costs allowance in the cap may be required given costs and allowances in 2022/23 and anticipated costs and allowances in 2023/24.
June 2023	A published letter to stakeholders providing a summary of responses to the CFI, an interim update on the review and setting out the next steps we intended to take.
October 2023	Policy consultation setting out the identification of a gap between costs and allowances between April 2022 and June 2023, proposing a float and true-up approach and presenting methodological options for the calibration of a temporary adjustment.
December 2023	Consultation on a minded-to position of introducing a temporary adjustment ('float') from April 2024 based on a lower-quartile benchmark recovered equally over direct debit and standard credit customers – resulting in a £16 dual fuel bill increase for affected customers.
February 2024	Decision to introduce a temporary adjustment ('float') from April 2024 for 12-months using a hybrid benchmarking approach recovered equally over direct debit and standard credit customers – resulting in a £28 dual fuel bill increase for affected customers.
February 2025	Decision to extend the 'float' allowance until the implementation of the operating cost review or September 2025, whichever is sooner.

May 2025	Decision to introduce a new higher dedicated debt-related cost allowance from July 2025 onwards as part of the operating costs review.
March 2026	Consultation on a minded-to position of making no further adjustment to the cap to 'true-up' the original 'float' allowance for debt-related costs. The spreadsheet models were made available via a disclosure ring to stakeholders and the underlying supplier data was also disclosed to third-party advisors appointed by stakeholders.
November 2026	Decision confirming the March 2026 minded-to position of making no further adjustment to the cap for debt-related costs.

Data collection and evidence gathering

1.17 Since January 2023 we have issued a quarterly data collection request ('DCR') on suppliers' actual incurred debt-related costs. These requests were designed to improve our understanding of the costs incurred by suppliers and how those costs had evolved during and after the energy crisis.

1.18 The information requested included data relating to:

- Bad debt;
- Debt administration costs;
- Working capital costs;
- Revenues;
- Customer accounts;
- Other factors relevant to understanding suppliers' recovery of debt-related costs.

1.19 We have used information gathered through DCRs, consultation responses, stakeholder engagement and subsequent analysis to inform the assessment presented throughout this document.

Related publications

1.20 The main general documents relating to the cap are:

- Domestic Gas and Electricity (Tariff Cap) Act 2018: https://www.legislation.gov.uk/ukpga/2018/21
- 2018 decision on the cap methodology ('2018 decision'): https://www.ofgem.gov.uk/publications/default-tariff-cap-decision-overview
- Energy Prices Act 2022: https://www.legislation.gov.uk/ukpga/2022/44

1.21 The main documents relating to this decision are:

- Call for input on the allowance for debt-related costs (April 2023): https://www.ofgem.gov.uk/call-for-input/price-cap-call-input-allowance-debt-related-costs
- Update on debt-related costs review (June 2023): https://www.ofgem.gov.uk/policy/price-cap-update-debt-related-costs-review
- Additional debt-related costs allowance policy consultation (October 2023): https://www.ofgem.gov.uk/consultation/additional-debt-related-costs-allowance-policy-consultation
- Energy price cap additional debt-related costs review consultation (December 2023): https://www.ofgem.gov.uk/consultation/energy-price-cap-additional-debt-costs-review-consultation
- Energy price cap additional debt costs review decision (February 2024): https://www.ofgem.gov.uk/decision/energy-price-cap-additional-debt-costs-review-decision
- Energy price cap operating cost and debt allowance decision (May 2025): https://www.ofgem.gov.uk/sites/default/files/2025-05/Energy-price-cap-operating-cost-and-debt-allowances-decision-overview_0.pdf
- Energy price cap review of historical debt-related costs consultation (March 2026): https://www.ofgem.gov.uk/consultation/energy-price-cap-review-historical-debt-related-costs

2. Net debt-related cost calculation

This chapter provides a reminder of the methodological approach used to calculate net debt-related costs as set out in our earlier consultation document. It also summarises changes to this approach we have taken in response to errors identified and suggestions made by suppliers and third-party advisers via the consultation and disclosure processes.

Context

2.1 To calculate an individual supplier's recovery of debt-related costs we need to know the debt-related costs they incurred and the debt-related revenue they were allowed to recover given the allowances in the price cap. By subtracting costs from revenues, we find a supplier's net debt-related costs.

2.2 Across chapters two and three of the consultation we described our approach to these calculations. In this chapter we summarise the approach and describe any changes made since the publication of the consultation. We consider stakeholder responses in this chapter where relevant but dedicate subsequent chapters to the most consequential methodological judgements.

Estimating debt-related revenue

Context

2.3 To calculate suppliers' net debt-related costs we need to estimate the value of debt-related revenue they were able to recover. To do this we first need to isolate the per day and per unit of energy charges set by the price cap which relate to debt-related costs (paragraphs 2.4-2.10). We then multiply these to reflect the length of the period of interest and each supplier's number of customers and level of consumption – a process we refer to as "scaling" the allowances (paragraphs 2.11-2.20).

Estimating allowance values

Context

2.4 Before the dedicated debt-related costs ('DRC') allowance was introduced in July 2025, debt-related costs were included across various cap allowances. Our consultation and decision documents for the float explain how we estimated the share of each relevant allowance attributable to bad debt charges, debt administration costs, and working capital costs. For a detailed overview of this estimation method please refer to Appendix 1 of the float decision document.

2.5 The true-up consultation document then set out two proposed amendments to the float approach to account for the longer period in question (i.e. the 15 months the float was in place itself). These amendments were the use of the updated Earnings Before Interest and Tax (EBIT) allowance and cost of capital estimates from October 2023 onwards and the inclusion of the value of the float itself as well as the temporary allowance for Additional Support Credit (ASC) payments.

Decision

2.6 We have maintained the approach to estimating allowance values set out at consultation for this decision, while correcting any calculation errors.

Stakeholder responses

Amendments to the float methodology

2.7 We received no substantive comments on the changes made to account for the addition of the period the float was in place, including using the EBIT allowance and cost of capital values that applied over this period.

Maintaining float methodology

2.8 Most suppliers stated or restated their objection to the inclusion of non-customer working capital in our assessment of debt-related allowances and costs. Non-customer working capital has been included within the scope of this float and true-up exercise since the setting of the float allowance and so does not represent a change. We consider these responses in chapter 5.

Identification of errors

2.9 Following the disclosure of the spreadsheet used to calculate allowance values, a third-party adviser identified a minor error which resulted in the wrong inflation adjustment being made.

Considerations

2.10 We accept the spreadsheet error related to inflation values identified through the disclosure process. Correcting for this reduces the value of debt-related cost allowances per dual fuel customer at typical consumption by around £0.03 per year for cap periods between October 2024 and March 2025 compared to the values presented in table 2.4 of the true-up consultation document. More detail on this error can be found in Appendix 1.

Scaling allowances to estimate revenue

Context

2.11 To estimate the total revenue suppliers could recover from debt-related allowances, we must apply allowance values to each supplier's specific circumstances. This requires scaling up the per-customer allowances.

2.12 In the true-up consultation we proposed changing the method for scaling allowances compared to the float. Instead of calculating the proportion of supplier's revenue related to debt-related cost allowances, we instead proposed scaling the allowances directly using suppliers' reported customer numbers and level of consumption (kWh).

2.13 We consider this to be a more accurate measure of the maximum revenue for debt-related costs suppliers are enabled to recover given the design of the price cap. The previous methodology, by using reported revenue, built in any under-recovery arising from commercial decisions to price beneath the price cap.

Decision

2.14 We have maintained the approach to estimating debt-related revenues as set out at consultation stage for this decision.

Stakeholder responses

Use of actual consumption

2.15 No stakeholders objected to the move away from the revenue-based approach to using customer numbers and consumption. However, one supplier argued that, rather than scaling using actual consumption, allowances should be scaled by Typical Domestic Consumption Values (TDCVs).

2.16 The case made by this supplier against the use of actual consumption was that it represented a departure from the practice of considering a 'notional' supplier when setting price cap allowances. It therefore introduced an inconsistency in approach and undermined the basis on which the cap should be set.

2.17 They also highlighted a finding by the adviser who participated in the disclosure exercise on their behalf. They reported that the use of actual consumption rather than TDCVs reduced average net debt-related costs by approximately £2.78 per dual fuel customer – resulting in a finding of under rather than over-recovery.

Errors

2.18 Through the disclosure process a small number of issues were found in the way suppliers' data submissions were converted into the dataset used to calculate and benchmark net debt-related costs. These issues included an error affecting the treatment of consumption data for a limited number of reporting months.

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Considerations

Use of actual consumption

2.19 One key purpose of this exercise is to quantify any difference between the debt-related costs suppliers faced and the debt-related revenue they recovered. As both costs and revenues vary by the level of consumption we need to assess both on the same basis. As costs are driven by actual consumption, calculating revenue also using consumption helps ensure comparability. Using anything other than actual consumption, such as TDCVs, would require an adjustment to reported costs to ensure a fair comparison with allowances.

Errors

2.20 The consumption issue arose due to differences in the formatting of column headings for two months of supplier submissions meaning that the ingestion process did not interpret the relevant consumption data as intended. As a result, certain consumption values were incorrectly processed within the consultation model.

2.21 We have corrected this error by standardising the affected headings. Whilst this correction affected estimates of debt-related cost recovery, it did not alter the overall conclusions of the consultation or final decision. Further details are provided in Appendix 1.

Calculating net debt-related costs

Context

2.22 Net debt-related costs are simply debt-related revenues minus debt-related costs. A positive value indicates that suppliers recovered more from customers than they cost (an over-recovery), a negative value indicates the opposite (an under-recovery).

Supplier reported debt-related costs

Context

2.23 When calculating the float, and values presented in the true-up consultation, we collected data on supplier's actual debt related costs (bad debt charge, debt administration and working capital costs) via a DCR.

2.24 The DCR is issued to suppliers with at least 100,000 default tariff customer accounts. This provides a sample of 10 suppliers representing 90% of default tariff customers and 93% of all domestic customers over this period.

2.25 The DCR collects a time series of debt-related costs, customer numbers and consumption values broken down by tariff type (default or active choice), fuel, metering arrangement (single or multi-rate) and payment type (direct debit, standard credit and prepayment meter) where relevant.

2.26 We sum the monthly bad debt charge (including debt write-offs) and quarterly debt administration costs over cap periods and calculate working capital costs by multiplying net account receivables by cost of capital values. For more detail on these transformations please refer to table 3.1 in the consultation document.

2.27 Our treatment of the data leaves us with values for bad debt charge, debt administration and customer and non-customer working capital costs for each supplier broken down by cap period, tariff type and payment type.

2.28 At consultation stage we proposed one small change in methodology compared to the float, which was to align the cost of capital values used to calculate working capital costs with the cost of capital values used to calculate the EBIT allowance at each relevant point in time. In practice the change this results in is assuming a 12.26% cost of capital for the period 1 October 2023 to 31 March 2024 instead of a 10% value when setting the float. For the period before this (1 April 2022 – 30 September 2023) the same 10% value is used, and for periods after this (1 April 2023 – 30 June 2025) the values align with the new EBIT allowance (12.26%, 12.82%).

Decision

2.29 We have decided to maintain the data source and methodology used to calculate debt-related costs as set out in the true-up consultation document.

2.30 We have decided to set out a more consistent approach to inferring costs by tariff type and payment type where no breakdown was provided in suppliers' responses to the DCR. Details of this approach can be found in Appendix 1.

Stakeholder responses

Working capital

2.31 As with allowances most suppliers objected to the continued inclusion of non-customer working capital costs, we cover this judgement in chapter 5.

2.32 Beyond this, one supplier argues that using supplier's actual working capital costs was inconsistent with the way the EBIT allowance is calibrated. They argue that the EBIT allowance was set with an independent non-vertically integrated notional supplier in mind (i.e. a supplier that is not part of a larger company that participates in other aspects of the energy system such as generation). As our sample includes large vertically integrated suppliers, who the supplier argues will have lower costs of capital, then we are including costs that we should expect to be lower than allowances.

2.33 This supplier therefore argues that an over-recovery of working capital costs compared to allowances for vertically integrated suppliers should not be taken as evidence of a miscalibration of those allowances and should not be used to offset under-recoveries elsewhere.

2.34 Relatedly another supplier argues that the definition of working capital used and collected via the DCR will understate the level of capital employed as it excludes off-balance sheet working capital. For example, some suppliers will have parent company guarantees (PCGs) or access to funds provided by a parent or group company. These could be sources of working capital that have a cost associated with them but are not captured by the measure of working capital collected via the DCR. Their exclusion therefore biases working capital costs downwards, it is claimed, skewing our assessment of net costs towards over-recovery.

2.35 This supplier also notes that these alternative sources of capital are already recognised by Ofgem Financial Resilience and Controls (FRC) framework via Standard Licence Condition (SLC) 4B of both the Gas and Electricity Supply Licenses.

Tariff type breakdowns

2.36 One supplier did not report costs by tariff type in their response to the debt-related costs DCR. In our consultation, when considering the impact of tariff type, for this supplier we assumed no impact and used the same cost and allowance values per customer for both default tariffs and fixed term contracts. In response to this the supplier suggested that we should instead assume equal costs and allowances at the payment type level, such that their net costs by tariff type reflect any difference in payment type composition.

Considerations

Working capital

2.37 To calculate suppliers working capital costs we observe the amount of working capital they hold from their responses to the DCRs and then multiply this by a common assumed cost of capital. This is the same cost of capital value used to set or estimate working capital allowances. The fact different suppliers will have higher or lower costs of capital therefore does not affect our comparison.

2.38 In addition to the cost of capital, we also consider the levels of working capital used to assess costs and allowances to be comparable with one another. Table 2.1 sets out the data sources used to assess both working capital costs and allowances. It shows that, to estimate costs, we collect data on the level of working capital held by suppliers from the previously mentioned DCR. The guidance provided alongside this DCR defines working capital as “current assets less current liabilities for the supply business” but excludes capital related to trading (i.e. collateral), corporation tax balances and derivates. We consider this comparable to the data and modelling used to value debt-related allowances.

2.39 For example, the primary allowance for working capital is the EBIT allowance, which allows for the return on all capital employed. The EBIT allowance methodology was changed in October 2023. Prior to this, we isolate the element of the allowance which relates to working capital by using data on working capital

levels submitted by six suppliers in 2017. The DCR issued in 2018 to gather this data used the same definition of working capital as in the DCR used to assess costs (i.e. "current assets less current liabilities").

2.40 From October 2023 onwards, a separate value (£ per dual fuel customer) for working capital is already identified within the allowance methodology itself and therefore can be used directly rather than proxied. This measure of working capital also refers to current assets minus liabilities, but in this case are modelled values for a notional supplier rather than reported. The model used was calibrated so that the notional suppliers working capital and cash balance would remain positive in the face of a price shock (see the model guidance for more detail). The working capital element of the EBIT allowance in this period therefore contains an element of capital held to mitigate risk (i.e. risk capital) as well as day-to-day working capital.

2.41 However, by way of sensitivity analysis, even if 70% of the post October 2023 EBT working capital allowance was for risk capital our preferred methodology would calculate an over-recovery of -£2 rather than the +£2 (see Table 3.2). Even, in the extreme, if we include no EBIT working capital allowance post October 2023 in our assessment at all, we would find an under-recovery of only around £4 per dual fuel customer over this three and a quarter year period (i.e. around £1.30 under recovery per dual fuel customer per year). Overall therefore, while we continue to consider our methodology to be appropriate, we also judge that our decision to make no further adjustment to the price cap is not sensitive to the degree of risk capital embedded the EBIT working capital allowance post October 2023.

2.42 The two other price cap allowances which provide revenue for working capital costs are the Payment Method Adjustment Percentage (PAP) and the debt-related cost float allowance we are reviewing in this document (aka the DRC float). The working capital element of PAP was set using the same 2017 data on six suppliers working capital levels as is used to isolate the working capital element of the EBIT allowance prior to October 2023. Finally, the DRC float was set using suppliers cost data collected from the same DCR we are using to assess working capital costs.

2.43 From this disaggregation of sources for working capital costs and allowances, we conclude that both costs and allowances are measured on a broadly comparable basis. Neither the working capital levels for costs nor allowances include off-balance sheet sources of working capital (e.g. parental company guarantees) and neither only reflect the costs of one supplier type (e.g. an independent or vertically integrated supplier). Finally, the same set of cost of capital values are applied to value costs and allowances.

Table 2.1 - working capital levels and cost of capital used to value of working capital costs and allowances

Cap period	Cost of capital (%)	Working capital requirement (**Costs**)	Working capital requirement (**EBIT allowance**)	Working capital requirement (**PAP allowance**)	Working capital requirement (**Float allowance**)
8	CMA estimate of retail supplier cost of equity[1]	Average of the sum of customer and non-customer net accounts payables from caps 8 to 14a[3]	Average net current assets of Big 6 energy suppliers as a % of revenue in 2017[4]	Difference between average DD and SC net current assets of one of the Big 6 energy suppliers as a % of revenue in 2017[4]	N/a
9	CMA estimate of retail supplier cost of equity[1]	Average of the sum of customer and non-customer net accounts payables from caps 8 to 14a[3]	Average net current assets of Big 6 energy suppliers as a % of revenue in 2017[4]	Difference between average DD and SC net current assets of one of the Big 6 energy suppliers as a % of revenue in 2017[4]	N/a
10a	CMA estimate of retail supplier cost of equity[1]	Average of the sum of customer and non-customer net accounts payables from caps 8 to 14a[3]	Average net current assets of Big 6 energy suppliers as a % of revenue in 2017[4]	Difference between average DD and SC net current assets of one of the Big 6 energy suppliers as a % of revenue in 2017[4]	N/a
10b	CMA estimate of retail supplier cost of equity[1]	Average of the sum of customer and non-customer net accounts payables from caps 8 to 14a[3]	Average net current assets of Big 6 energy suppliers as a % of revenue in 2017[4]	Difference between average DD and SC net current assets of one of the Big 6 energy suppliers as a % of revenue in 2017[4]	N/a
11a	Ofgem estimate of retail supplier cost of equity[2]	Average of the sum of customer and non-customer net accounts payables from caps 8 to 14a[3]	Modelled net current assets held by a notional supplier under a price shock scenario[5]	Difference between average DD and SC net current assets of one of the Big 6 energy suppliers as a % of revenue in 2017[4]	N/a
11b	Ofgem estimate of retail supplier cost of equity[2]	Average of the sum of customer and non-customer net accounts payables from caps 8 to 14a[3]	Modelled net current assets held by a notional supplier under a price shock scenario[5]	Difference between average DD and SC net current assets of one of the Big 6 energy suppliers as a % of revenue in 2017[4]	N/a

12a	Ofgem estimate of retail supplier cost of equity[2]	Average of the sum of customer and non-customer net accounts payables from caps 8 to 14a[3]	Modelled net current assets held by a notional supplier under a price shock scenario[5]	Difference between average DD and SC net current assets of one of the Big 6 energy suppliers as a % of revenue in 2017[4]	Average of the sum of customer and non-customer net accounts payables from caps 8 to 10b[6]
12b	Ofgem estimate of retail supplier cost of equity[2]	Average of the sum of customer and non-customer net accounts payables from caps 8 to 14a[3]	Modelled net current assets held by a notional supplier under a price shock scenario[5]	Difference between average DD and SC net current assets of one of the Big 6 energy suppliers as a % of revenue in 2017[4]	Average of the sum of customer and non-customer net accounts payables from caps 8 to 10b[6]
13a	Ofgem estimate of retail supplier cost of equity[2]	Average of the sum of customer and non-customer net accounts payables from caps 8 to 14a[3]	Modelled net current assets held by a notional supplier under a price shock scenario[5]	Difference between average DD and SC net current assets of one of the Big 6 energy suppliers as a % of revenue in 2017[4]	Average of the sum of customer and non-customer net accounts payables from caps 8 to 10b[6]
13b	Ofgem estimate of retail supplier cost of equity[2]	Average of the sum of customer and non-customer net accounts payables from caps 8 to 14a[3]	Modelled net current assets held by a notional supplier under a price shock scenario[5]	Difference between average DD and SC net current assets of one of the Big 6 energy suppliers as a % of revenue in 2017[4]	Average of the sum of customer and non-customer net accounts payables from caps 8 to 10b[6]
14a	Ofgem estimate of retail supplier cost of equity[2]	Average of the sum of customer and non-customer net accounts payables from caps 8 to 14a[3]	Modelled net current assets held by a notional supplier under a price shock scenario[5]	Difference between average DD and SC net current assets of one of the Big 6 energy suppliers as a % of revenue in 2017[4]	Average of the sum of customer and non-customer net accounts payables from caps 8 to 10b[6]

Notes: 1. CMA (2016) Energy market investigation: Appendix 9.12: cost of capital, paragraph 2; 2. Ofgem (2023) EBIT decision; 3. Data from debt-related costs DCR issued in July 2026; 4. Data collected in 2018 to support the establishing the price cap; 5. Working capital model published alongside EBIT decision; 6. Data from debt-related costs DCR issued in October 2023

Tariff type breakdowns

2.44 We accept the suggested improvement to our treatment of costs provided by a supplier without a breakdown between tariff types. This does not impact our conclusions as under our preferred approach we look at costs and revenues across all customers. Further detail on this can be found in Appendix 1.

Subtracting debt-related costs from debt-related revenues

2.45 The sections above set out our approach to calculating debt-related revenues and debt-related costs for each supplier who responded to our DCR. To calculate net

debt-related costs we simply subtract debt-related costs from debt-related revenues. We then normalise this value by dividing by the number of each supplier's customer accounts in the final cap period the float applied (April-June 2025) and then multiply this by two to present values in £'s per dual fuel customer terms.

2.46 Table 2. below summarises the net debt-related costs values the approach described in this chapter produces. The table shows how the range of values differ depending on the scope of customers included when calculating net bad debt costs. We then use these values by supplier to calculate a benchmark; this process is described in Chapter 3.

Table 2.2 – Range of net debt-related cost per dual fuel customer by tariff and payment type (1 April 2022 – 20 June 2025)

	All customers	Default tariff customers*
Maximum	£52	£53
Upper Quartile	£16	-£5
Weighted average	£2	-£26
Lower quartile	-£110	-£165
Minimum	-£190	-£499

*Notes: Positive value indicates an over-recovery of costs, a negative value an under-recovery;*Only bad debt charge net costs calculated over default tariff customers, debt administration and working capital costs calculated over all customers; values calculated over eight supplier sample.*

3. Benchmarking net debt-related costs

We have decided to maintain the weighted average benchmark. This is calculated using suppliers' net debt-related costs per customer aggregated over cost categories, fuels, cap periods, tariff types and payment types.

Context

3.1 In chapter 2 we established how we have decided to calculate net debt-related costs for each supplier. The next stage is to summarise those values to gain a market level view of efficient net costs – this is the process of benchmarking. There are three key choices we face when benchmarking, these are:

i. The suppliers included in the sample

ii. The parameters over which the benchmark(s) are calculated (e.g. whether to benchmark total net costs or break them down by tariff or payment type)

iii. The choice of the benchmark metric (e.g. lower quartile or weighted average)

3.2 Our minded-to positions of each of these choices at consultation stage were:

i. Removal of two out of the ten suppliers in the full sample. One due to data incompleteness and the other because their multi-utility business model makes it difficult to isolate retail energy costs.

ii. Aggregate costs and revenues across cost categories, fuels, cap periods, tariff types and payment types before benchmarking.

iii. A weighted average benchmark metric.

Decision

3.3 We have decided to maintain our minded-to benchmarking position set out in the consultation. This means moving away from the combination of a weighted average benchmark for bad debt costs and lower-quartile benchmarks for debt-related administration and working capital costs used to set the float. We instead take a weighted-average benchmark of total net debt-related costs.

3.4 These positions are taken having considered consultation responses and in the context of other methodology decisions, such as the inclusion of non-price cap customers in our assessment, and with reference to the matters set out in S1(6) of the Tariff Cap Act 2018 to form an overall position on a true-up adjustment.

Stakeholder responses

Supplier sample

3.5 We received no responses relating to our minded-to position of removing two suppliers from our sample.

Benchmark parameters

Tariff types

3.6 All but one supplier who responded to our consultation disagreed with our position on including the debt-related costs and revenues of customers on all tariffs, both price cap and non-price cap. One customer group responded in support of this approach.

3.7 We discuss this topic separately in chapter 4.

Payment types

3.8 Several suppliers argued that aggregating over payment types prior to benchmarking masks the under-recovery of costs amongst standard credit (SC) and prepayment meter (PPM) customers. We were told that any over-recovery amongst direct debit (DD) customers that offsets this cannot be relied upon for suppliers with higher-than-average shares of SC or PPM customers. As payment method mix is largely outside suppliers' control, aggregating over payment type favours some suppliers over others and therefore distorts competition.

3.9 Two suppliers and one supplier representative body specifically raised the impact of this cross-subsidy on suppliers with high SC or PPM customer shares. This was expressed as an ongoing concern about the design of the debt-related cost allowances, which should be addressed through a review, not just an issue for this true-up exercise.

3.10 One of these suppliers acknowledged the merit of our concerns that attempting to retrospectively transfer revenue between payment type groups could undermine regulatory certainty. However, they viewed this position as inconsistent with our position on introducing non-price cap customers into the true-up assessment having not done so at the float.

Benchmark metric

3.11 No suppliers actively disagreed with the move to a weighted average benchmark, away from the stricter hybrid benchmark used when setting the float.

3.12 One consumer organisation did disagree with this change. They argued that uncertainty over the degree of cost inefficiencies meant a weighted average benchmark could at best be seen as the upper bound of a plausible range, as it implies no aggregate inefficiency. A lower bound could be defined by a lower

quartile benchmark and a position somewhere between these two points, such as the mid-point, would be justified.

Considerations

Supplier sample

3.13 We continue to judge it appropriate to remove two suppliers from our sample for the reasons previously given (paragraph 3.2 point i).

Benchmark parameters

Tariff types

3.14 Considerations relevant to this topic are also discussed in chapter 4.

Payment types

3.15 We continue to consider that benchmarking net debt-related costs aggregated across payment types to be appropriate for the purposes of this true-up exercise.

3.16 As discussed in our consultation document (paragraphs 3.55 to 3.59), we judge that differences in net debt-related costs per customer across payment types are not cost-reflective. They do not represent the underlying cost of serving a typical customer. Instead, they partly reflect the tendency for higher debt customers to end up on SC rather than DD or PPM, regardless of which payment type they first accrued debt on. It is also not the case that all SC customers reflect high debt costs. Customers that pay on time, and from whom debt related revenue is recovered, will have very low debt costs.

3.17 Furthermore suppliers, in their returns to our DCRs, allocated debt-related costs across payment types in several different ways, including in proportion to customer numbers or revenue, entirely to one payment type, or no breakdown is provided at all. The approach to disaggregating costs also differs between each of the debt-related cost categories. Cost categories like non-customer working capital are not associated to a customer and therefore allocating these costs to payment types is inherently arbitrary. As a result, payment type breakdowns of debt-related costs are not always meaningful or comparable between suppliers. The results of payment type specific benchmarks would therefore reflect these methodological inconsistencies as well as any true underlying net cost differentials.

3.18 Table 3.1 shows that if we did take suppliers reported costs by payment type as being cost reflective, the differences between payment methods are very large. This implies any adjustments calibrated using these net costs could result in changes of £100’s to the annual bills of typical consumers. The prices paid by DD customer would fall substantially while the prices paid by SC and PPM customers would rise even more.

3.19 As a result of this a typical SC or PPM customer who has made little or no contribution to their supplier's total debt-related costs would be required to make a significantly larger contribution to covering those costs than a similar customer paying via a DD. Any SC or PPM customers reacting to this penalty by switching to paying by DD would reduce aggregate recovery of debt-related costs. Equally any SC or PPM customer not reacting to this discrepancy in price cap levels would be significantly disadvantaged in a way analogous to the loyalty penalty the price cap was introduced to prevent.

3.20 Therefore, even if we were to be convinced that net debt-related cost by payment type reflected true underlying cost differentials, we judge reflecting these through this true-up adjustment would not be consistent with the need to protect current and future price cap customers as set out in the S1(6) of the Tariff Cap Act 2018.

Table 3.1 – Net debt-related costs by payment type 1 April 2022 – 30 June 2025 (£ per dual fuel customer)

Payment type	Weighted average net-debt related costs
Direct Debit	£146
Standard Credit	-£526
Prepayment	-£111

Notes: Values assessed in line with methodology decisions described in this document, including inclusion of non-price cap costs and revenues; if translated into price cap adjustments a positive net cost would imply a reduction in the cap and vice versa.

3.21 It could be the case that by protecting customers in this way we are trading off against suppliers' ability to finances their activities or compete effectively. This might be the case if the allocation of allowances over this period materially disadvantaged some suppliers and not others. Debt-related allowances were around four times higher for the SC cap and 60% lower for the PPM cap than the DD cap over this period. The consequences of these differentials for suppliers will have depended on their customer mix, over which suppliers have limited control in the short run.

3.22 However, as shown later in Table 4.2, we find only moderate correlations between a supplier's net debt-related costs and the payment method shares of their price cap customers. This suggests any attempt at adjusting the future payment type caps to reallocate revenues between suppliers would struggle to target revenues at those suppliers most disadvantaged by historic allowance allocations.

3.23 Overall, we do not consider reported payment type debt-related costs to be reflective of underlying cost differentials. Even if we did any adjustment calibrated using them would fail to protect price cap customers paying via SC or PPM. For these reasons we do not benchmark at the payment type level.

3.24 In addition to advocating for this true-up exercise to be considered by payment type, supplier responses also alluded to concerns about the payment type

allocation of the enduring debt-related costs allowance. Decisions made in relation to this true-up exercise wouldn't alter the workings of the enduring allowance. We therefore do not engage in discussion of this issue here.

3.25 However, we continue to monitor the functioning of the enduring allowance through quarterly DCRs – which we also use to publish aggregated data on debt-related costs. Should we consider this data indicates a clear reason to do so, we are open to reviewing both the level of the allowance and its allocation across customers.

Benchmark metric

3.26 In our consultation we explained that we favoured a weighted-average benchmark because it helps reduce the risk of setting a benchmark that is unachievable for suppliers with higher-costs customer bases – for example those with more financially vulnerable customers. We also expressed concern about the sensitivity of benchmarks using quartile measures, such as the float hybrid benchmark or simply a lower quartile value.

3.27 We also acknowledged at the consultation stage that the wide variation in net5 debt-related costs between suppliers might indicate a role for supplier efficiency and therefore a case could be made for a more stringent benchmark (e.g. lower quartile). However, the decision to move away from the stricter hybrid benchmark of the float to a more generous weighted average benchmark as proposed in our consultation has been taken in the context of other judgements, notably the decision to include costs and revenues from non-price cap customers in our assessment of net debt-related costs.

3.28 While it is difficult to quantify, the crisis was a significant shock to suppliers, and they have therefore needed to adapt their practices in response. We consider it likely that not all debt-related costs incurred by suppliers will have been "efficiently incurred". Some suppliers have acknowledged needing to make improvements to their debt management systems and processes both to support customers but also to manage debt effectively which would suggest inefficiencies did and do exist

3.29 As is discussed in more detail in chapter 4, the combination of these two choices, a weighted average benchmark and assessing net costs over all customers, results in a finding of broad cost recovery. While they are separate judgements with their own justifications, reflecting uncertainty about cost efficiency by using a weighted average benchmark helps mitigate risks to supplier financeability arising from including non-price cap customers in our assessment.

Table 3.2 – Net debt-related costs by benchmark metric and cost category (1 April 202 – 30 June 2025; £ per dual fuel customer)

	Weighted average	Hybrid	Lower quartile
Bad debt charge	-£16	-£16	-£2
Debt administration costs	-£1	£13	£0
Working capital costs	£19	£22	£26
Total	£2	£20	£25

Notes: Net debt-related costs calculated as debt-related revenues minus debt-related costs; a positive value therefore indicates an over-recovery of costs and a negative value and under-recovery; values presented include net -debt related costs of price cap and non-price cap customers; weighted average calculated using full eight supplier sample; lower quartile elements calculated using restricted six supplier sample in line with float methodology.

4. Inclusion of non-price cap customers

This chapter confirms our decision to include non-price cap customers in our assessment of net debt-related costs. It summarises stakeholders' responses on this topic and sets out our consideration of the points made.

Context

4.1 The information we collect from suppliers on their debt-related costs asks for data to be broken down into two types of tariffs; tariffs subject to the price cap, such as standard variable tariffs, and non-price cap tariffs such as fixed-term contracts.

4.2 When setting the float allowance, we sought to compare revenues recovered and costs incurred over price cap customers only. This was in line with our general approach to price cap allowances, which seek to enable efficient cost recovery over price cap customers – not all customers. Due to limitations in the data provided by suppliers, in practice this still meant assessing administration and working capital costs per customer over all customers with only bad debt costs assessed over price cap customers.

4.3 For the true-up we consulted on a different approach by also assessing bad debt costs over all customers not just those subject to the price cap. This change reflected our judgement that debt-related costs should be shared across customers and not disproportionately recovered from current price cap customers.

4.4 In practice this means applying the price cap debt-related allowances to non-price cap customers, assigning equal debt-related revenues to customers regardless of tariff type. For the avoidance of doubt, this does not mean we assume this has always happened in practice, but rather that we judge it is not in price cap customer's interests for them to pay a greater share of total debt-related costs than their collective share of the total number of retail customers.

4.5 We set out the impact of this new approach on the case for a true-up in our consultation document (table 3.4). Table 4.1 updates those values taking into account the correction of modelling errors and other changes set out in Appendix 1.

Table 4.1 – Net debt-related costs by method and benchmark (£ per dual fuel customer) from 1 April 2022 to 30 June 2025

Methodology	Weighted average	Hybrid	Lower quartile
Baseline (all customers)	*£1.64*	*19.39*	*£25.02*
Calculate bad debt charge costs over price cap customers only	-£26.15	-£8.40	£20.28

4.6 This shows how the inclusion of non-price cap customers changes our assessment of net debt-related costs over from a £26 under-recovery to a small £2 over-recovery when using a weighted average benchmark.

Decision

4.7 We have decided to maintain our consultation position of including all customers, price cap and non-price cap, in our assessment of net debt-related costs. This includes modelling revenues recovered from non-price cap customers using price cap allowances.

Stakeholder responses

4.8 Most supplier respondents opposed including non-price cap customers in the assessment of net debt-related costs. Their concerns covered alleged retrospectivity in making this change, the commercial and contractual constraints on recovering equivalent revenues from non-price cap customers, the evidence supporting our revenue assumptions, and the scope of the true-up exercise itself. Suppliers also raised concerns about differing impacts across suppliers and the implications for competition and financeability.

4.9 One consumer group organisation supported the inclusion of non-price cap customers, agreeing that doing so prevented price cap customers from making a disproportionate contribution to these shared costs.

Alleged retrospectivity

4.10 Suppliers argue that they priced their non-price cap tariffs using the information and regulatory framework available at the time. The bad debt element of the float was set using the costs and allowances of price cap customers only, and there was no reason to expect that the true-up would subsequently assume equivalent debt-related revenues from non-price cap customers. They consider that this changes the recovery assumptions after the relevant pricing decisions have already been made.

4.11 Some suppliers pointed to the example of the true-up process for the COVID-19 adjustment as an example of a similar exercise where the methodology applied at the float stage was maintained at the true-up. They argue it was therefore reasonable to expect the same approach here.

4.12 Suppliers told us that, had this approach been signalled in advance (i.e. at or shortly after the introduction of the float), they could have considered its implications when setting non-price cap tariff prices. However, they distinguish between the opportunity to consider different pricing strategies and their practical ability to recover additional costs in a competitive market.

4.13 Suppliers argue that as it is not possible to go back and reprice tariff contracts agreed in the past and to the extent suppliers priced less for debt-related costs

into their non-price cap tariffs than was allowed under the price cap they have no way of meeting the revenue assumptions underpinning the true-up methodology.

4.14 Consequently, suppliers argue our assessment of revenues is exaggerated and therefore our conclusion that suppliers recovered their efficient costs is unsound. Suppliers argue that they in fact under-recovered their efficient costs and an upward adjustment to the cap is justified to true-up an inadequate float allowance.

4.15 Beyond the direct impact on revenues from not introducing an upward adjustment, suppliers argue the unexpected nature of the methodology change reduces the certainty they have in Ofgem to act in a predictable manner which enables them to recover their efficiently incurred costs. One supplier organisation told us that this uncertainty would add risk premia to non-price cap tariffs harming future consumers.

Constraints on reflecting price cap debt allowances in non-price cap tariffs

4.16 Several suppliers argued that, even with advance notice, they could not have recovered the full equivalent of the price cap debt-related allowances through non-price cap tariffs. They cited competitive pressure, lower expected debt costs for non-price cap customers, limited margins and restrictions on repricing existing contracts.

Approach to pricing non-price cap tariffs

4.17 Suppliers provided different descriptions of their pricing approaches for tariffs not subject to the price cap. Some told us they explicitly sought to recover expected debt-related costs, while others suggested they focused primarily on achieving a competitive price. In all descriptions suppliers were clear that they did not seek to recover debt-related costs incurred by customers elsewhere in their portfolio, such as those on the price cap.

4.18 Suppliers and their advisers argued that the competitive nature of the non-price cap market meant prices reflected the expected costs of serving additional customers rather than historical debt-related costs associated with a wider set of customers. A supplier attempting to recover those wider costs could be undercut by competitors with lower historical debt exposure or a different customer mix. One adviser also described acquisition pricing based on expected customer lifetime value, under which an initial non-price cap tariff need not recover all costs when assessed in isolation.

Expected debt-related costs from non-price cap customers

4.19 Several suppliers argued that non-price cap customers had lower average debt-related costs than price cap customers. They attributed this to differences in payment method, engagement and credit risk. They said non-price cap customers

were more likely to pay by DD, manage their accounts online and have provided usable contact details. Suppliers could also undertake credit checks before offering tariffs not subject to the price cap. As a result, we were told non-price cap customers are less likely to be financially vulnerable customers and therefore have a lower probability of falling into debt.

4.20 Several respondents emphasised that payment method remained an important driver of debt-related costs within each tariff type, with DD customers least likely to be in debt at any given time. As a higher proportion of non-price cap customers pay by DD compared to price cap customers, the average level of debt-related costs is lower. Lower average costs for non-price cap customer did not mean that every non-price cap customer group had lower costs than its price cap equivalent. One supplier reported higher expected bad debt costs for its small cohort of non-price cap customers paying by SC than for equivalent price cap customers, reflecting the presence of customers whose DD arrangements had failed.

4.21 Suppliers argued that the gap between expected debt-related costs for DD non-price cap customers and the DD price cap allowance was further increased by the contribution that price cap DD customers made towards SC debt-related costs. They said competitive pricing of non-price cap tariffs did not provide an equivalent route for imposing a similar cross-subsidy.

4.22 All these reasons result in debt-related costs being lower on average across non-price cap customers than price cap customers, according to suppliers, and therefore the amount priced into non-price cap contracts for such costs being lower than what was allowed for under the price cap over this period.

Non-price cap tariff margins and profitability

4.23 Respondents argued that non-price cap tariff margins did not provide sufficient additional revenue to compensate for lower explicit recovery of debt-related costs. One supplier explained that its aspirational margin had to cover operating costs and bad debt as well as profit, and that competition constrained the margin achievable in practice. Its advisers considered that this approach was unlikely to recover the expected bad debt costs for an average customer.

4.24 An industry body cited figures showing aggregate supplier profitability in 2024 and 2025 was below the allowance for profit in the price cap, implying low non-price cap tariff margins and therefore little room for debt-related costs to be recovered. They argued that suppliers had passed savings to customers through competitive fixed offers rather than retained sufficient margins to fund wider debt costs.

Existing contracts and limited repricing opportunities

4.25 One supplier examined the movement of customers from and to non-price cap tariffs over the period under assessment (April 2022 to June 2025). They characterise three distinct periods and explain why during each of them suppliers

were constrained in their ability to price additional debt-related costs in. These periods are:

- April 2022 – December 2023
    - Very few new non-price cap contracts were being agreed over this period, so existing prices of non-price cap tariffs largely pre-dated the increase in debt costs and could not be retrospectively repriced.
- January – April 2024
    - The share of customers on tariffs not subject to the price cap started to return from 2024 but the value of the float allowances (£28 per dual fuel customer) was not yet known so suppliers could not have incorporated an equivalent amount to those new contracts.
- April 2024 – July 2025
    - With a rising share of non-price cap customers and the float value known there was more opportunity to adjust prices charged to non-price cap customers to recover additional debt-related costs over this period. However, in practice any ability was limited by competitive pressure combined with lower expected debt costs for those customers.

4.26 In addition, the same supplier noted that the float sought to enable the recovery of additional debt-related costs incurred over 13 quarters (April 2022 – June 2025) but was only in place for 5 quarters (April 2024 – July 2025). This, they argue, made imposing these costs through the pricing of non-price cap tariffs even harder as it would have meant recovering 2.6 times the normal expected debt costs, causing any non-price cap tariff to be uncompetitive.

Evidence supporting debt-related revenues from non-price cap customers

4.27 Several suppliers argued that in our consultation we had not attempted to establish empirically the extent to which non-price cap tariffs recovered the level of debt-related revenues we incorporate into our assessment. They told us that our acknowledgement of uncertainty about this question did not justify assuming recovery equal to the price cap allowances.

4.28 One supplier argued that Ofgem had a 'duty of enquiry' to take reasonable steps to gather the evidence demonstrating that suppliers had recovered the assumed level of debt-related costs from non-price cap customers. They suggest that this could be achieved through issuing information requests to understand better how suppliers approached pricing their non-price cap tariffs over this period. This information could then be used to evidence a value for the proportion of debt-related costs recovered via non-price cap customers relative to those recovered

via price cap customers. In contrast to this they argue we are simply assuming this proportion is 100% without evidence.

Impacts across suppliers and competition

4.29 Suppliers told us that our approach to including non-price cap customers generates competitive distortions by preventing cost recovery – which hurts some suppliers more than others.

4.30 One supplier argued that suppliers with higher levels of debt-related costs would be placed at a material disadvantage if no adjustment was made to enable them to recover some of their historical costs. They state that as debt-related costs are higher for price cap customers and customers paying by SC, suppliers with higher proportions of these customers would lose out more relative to their competitors. As a supplier's customer mix is largely out of their control this will distort competition in the retail market in favour of suppliers with high non-price cap and DD customer shares.

4.31 We were told that this distortion would build on the existing impact of the design of the enduring debt-related cost allowance, which smears costs from SC to DD – which again makes it more difficult for suppliers with high SC customer shares to recover their debt-related costs.

4.32 More generally we were told that by not enabling suppliers with high historical debt-related costs to recover them we would make it harder for them to compete against suppliers with lower historical debt exposure, such as newer entrants.

Scope of the true-up exercise

4.33 Several suppliers expressed the view that by including the costs and revenues of non-price cap customers we had expanded the scope of the true-up exercise from one seeking to enable the recovery of historical costs to one seeking to socialise debt-related costs across a wider customer base. Suppliers see this as a substantive change of policy rather than a technical refinement to the true-up modelling approach. Some respondents argued that this wider scope went beyond Ofgem's remit as a regulator and that distributional questions, such as which customers should cross-subsidise others, were a matter of social policy and therefore were for Government.

4.34 By widening the scope of the true-up several suppliers viewed the inclusion of non-price cap customers as distinct from other methodology changes, such as the move to a weighted average benchmark. They also argued that each methodological choice required its own justification and that while a weighted average benchmark and the inclusion of non-price cap customers moved assessed net debt-related costs in opposite directions, one doesn't justify the other.

4.35 Some suppliers also suggested that the question of the extent of suppliers' actual cost recovery and the question of which set of customers should pay for this should be separated. If Ofgem wanted to socialise historical debt-related costs across price cap and non-price cap customers then this should be done through an explicit mechanism, such as a levy, rather than assuming equal recovery had already been achieved through historical prices.

Considerations

Alleged retrospectivity

4.36 We recognise that the approach used for the true-up differs from the approach used to set the float. We also accept that suppliers would not have had certainty over our final approach over the period in question (April 2022 – June 2025). In part this uncertainty is inherent to the ex-post nature of float and true-up exercises. For the period April 2022 to February 2024 suppliers had no certainty a "float" would even exist. From December 2024 suppliers would have had visibility of our minded-to position to base permanent debt allowances on an "all customers" methodology. While this would not have provided a definitive read across to this true-up it could have at least signalled the potential consideration.

4.37 More importantly, we do not accept that such a change of approach, even if it were unforeseeable, would be ruled out by the nature of the float and true-up exercise. A true-up exercise does not imply using the same methodology as was used to set the initial allowance. Like any other review of price cap allowances, it is an exercise in coming to a reasonable evidence-based assessment of whether a change is appropriate to better balance protecting customers today against protecting future customer and against the other consideration we must have regard to, as set out in legalisation.

4.38 Furthermore, we have previously made clear that there were multiple factors it may be appropriate to take into consideration at the true-up stage. For example, we stated in our May 2025 decision document on the new debt-related cost allowance that there were "multiple factors it may be appropriate to take into consideration as part of any extended future debt-related costs true-up exercise" (paragraph 7.23) and we declined to define the full scope of the exercise at that point.

4.39 Similarly in earlier publications, such as the float decision we stated we would look again at aspects of the methodology at the true-up stage, "we may reconsider the stringency at which we benchmark costs and the allocation of costs over payment methods" and in the decision to extend the true-up we described our intention to undertake a "broader true-up review of various debt elements".

4.40 We note that most suppliers responding to the consultation made the case for changing the benchmarking choice between the float and true-up, thereby acknowledging changes can be made between these two stages. We accepted this case, judging that a less stringent benchmark better balanced supplier financeability and customer protection. Similarly, we have decided to expand the scope of customers included in our calculations at the true-up stage, judging that doing so better achieves the principal aim of the price cap, that of protecting price cap customers.

4.41 While the effect of this true-up, or any true-up, will be retrospective (in the sense that it considers the appropriate approach to historical periods), changes in methodology at the true-up stage only alters the value of the adjustment not the nature of the exercise. Further, our statutory duties require us to have regard to multiple and sometimes competing considerations and priorities, such as between protecting price cap customers and supporting supplier financeability. It is inherent in this that it may be appropriate to alter the methodology at the true-up stage to give effect to our judgement about how to balance these priorities.

4.42 Altering the value of the adjustment to reflect regulatory judgement about how to best balance competing priorities, such as between protecting price cap customer and supporting supplier financeability, is within scope of a true-up exercise.

4.43 Furthermore, some suppliers simultaneously claim that even if the float methodology had included non-price cap customers – such that this did not represent an unexpected change at the true-up – they were practically constrained in reacting any differently (see next sub-section). To the extent this is true, even if suppliers were right to say that they could not have foreseen this change they would not have acted differently, or would have been constrained in doing so.

Constraints on reflecting price cap debt allowances in non-price cap tariff

4.44 It may be the case that suppliers faced constraints when pricing non price cap tariffs over the review period, for the reasons summarised earlier. However, while suppliers pricing powers were constrained, they were likely not zero. We continued to observe a range of prices across different suppliers' non-price cap tariff offerings throughout this period. While some of these prices may have been more or less competitive in attracting consumers, it does suggest that suppliers are not simply acting as price takers in a fully competitive market.

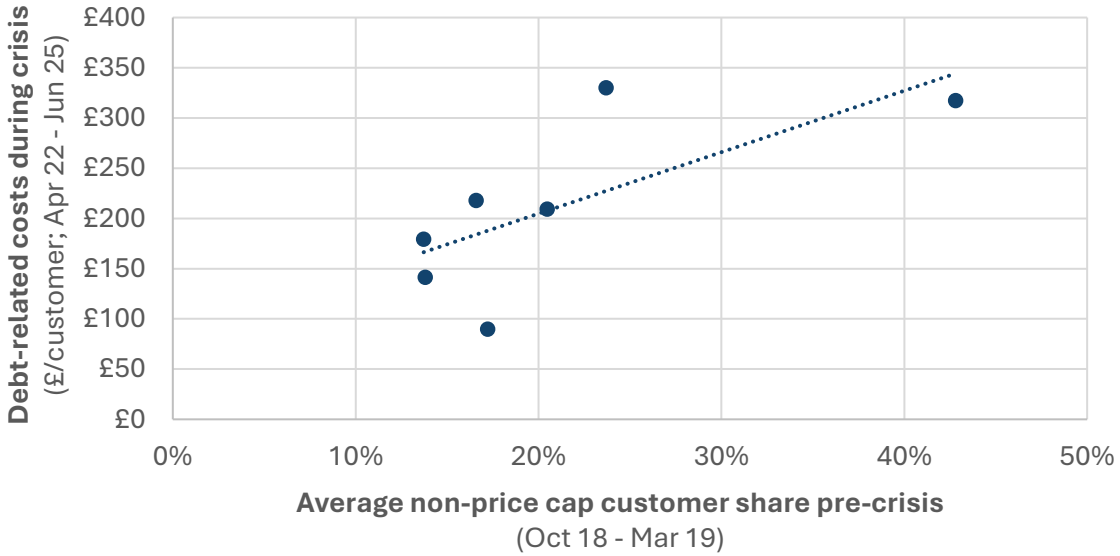
4.45 More generally we do not consider tariff type to be an inherent driver of debt-related costs. Customers move between tariff types, and the tariff recorded when debt is recognised does not necessarily identify the tariff on which the debt arose or the customer was acquired. A non-price cap customer with low debt-related

costs can become high debt-related cost customers on the price cap, however the rise in costs will not have been caused by the change in tariff.

4.46 To some extent this is reflected through suppliers who had a high share of non-price cap customers in the periods before the crisis being somewhat more likely to emerge from the crisis having accumulated higher debt-related costs than suppliers who entered the crisis with relatively fewer non-price customers. This is shown in Figure 4.1 below, where we see a positive correlation between supplier shares of non-price cap customers in the cap periods prior to April 2022 and their subsequent debt-related costs per customer over the price cap periods to June 2025.

4.47 If it was simply the case that non-price cap customer had inherently lower propensity to generate debt-related costs, regardless of which tariff they ended up on, we might have expected to find the opposite relationship – though we accept this is a suggestive finding only as we cannot follow individual customers over time. It is possible that this correlation also suggests a general under-pricing of debt risk in non-price cap tariffs pre-crisis, which would then be carried forward as debt costs to be paid for by post-crisis consumers –again raising questions around the appropriateness of leaving those costs to be disproportionately paid by price cap customers.

Figure 4.1 – Relationship between supplier's non-price cap customer share (Oct 18 – Mar 19) and total debt-related costs per customer (Apr 22 – Jun 25)



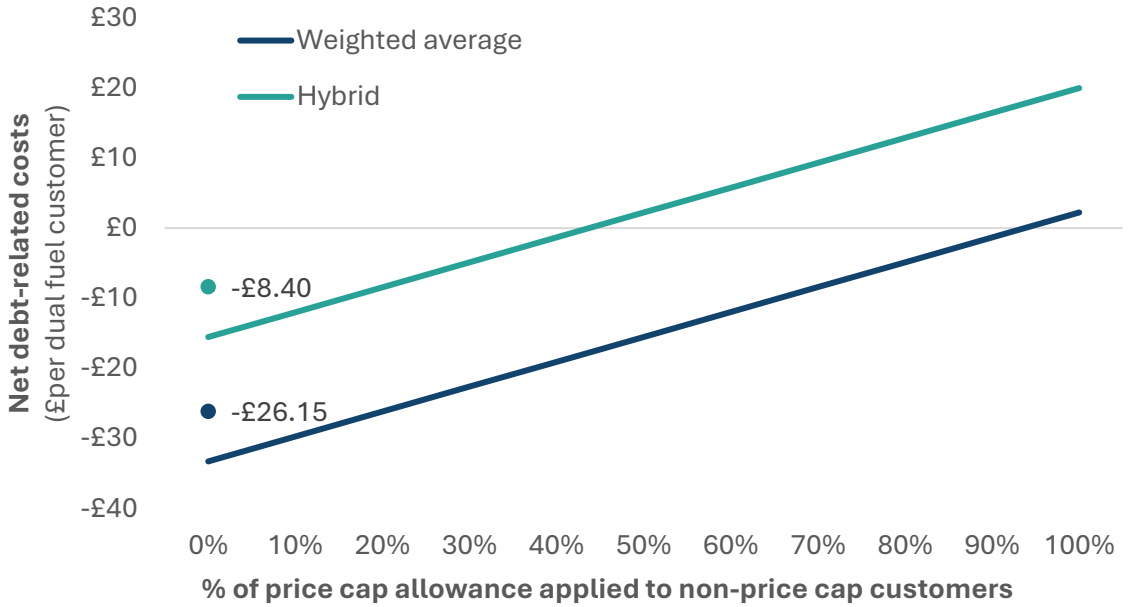
Notes: Same supplier sample as used for benchmarking minus one supplier removed due to having zero non-price cap customers; debt-related costs calculated over all customers.

4.48 For these reasons tariff type is not, in our judgement, an inherent driver of debt-related costs. Recovering the shortfall only from price cap customers would have the effect that costs shared across suppliers' portfolios would be loaded disproportionately onto the customers protected by the cap. That would cut across the cap's purpose of protecting existing and future price cap

customers. Indeed, the price cap is in essence a competition remedy, and as such an argument that suggests it should be used to recover costs that cannot be priced in competitively is somewhat at odds with the purpose of the price cap.

4.49 Figure 4.2 shows the sensitivity of two benchmark metrics, weighted average and hybrid, to the proportion of price cap allowances applied to non-price cap customers. To find a net debt-related cost value close to zero under a weighted average benchmark, we need to model non-price cap customer revenues as close to equal those of price cap customers. In contrast, we find a value close to zero under the hybrid benchmark, used to set the original float, when only recovering half as much debt-related revenue from non-price cap customers as price cap customers.

Figure 4.2 – Benchmarked net debt-related costs by proportion of price cap allowances applied to non-price cap customers



Notes: Benchmark lines calculated over all customers and so include all non-price cap customer debt-related costs and a varying degree of non-price cap customer debt-related revenue; labelled marks at 0% show values when also excluding non-price cap customer costs and align with values from Table 3.2; hybrid benchmark set using restricted sample for lower-quartile components in line with original float methodology.

4.50 Having weighed these considerations, while recognising there may have been practical limits on the pricing of non-price cap tariffs, it remains our judgement that this methodology ensures an appropriate contribution from price cap customers to these shared costs. Limiting the degree to which we share these costs equally across customer groups to reflect these pricing constraints identified by suppliers would prevent us giving effect to our regulatory judgement in this case.

Evidence supporting debt-related revenues from non-price cap customers

4.51 Several respondents asked us to gather further evidence on the amount of debt-related revenue included in historical prices of non-price cap tariffs. We do not consider that such an estimate could be isolated robustly.

4.52 Unlike the price cap, non-price cap tariffs are not constructed as an observable regulatory cost stack. The price can reflect expected costs, hedging, acquisition and retention strategies, customer lifetime value approaches, target margins and competitors' offers. Even where a supplier can describe its pricing process, it is not clear how they could identify how much higher or lower a historical offer would have been in the absence of wider portfolio debt costs. Evidence from individual suppliers would also be difficult to apply consistently across the market because pricing approaches and customer portfolios differ.

4.53 Further, pricing processes are not static, and over the period suppliers are likely to have weighed different considerations at different points as competition and market conditions have changed. This is a point that suppliers have made qualitatively in response to other suggestions that we/HMG might look to examine the components of fixed prices (for example in relation to options for monitoring the pass through of bill reductions into fixed tariffs).

4.54 We have nevertheless considered the evidence suppliers and their advisers provided through consultation, disclosure and follow-up engagement. While one supplier provided quantitative evidence on the cost to serve differences between price cap and non-price cap customers, generally the evidence provided was qualitative in nature (underlining the challenge), but we acknowledge that it supports the argument that equal recovery did not necessarily occur and may have been difficult to achieve during parts of the period.

4.55 However, our decision not to introduce a further adjustment does not depend on assuming or establishing that suppliers recovered a specified amount from non-price cap customers. Rather the appropriate basis for deciding whether the price cap allowances have been sufficient to recover appropriate costs from price cap customers is a matter of regulatory judgement for Ofgem.

4.56 Having considered the evidence provided, our judgement remains that customers should make an equal contribution regardless of tariff type. It follows from this judgement that it is appropriate to assume equal revenues. As a result, seeking a more precise historical allocation would not alter our approach to modelling net debt-related costs. It would therefore also not change our judgement that making no further adjustment is appropriate having regard to our statutory duties, including that it is in the best interests of price cap customers now and in the future – which is the key judgement we face when setting the price cap.

Impacts across suppliers and competition

4.57 We recognise that suppliers entered the review period with different customer and payment-method mixes, different levels of historical debt and different proportions of price cap and non-price cap customers. The decision to make no adjustment will therefore not affect every supplier in the same way. For example, suppliers with a greater concentration of customers in groups associated with higher debt costs may experience a weaker recovery position than suppliers with lower shares of such customers regardless of efficiency.

4.58 However, it is not automatically the case that making an adjustment would improve the ability of suppliers to compete with one another. The ability of a supplier to offer a competitively priced tariff depends on their costs and financial position relative to competitors and the costs and benefits of acquiring the marginal customer. It is not a given that simply being able to increase prices for price cap customers would alter these fundamentals as, at a certain point, higher prices could either reduce price cap market share by increasing the gap to non-price cap products; or enable suppliers with lower debt costs to further undercut.

4.59 To the extent that an adjustment could narrow the degree of cost recovery between suppliers, and therefore help high debt cost suppliers compete, it would need to be larger for suppliers with the highest net costs and smaller for those with the lowest. For this to be achievable there would have to be sufficient correlations between the characteristics we can target, such as payment type and share of price cap customers, and the degree of cost recovery. We do not find strong correlations of this type (see Table 4.2).

4.60 More fundamentally, arguments that imply it is easier to pass costs incurred by others onto price cap customers because they are less likely to switch tariff or supplier than non-price cap customers could be seen as in tension with the role of the price cap as a remedy for ineffective competition.

Scope of the true-up

4.61 We do not agree that including non-price cap customers takes the exercise outside the scope of the true-up or outside of our statutory functions. In all price cap decisions we are required to weigh up the need to protect current and future price cap customers against a range of other considerations, and in so doing we seek to come to a judgement about the best course of action in the round. Defining the relevant customer base and deciding how to compare costs and allowances are necessary parts of coming to a judgement in this case.

4.62 Our earlier publications did not define the true-up as a purely mechanical re-run of the float methodology. We signalled that we could revisit elements of the methodology and allocation approach and later referred to a broader exercise in which several factors would be considered together (see earlier paragraph 4.39). The enduring debt-related cost decision also provided relevant evidence and

policy reasoning about the nature of debt-related costs as inherently shared costs.

4.63 We also do not accept that our approach creates a new social policy scheme, or that it falls outside Ofgem's regulatory remit. Costs of non-payment are necessarily borne by those not generating the costs, this includes both suppliers and paying customers. The price cap does not offer a mechanism by which we can transfer costs between price cap and non-price cap customers and so this decision does not generate literal transfers between different customer groups. Instead, we are answering the question of whether the price cap customers today should bear the full burden of historical debt-related costs suppliers have ascribed to price cap customers due to their current tariff type. Answering that question is an inherent part of setting the cap and again requires us to exercise our judgement with a view to protecting existing and future customers on standard variable and default tariffs, while having due regard to other matters set out in legalisation

4.64 We considered whether a separate levy or reconciliation mechanism could spread historical debt-related costs more widely. No such mechanism is currently in place and introducing one would be a different policy intervention with its own legal, design and implementation questions. The absence of such a mechanism does not require us to calculate a net debt-related costs across price cap customers only. Our decision is limited to whether a further adjustment to the cap is justified under this true-up.

Cost efficiency

4.65 Our decision also takes account of whether the reported debt-related costs were efficiently incurred. A weighted average benchmark treats the market's aggregate costs as efficient. However, as Table 2. shows suppliers' net recovery positions vary substantially. In addition, Table 4.2 below shows that observable characteristics of supplier's customer bases explain only part of the variation in net cost – typically no more than 35%. This indicates that differences in the efficiency and effectiveness of suppliers' debt management, provisioning and operating practices may also have contributed to the variation in net costs.

4.66 Beyond this, we know from market engagement that not all suppliers had mature debt-management practices in place when non-payment began to rise in response to rising wholesale prices. This suggests that, at least initially, not all debt-related costs incurred were unavoidable and therefore efficient.

4.67 This evidence means we cannot assume that the entirety of any aggregate under-recovery, calculated on a price cap customer only basis, represent efficient costs that should be recovered from current price cap customers. This is relevant as Table 4.1 shows, applying a more stringent lower-quartile benchmark while calculating bad debt costs over price cap customers leads to a finding of no material under-recovery. In fact it suggests an over-recovery.

Table 4.2 - Correlation coefficient (and R^2) between customer shares (%) and net debt-related costs per customer (£) between April 2022 and June 2025

Customer share %	Net debt-related costs (all customers)[1]	Net debt-related costs (price cap customers)[2]
DD	+0.48 (0.23)	-0.04 (0.00)
SC	+0.57 (0.32)	+0.08 (0.01)
PPM	-0.59 (0.35)	+0.02 (0.00)
Non-price cap tariffs	+0.02 (0.00)	-0.56 (0.31)

Notes: 1. Correlation between (a) net debt-related costs per customer calculated over all customers and (b) share of all customers by payment type and tariff type 2. Correlation between (a) net debt-related costs per customer calculated using price cap customers only for bad debt costs and all customers for administration and working capital costs and (b) share of price cap customers by payment type/share of all customers by tariff type. Eight supplier sample in line with benchmark sample decision.

4.68 The choices we have made over the inclusion of non-price cap customers and to move to a less stringent benchmark can be justified independently. A less stringent benchmark reflects our uncertainty about the relative importance of supplier efficiency and customer base effects. t also avoids the sensitivity of benchmarks based on ranked positions, such as quartiles or medians, and so it is a methodologically more robust way of assessing costs. However, the overall stringency of an allowance is always the net result of cumulative decisions and it is therefore always necessary to consider the combined effect of decisions.

4.69 In that context, we do not necessarily consider that choosing a weighted average benchmark implies a decision that we should have confidence that full cumulative cost recovery of debt costs from customers has definitely occurred. To the contrary, we consider that the likely presence of some inefficiency in the overall level of incurred costs supports the combination of a weighted average benchmark with less stringent methodological choices elsewhere.

4.70 Despite the stand-alone justifications for each change in methodology, the decision to make both at this stage has been tested in the round. This means we considered the joint impact of these changes on the outcome of this review (i.e. to make no further change to the price cap) represents an appropriate and reasonable balance between the competing considerations of supplier cost recovery and protection of price cap customers. Either decision taken separately without the other may not have achieved the same balanced outcome.

5. Inclusion of non-customer working capital

In this section we summarise and respond to stakeholder feedback on the inclusion of non-customer working capital in our assessment of suppliers' net debt-related costs. We confirm our consultation position to include these costs so that we can compare working capital costs and allowances on a like-for-like basis.

Context

5.1 When consulting on whether and how to update the price cap to account for the impact of COVID-19 we identified three related costs that we thought could increase. These were bad debt (as measured by the bad debt charge), due to rising non-payment, associated increases in administration costs and higher working capital costs due to greater late payments. We collectively referred to these as debt-related costs.

5.2 The method for calculating working capital costs for the COVID-19 float and true-up focused on the costs associated with an increase in the average number of days it took customers to pay suppliers (debtor days). This measure of working capital was therefore specific to customers. However, in neither the COVID float nor the true-up did we compare these costs against allowances. They were calibrated by looking at incremental costs, calculated by comparing reported costs against a 2019 baseline.

5.3 When setting the float for additional debt costs we continued to look at the same three categories of debt-related costs. However, for this exercise we took the approach of comparing costs against allowances. This reflects that both costs and allowances are likely to scale with rising wholesale prices, whereas COVID was primarily only a shock to costs. To compare costs and allowances we needed to align cost and allowance categories to make sure they captured the same supplier activities.

5.4 Price cap allowances for working capital are there to reflect all working capital costs. Suppliers will employ working capital to manage the timing difference between incurring costs and customer payments (e.g. due to customers paying in arrears). We refer to this as customer working capital. Suppliers will also employ working capital elsewhere in their business (e.g. relating to the timescale for paying firm who provide them with services), which we refer to as non-customer working capital. The allowance made in the price cap does not distinguish between these two categories of working capital.

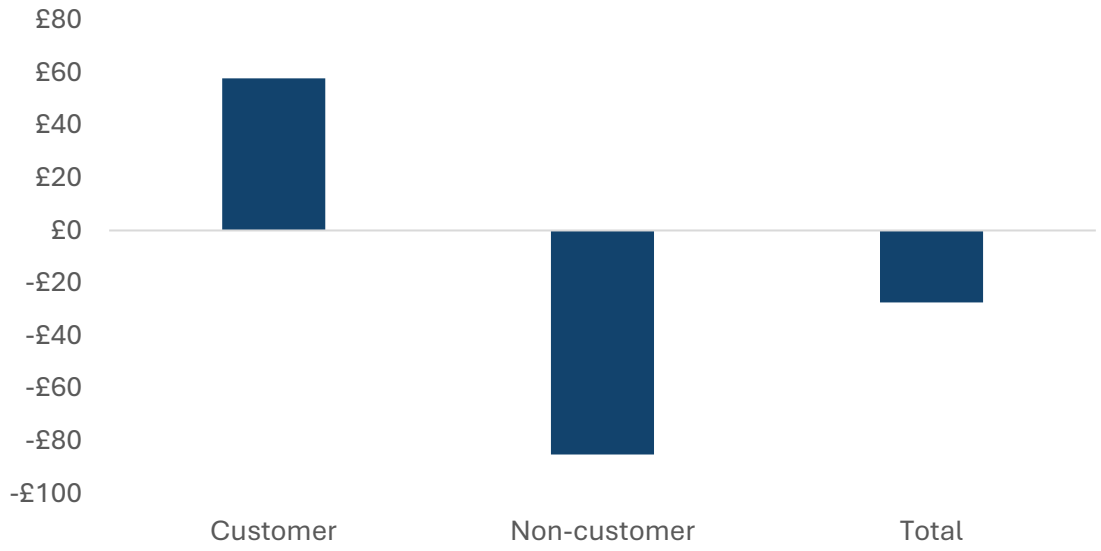
5.5 Given the need to compare costs and allowances we adjusted our approach to measuring working capital costs when setting the additional debt-related costs element of the float. Instead of using debtor days, we requested data from suppliers on their net account receivables for both customers and non-customers. Averaging these values at the beginning and end of each cap period

and multiplying by the cost of capital and the share of the year the period accounted for gave us suppliers' working capital costs.

5.6 In our true-up consultation we retained this approach but instead of a static 10% cost of capital we aligned the cost of capital values with the values used to set the EBIT allowance in each period.

5.7 We find that non-customer working capital tends to be negative and therefore represents a working capital benefit, indicating that suppliers owe more to non-customers than is owed to them. Across the suppliers in our sample this benefit offsets the costs of customer working capital, figure 5.1 below.

Figure 5.1 – Working capital costs by source (1 April 2022 – 30 June 2025; £ per dual fuel customer)



Notes: Value over all customers, same eight supplier sample as used for weighted average benchmark.

Decision

5.8 We have decided to maintain the approach to assessing working capital costs and allowances we set out at consultation, including the inclusion of non-customer working capital costs.

Stakeholder response

Scope of debt-related costs

5.9 Several suppliers made the argument that non-customer working capital costs are not related to the costs of non-payment and are therefore not debt-related costs, so should not be considered in scope of this review.

5.10 We were told that a negative non-customer working capital balance did not demonstrate recovery of debt costs and that a negative balance could reflect

"temporary creditor financing, delayed outflows, parent-company support, collateral arrangements or other timing differences."

5.11 One supplier argued that the irrelevance of non-customer working capital to debt-related costs mean its inclusion expanded the scope of the review into a partial true-up of the EBIT allowance itself. The partial nature of the true-up also meant favourable non-customer working capital outcomes were being used to offset debt-related costs without considering whether suppliers were achieving the overall level of EBIT allowed under the cap. Had we done so, this supplier noted, we would have found an under-recovery of the EBIT allowance across suppliers.

Materiality

5.12 Some suppliers argued that, even accepting the data limitations, we should have shown greater consideration of the degree to which our findings were influenced by the inclusion of non-customer working capital. For example, one supplier told us that they estimated the inclusion of non-customer working capital understated their under-recovery of debt-related cost by £12 per dual fuel customer.

5.13 Given the material impact the inclusion of non-customer working capital has on costs and the uncertain impact it has on allowances, one supplier suggested this should result in Ofgem being cautious in its overall findings. The uncertainty related to the net impact of non-customer working capital should lead us to err on the side of caution when it comes to benchmarking to avoid creating an efficiency incentive not grounded in debt-related costs.

Alternative approaches

5.14 One supplier provided a suggestion as to how we could isolate the customer element of working capital allowances, enabling a like-for-like comparison with just customer working capital and thus avoid the inclusion of non-customer working capital.

5.15 The working capital model published alongside the EBIT allowance decision in 2023 produced a value of £102 of working capital per customer, including cash for ringfencing Renewables Obligation (RO) liabilities. This value is used to set the EBIT allowance. By focusing on the relevant asset and liability line items in the modelled balance sheet, the supplier separately identified the level of working capital attributable to customers, non-customers and corporation tax. They conclude that of the £102 of working capital assumed, £91 was for customers, £36 for non-customers and -£25 for corporation tax.

5.16 As this disaggregation cannot be repeated for the EBIT allowance in place prior to October 2023, as there is no equivalent model, the supplier suggests applying the share of total working capital attributable to customers (90%) to the EBIT working capital values prior to October 2023.

5.17 This supplier's adviser told us that applying this method to remove non-customer working capital costs and allowances resulted in finding an under-recovery of £94 per dual fuel customer (or £125 if taking a price cap only approach to bad debt costs). This change reflects that under the suppliers proposed approach there is a small reduction in working capital allowances (-10%) and a large increase in working capital costs (+300%).

5.18 To come to these estimates the adviser subtracted the renewables obligation (RO) ringfencing component of total capital employed from their £91 estimate of customer working capital, resulting in a figure of around £20 for customer working capital. The supplier's own response suggests that RO ringfencing shouldn't be subtracted as it is already accounted for in the £36 of non-customer working capital.

Incremental working capital costs

5.19 One supplier noted that there is no positive allowance in the price cap to account for the impact of increased non-payment on working capital costs. They point to the growth in the level of customer debt and arrears over time, implying a greater need to hold working capital and therefore higher working capital costs. Given this context they said they would expect a positive allowance for these higher costs to be included in the enduring debt-related cost allowance, including through any adjustments to it.

5.20 While they accept working capital allowances have scaled with the level of the cap, and therefore grew significantly in some periods, this hasn't aligned with the ongoing high debt and arrears situation. As a result, they argue that any systematic and material increase in working capital costs from higher non-payment should be addressed.

Considerations

Scope of debt-related costs

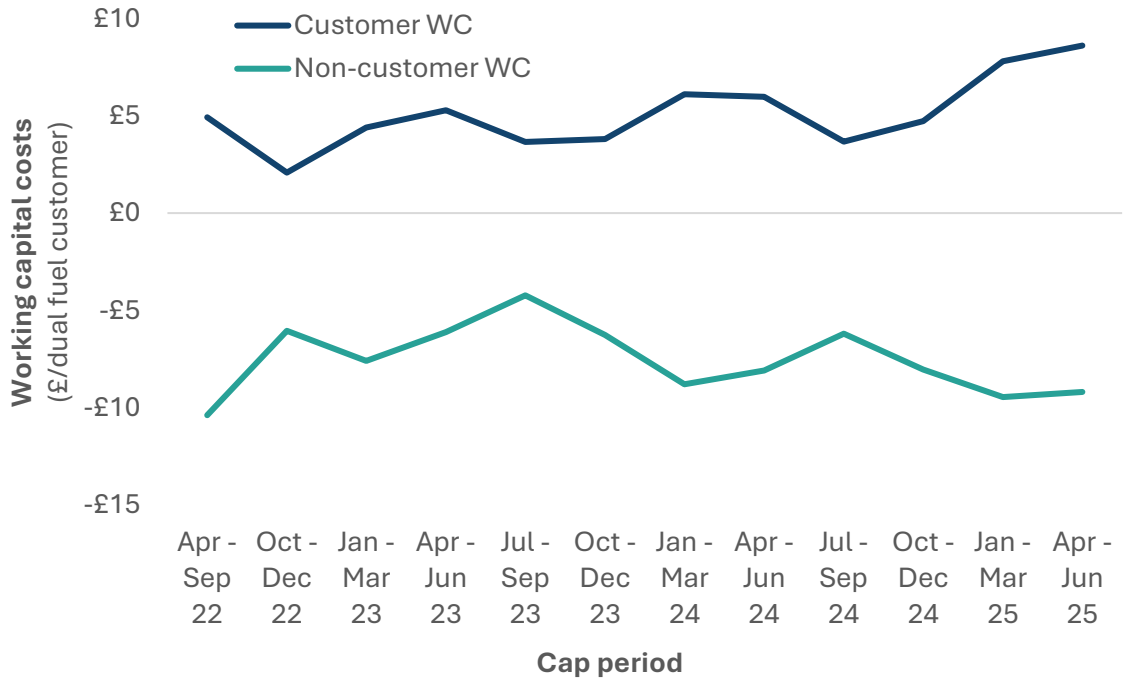
5.21 The costs and allowances included in the scope of this true-up exercise were set out at the beginning and have always included non-customer working capital. We acknowledge that the level, and therefore cost, of non-customer working capital is not driven by customer non-payment. Its inclusion is in part a matter of practicality. To meaningfully compare costs against recovered allowances they need to refer to the same set of activities and we judge there is no reliable method available to compare costs and allowance on a customer only basis. Any lack of specificity in the title used to describe this exercise (i.e. the use of the phrase "debt-related"), given the inclusion of some non-debt-related costs, simply reflects the need to communicate succinctly.

5.22 In addition to practical constraints, we also judge that it is not in customers interests to narrow the scope of reviews to only areas where suppliers may have

under-recovered costs. Incorporating evidence of over-recovery within other elements of the same allowances under review, such as the non-customer working capital element of the EBIT allowance, prevent an overly partial consideration of supplier cost recovery.

5.23 Moreover, there is evidence that movements in customer and non-customer working capital are related. Figure 5.2 below shows that they show some negative correlation over time, with a rise in customer working capital being associated with a fall in non-customer working capital. This apparent offsetting relationship supports the consideration of them together.

Figure 5.2 – Working capital costs per dual fuel customer by cap period and category



Notes: Values calculated over all customers.

5.24 Supplier criticism of this exercise being a partial true-up of the EBIT allowance could logically be applied to many other allowances. Debt-related costs were not consolidated into a single allowance over much of the period under review. As a result, debt-related allowances are calculated by aggregating over fractions of several different allowances. These include operating costs, the Payment Method Adjustment Percentage (PAAC), the Payment Method Adjustment Percentage (PAP), PPM uplift and EBIT – as well as entire allowances like the float itself and the temporary ASC allowance (see table 2.1 in the consultation document). It would therefore be possible to characterise this true-up as a partial true-up of all these allowances, not just EBIT.

Materiality

5.25 At consultation we did not provide an assessment of the impact of non-customer working capital costs on net debt-related costs because, as previously discussed, we can only observe the value of the costs and not the allowances. Removal of the costs alone would generate the net cost figure that did not accurately portray the impact of non-customer working capital. For this same reason we do not provide an assessment here.

5.26 However, we did disclose our full modelling as part of a disclosure process, enabling participating supplier's advisors to investigate the impact of including non-customer working capital.

Alternative approaches

5.27 As above, we do not think that there is a strong case for isolating the customer working capital from non-customer working capital. We also do not consider the method suggested to isolate and remove non-customer working capital from overall working capital allowances to be sufficiently robust. The working capital model used to set the working capital and RO ringfencing elements of the EBIT allowance was not designed with a distinction between customer and non-customer working capital in mind.

5.28 To have accurately simulated non-customer working capital levels for a notional supplier the model would have had to make assumptions about the drivers and dynamics of non-customer working capital. As the supplier noted, this could include things like creditor financing and delayed outflows. The model makes no such assumptions.

5.29 Under the proposed methodology we would ascribe the modelled levels of cash held on the balance sheet (including ringfenced cash for RO liabilities) as non-customer assets and fuel, policy, network costs and VAT payable as non-customer liabilities, with the assets minus liabilities giving the level of non-customer working capital.

5.30 The level of non-ringfenced cash held in the model is primarily determined by calculating the amount of cash needed at the start of the period to keep cash and working capital above zero over the period of the model in the face of a 1 in 20-year wholesale energy price shock. This starting balance is therefore strongly related to the working capital suppliers need to deal with customer payment timing differences.

5.31 Beyond the specifics, under the methodology proposed the model produces a value for non-customer working capital that is different in nature to the one we observe. As shown in Figure 5.1 suppliers report a negative non-customer working capital position (i.e. a working capital benefit). In contrast the EBIT working capital model consistently outputs a positive value for the net value of the assets and

liabilities identified by the supplier as amounting to non-customer working capital.

Incremental working capital costs

5.32 While the stock of debt and arrears has increased (see debt and arrears indicators), the relationship between this and working capital costs is not linear. Some debt will be provisioned as bad debt and some written-off entirely, this represents a discrete financial loss rather than on-going working-capital financing costs. These losses are accounted for by the bad debt elements of price cap allowances. However, it is reasonable to expect some positive relationship between the amount customers owe suppliers and the level of working capital suppliers need to hold.

5.33 Two allowances for working capital have been introduced since the overall stock of debt began to increase. These are the float allowance we are reviewing in this document and the new enduring DRC allowance; both were calibrated using supplier reported costs. To the extent suppliers reported higher working capital costs than they otherwise would have, had non-payment not increased, then both allowances increased the revenue suppliers could recover for working capital compared to the counterfactual. That this isn't presented as a new positive price cap allowance is because those allowances set the allowed revenue for all working capital costs, not just those driven by changes in non-payment.

Appendix 1. Modelling corrections and changes

Summary

A1.1 As part of the March 2026 consultation, we disclosed the excel spreadsheet models used to calculate debt-related costs and allowances to relevant parties. Suppliers who took part in this disclosure exercise received versions of these spreadsheets with all supplier data removed. Suppliers could however appoint third-party advisers to receive the models on their behalf with anonymised supplier data included. Advisers could then provide suppliers with reports on their findings, subject to checks and approval from Ofgem that those reports did not disclose any identifiable or market sensitive information.

A1.2 Through this process several errors in the model calculations and the treatment of supplier data were identified and communicated to us via supplier consultation responses and adviser reports. In this appendix we summarise the issues identified and describe the corrections made.

A1.3 The impact of these corrections on our preferred measure of net debt-related costs (i.e. a weighted average benchmark calculated over all customers) is small, see table A.1 below.

Table A1 – Cumulative impact of model corrections on weighted average net debt-related costs (£ per dual fuel customer)

Corrections / Changes	Weighted Average Net Debt-Related Costs
(A) Original consultation	£1.22
(B) = (A) + Working capital correction	£1.07
(C) = (B) + Consumption correction	£1.62
(D) = (C) + Allowance and revenue corrections	£1.64

A1.4 In addition to correcting errors, we have also made changes to the way we apportion suppliers reported costs across payment and tariff type customer groups. These changes have been made to help improve the consistency of cost breakdowns. Whilst these changes resulted in some movement in debt-related cost recovery outputs, they did not change the overall outcome of our decision.

A1.5 Finally, since publication of the consultation, we have sought to improve our data handling processes to ensure high degree of quality assurance. To do this we have transitioned from an Excel-led modelling process to a Python-based analytical framework. This reduced the reliance on manual processing and improved the transparency, repeatability and auditability of the analysis by applying consistent transformation and validation processes across all supplier submissions.

Correcting errors

Working Capital Calculation Issue

A1.6 During post-consultation quality assurance, we identified issues affecting the treatment of working capital within both the cost model and the allowance model.

A1.7 The most significant issue related to the calculation of average balances in the earliest cap periods included within the assessment. For several periods, balances were calculated using a shorter observation period than originally intended, leading to inconsistencies between cap periods.

A1.8 We corrected the methodology to calculate average balances and applied the revised treatment consistently across all relevant periods.

A1.9 We also identified issues within the debt-related cost allowance model following changes to the underlying working capital methodology. In a small number of cases, both legacy and revised approaches remained within the model following methodology updates, resulting in duplicated calculations and inconsistencies in the references used to estimate working capital allowances.

A1.10 These calculations were reviewed and corrected to ensure a single methodology was applied throughout the assessment.

Consumption Correction

A1.11 Issues were identified in the processes used to transform supplier submissions into a dataset used as an input into our cost model.

A1.12 These included a small number of cases where differences in supplier formatting prevented consumption values from being interpreted as intended. As a result, a limited number of consumption observations were incorrectly processed within the consultation model.

A1.13 We corrected the transformation logic and reprocessed the relevant submissions to ensure that consumption data was treated consistently across suppliers and cap periods.

A1.14 We also identified inconsistencies between customer numbers reported at detailed tariff and fuel levels and the aggregate customer counts used elsewhere within the model.

A1.15 These inconsistencies arose because customer categories were combined incorrectly during part of the transformation process. We corrected the underlying logic and ensured that customer numbers reconcile consistently between detailed and aggregate levels throughout the assessment.

Allowance and revenue corrections

A1.16 We identified a small number of issues affecting the calculation of debt-related allowances and revenues used within the consultation analysis.

A1.17 These included the use of incorrect CPIH reference values for certain cap periods and inconsistencies between allowance values generated within the debt-related allowance model and the values subsequently used within the true-up model.

A1.18 These issues did not reflect changes to the underlying methodology. Rather, they arose through the implementation of calculations within the consultation modelling process.

A1.19 We corrected the relevant CPIH references and updated affected allowance values to ensure consistency between the allowance calculations and the final true-up assessment.

A1.20 We also identified differences in the basis on which certain revenues had been reported. To improve comparability across suppliers, we applied standardisation adjustments where required so that revenues were assessed on a consistent basis across the dataset.

Methodological changes and standardisation

A1.21 In addition to the modelling corrections described above, we made several methodological and data-processing improvements following publication of the consultation. These changes were not made to correct errors within the consultation analysis. Rather, they were introduced to improve consistency across supplier submissions, reduce reporting burden and apply a more standardised treatment of data where detailed information was not available.

A1.22 These changes do not impact total costs or allowances, and so do not change our preferred measure of efficient net debt-related costs (i.e. weighted average benchmark over all customers).

A1.23 The following sections describe the principal methodological changes and data standardisation approaches adopted for the final assessment.

Supplier data standardisation and allocation

A1.24 We identified instances where suppliers had reported complete aggregate debt-related costs but had not provided the tariff-type or payment-method breakdowns required for parts of the assessment. In our consultation document for one large supplier who did not provide tariff type breakdowns we assessed their net debt-related costs over all their customers regardless of the methodology approach we presented in the document. In their consultation response the supplier suggested an alterative to this approach, which we have implemented.

A1.25 Where tariff-level cost breakdowns were unavailable, we now calculate costs and revenues per customer at the payment type level and then allocate these between tariff type groups in line with those group's payment type shares. This means within each tariff type costs and revenues per customer are the same for customers paying by the same payment type, but the aggregate values differ due to the differing proportions of customers by payment type within each tariff type group.

A1.26 We consider this approach preferable to applying supplier-specific assumptions or excluding relevant data, as it maintains consistency across suppliers and improves comparability within the assessment.

A1.27 While this does not impact our assessment of net debt-related costs under our preferred approach, it did alter the value obtained when bad debt costs are assessed over price cap customers only. In our consultation the weighted average benchmark under this alternative approach was given as -£15.55 per dual fuel customer (see Table 3.4 in the consultation document). This new allocation approach significantly changed one supplier's values for bad debt costs and revenues over price cap customers. This is the primary driver of the increase in the weighted average benchmark to -£26 per dual fuel customer (see Table 4.1 in Chapter 4).

Debt write-off allocation

A1.28 We also identified instances where debt write-off values were reported only at aggregate levels and were not available across the tariff-type and payment-method breakdowns required for the true-up assessment.

A1.29 To address this issue, we developed a standardised allocation methodology that distributes write-offs according to the distribution of reported bad debt charges.

A1.30 This approach reflects the close relationship between bad debt charges and debt write-offs and provides a reasonable basis for allocating costs where more granular information is unavailable.

A1.31 Applying a common methodology improved consistency across supplier submissions while ensuring that total reported write-off values remained unchanged.

Non-customer working capital

A1.32 Following the consultation, we reviewed both the collection and treatment of non-customer working capital data.

A1.33 We found significant variation in the level of granularity provided by suppliers. Some suppliers reported detailed tariff-type and payment-method breakdowns, others reported only aggregate values. For supplier who did

attempt to provide a tariff and payment type breakdown of non-customer working capital we also found significant variation in the methods used.

A1.34 To improve consistency across suppliers and reduce reporting burden, we amended the data collection approach for non-customer working capital. Rather than collecting tariff-type and payment-method breakdowns directly from suppliers, we now collect aggregate values and apply a consistent allocation methodology.

A1.35 Under this methodology, non-customer working capital is allocated using the same proportional distribution observed within consumer working capital. This ensures that all suppliers are treated consistently while preserving the overall value reported by each supplier.

A1.36 We consider this approach to be more transparent, more reproducible and less dependent on differences in supplier reporting practices. It also improves comparability across suppliers by ensuring that a common methodology is applied throughout the assessment.

A1.37 As we combine customer and non-customer working capital when assessing net debt-related costs this does not impact our values and therefore conclusion.

Data handling improvements

A1.38 Following publication of the consultation, we rebuilt the Excel data ingestion, transformation and modelling steps in a series of python scripts.

A1.39 The revised process applies a consistent set of transformation, validation and quality assurance checks to all supplier submissions before they are incorporated into the analysis.

A1.40 This has reduced the reliance on manual processing, strengthened quality assurance and improved the reproducibility of the assessment.

A1.41 We consider that these improvements have strengthened the robustness of the analysis presented in this decision and improved our ability to identify and correct issues before publication.