



Making a positive difference  
for energy consumers

To Distribution Network  
Operators (DNOs), Gas  
Distribution Networks (GDNs),  
Transmission Owners (TOs), the  
Electricity System Operator  
(ESO), Energy supply companies,  
gas shippers and other interested  
stakeholders

Direct Dial: 020 7901 7000  
Email: [regfinance@ofgem.gov.uk](mailto:regfinance@ofgem.gov.uk)

Date: 7 August 2020

Dear Colleague,

**Managing network charge bad debt – proposal enabling networks to recover potential bad debts arising from COVID-19 related deferred network charge payments and to introduce an enduring solution to bad debt recovery in general.**

The Network Charge Deferral (NCD) scheme, run by the ENA, will help to minimise disruption to customers and other market participants, by assisting suppliers and shippers who face cash-flow issues due to the unprecedented public health crisis triggered by COVID-19.

In our open letter published on 2 June 2020 on the NCD scheme<sup>1</sup>, we said that where any supplier or shipper takes advantage of such schemes, we would expect network companies to pursue any debt through the liquidation process. However, where they have sought to do this, we said they would be able to recover outstanding bad debt within the year 2021-22. We said that in due course we would propose licence modifications to give effect to this.

In this letter we set out options for enabling networks to recover any potential bad debts arising as a direct result of that scheme in the year 2021-22. Our proposals within this letter will enable the effective recovery of bad debts.<sup>2</sup> Our preferred option for the recovery of bad debts arising as a result of that scheme would also allow for the recovery of other bad debts

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<sup>1</sup> Open letter on relaxing network charge payment terms, published 2 June 2020 - [https://www.ofgem.gov.uk/system/files/docs/2020/06/open\\_letter\\_on\\_relaxing\\_network\\_charge\\_payment\\_terms\\_1.pdf](https://www.ofgem.gov.uk/system/files/docs/2020/06/open_letter_on_relaxing_network_charge_payment_terms_1.pdf)

<sup>2</sup> Net of interest income accrued at the default interest rate set out in the relevant code.

incurred due to non-payment of network charges, net of interest income accrued, on an enduring basis.

### **Potential COVID-19 bad debts arising from NCD in 2021-22**

The options set out below would allow networks to recover potential bad debts incurred as a direct result of the NCD scheme, as well as other bad debt that may arise on an enduring basis due to the non-payment of network charges. NCD bad debt refers to:

- Debt accrued from non-payment of electricity distribution and transmission network charges by electricity suppliers, and to gas distribution transportation capacity charges and gas transmission transportation charges by gas shippers.
- Debt accrued from non-payment over the three-month period in which the Network Charge Deferral scheme was active. The specific time periods to which the arrangements would apply may vary across the different sectors.
- Debt accrued per supplier and shipper of no more than 75% of the monthly invoice amount at the time of deferral.
- Debt accrued per supplier and shipper capped at £1.6m per electricity supplier group and £1m per gas shipper (both per network licence area and over the scheme length of three months).
- Any deferred payments would accrue interest at the default rates set out in the relevant industry codes. (currently 8.1%).<sup>3456</sup>

### **Options to recover COVID-19 NCD bad debt in 2021-22, and other bad debt on an enduring basis**

We considered three options that would allow licensees to recover NCD related bad debt in 2021-22, and also provide an enduring solution to the recovery of bad debts in general.

These options are detailed in table 1, but briefly they are:

- (1) Miscellaneous pass through term;
- (2) Eligible Bad Debt (EBD<sub>t</sub>) pass through term; and
- (3) Bad debt term.

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<sup>3</sup> Late payment of Commercial Debts (Interest) Act 1998 - <http://www.legislation.gov.uk/ukpga/1998/20/contents>

<sup>4</sup> DCUSA Document - <https://www.dcusa.co.uk/dcusa-document/>

<sup>5</sup> CUSC Document - <https://www.nationalgrideso.com/document/141131/download>

<sup>6</sup> UNC Document - <https://gasgov-mst-files.s3.eu-west-1.amazonaws.com/s3fs-public/ggf/page/2020-06/General%20%28Consolidated%2C%20printable%20version%29.pdf?xmcIb0BVuecDwXQXeD5ADsEzSobExRaw>

We discussed these options with energy network companies, and are now seeking wider views on applying option 3 to each sector. We consider that option 3 best delivers the policy intent and we have set out our rationale in table 1 below. We are of the view that option 3 allows for consistency and transparency across all sectors, and is proportionate to the relative materiality of the potential bad debt.

To ensure that consumers benefit from any interest accrued by networks due to the proposed schemes, we propose to adjust any bad debt recovery with the interest accrued by the network companies, net of the cost of capital.<sup>7</sup>

**Table 1: Proposed options for bad debt recovery**

Sector	Option 1	Option 2	Option 3 (preferred)
Gas Distribution (GD)	<p>Use the existing Miscellaneous Pass-through term (<math>MP_t</math>).<sup>8</sup></p> <p>This term enables the licensee to request a direction from Ofgem to allow a given amount to be included in its pass-through costs.</p>	<p>Adopt the existing ED1 <math>EBD_t</math> pass-through term.</p> <p>This terms enables the licensee to recover Eligible Bad Debt (<math>EBD_t</math>), inclusive of Eligible Bad Debt Allowance (<math>EBDA_{t-3}</math>), historic bad debts (HBD) and Valid Bad Debt Claims (<math>IBDA_t</math>).<sup>9</sup></p>	<p>Introduce a new bad debt term (<math>BD_t</math>) in the RIIO-2 licence, similar to existing business rates/licence fee terms. This would involve us setting a provisional allowance, based on estimated values provided by the licensee, which is trued-up in the following period through RIGs reporting.</p> <p>This would allow for the on-going recovery of general bad debts incurred due to non-payment of network charges including NCD specific bad debt.</p> <p>No change would be proposed to the existing RIIO-1 licence conditions. Instead, where potential bad debts relating to the RIIO-1 period crystallise during the RIIO-2 price control, we propose to reflect an estimate of these amounts in our Final Determinations, which would enable the recovery of those amounts in 2021-22. These estimated amounts will be trued-up in a subsequent regulatory period, once actuals are known.</p>
Gas Transmission (GT)  Electricity System Operator (ESO)	<p>Introduce a Miscellaneous Pass-through term similar to that in Gas Distribution Special Licence Conditions.</p>	<p>Adopt the existing ED1 <math>EBD_t</math> pass-through term.</p> <p>Adopt the existing ED1 <math>EBD_t</math> pass-through term.</p>	<p>As per GD</p> <p>Note the ESO collects revenue on behalf of the Transmission Owners. As such, any bad debts arising from non-payment of Transmission Network Use of System (TNUoS) and</p>

<sup>7</sup> For any bad debt associated with the Network Charge Deferral scheme this will be the relevant sector RIIO-1 weighted average cost of capital (WACC). For RIIO-2 we propose to use a fixed margin over a floating bank rate as the cost of capital. This is relatively simple and parallels how floating debt may be priced in practice, which is more relevant to short term debt. This will be set out in the relevant sector RIGs.

<sup>8</sup> Special Condition 1C. Distribution Network allowed pass-through items of the Gas Distribution Network licensees' gas transporter licence.

<sup>9</sup> CRC 2B. Calculation of Allowed Pass-Through Items of the Electricity Distribution Network licensees' electricity distribution licence.

		This terms enables the licensee to recover Eligible Bad Debt( $EBD_t$ ), inclusive of Eligible Bad Debt Allowance( $EBDA_{t-3}$ ), historic bad debts(HBD) and Valid Bad Debt Claims ( $IBDA_t$ ).	Balancing Services Use of System (BSUoS) charges will be incurred by the ESO. <sup>10</sup>
Electricity Distribution (ED)	Introduce a Miscellaneous Pass-through term similar to that in the Gas Distribution Special Licence Conditions.	Modify the existing $EBD_t$ pass-through term in the current ED1 licence by introducing an allowance term ( $EBDE_t$ ) to represent the estimated provision for bad debts relating to non-payment of network charges and the associated accrued interest income.	<p>Introduce a new NCD specific bad debt term (<math>CBD_t</math>) similar to existing business rates/licence fee terms in the RIIO-1 licence. This would involve setting a provisional allowance, based on estimated values provided by the licensee, which is trued-up in the following period through RIGs reporting.</p> <p>This would allow for recovery of bad debt costs directly resulting from the NCD scheme only.</p> <p>We propose to eventually replace this with the proposed all-purpose bad debt term, <math>BD_t</math> in the RIIO-ED2 licence, to make it consistent with the other sectors.</p>
Rationale	This approach whilst simple to implement, would require companies to request consent for the pass-through. Therefore, this option would place an administrative burden on all parties, with Ofgem potentially having to consider a number of requests for consent each year.	This approach would likely be more difficult to implement in comparison to the other options.	<p>This approach involves a relatively simple pass-through term, which can be reported through the RIGs. This option is both easier to implement and maintain in comparison to the other options. Additionally, this approach would ensure consistency across all sectors and would provide the appropriate level of transparency.</p> <p>For ED this alternative approach is preferred as it is the simplest way to modify the existing ED1 licence conditions in comparison to the other options. This approach avoids the complexities of modifying the existing <math>EBD_t</math> term, and allows for the recovery of NCD specific bad debt in 2021/22 through the <math>CBD</math> term.</p>

In order to enable the recovery of potential NCD related debts in 2021-22, we propose to allow licensees to inform us of a provisional bad debt value, which can be used as part of their notice of tariff changes.<sup>11</sup>

<sup>10</sup> Electricity Transmission bad debt is incurred by the Electricity System Operator - [https://www.ofgem.gov.uk/system/files/docs/2020/07/tnuos\\_decision\\_letter\\_final\\_0.pdf](https://www.ofgem.gov.uk/system/files/docs/2020/07/tnuos_decision_letter_final_0.pdf)

<sup>11</sup> ED licensees will have to ask the Authority for a consent for them to only give 40 days' notice of tariff changes.

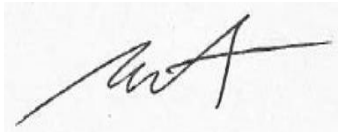
We are seeking your views on our proposal for the recovery of network charge related bad debt. We would especially welcome responses to the specific questions which has been set out below:

**Q1: Do you agree that our proposals would allow the recovery of bad debts, by network licensees, relating to Network Charge Deferral scheme (COVID-19) in 2021-22?**

**Q2: Do you agree with the introduction of a pass-through term in the RIIO-2 licence as an enduring solution for the recovery of bad debt?<sup>12</sup>**

The deadline for response is 4 September 2020 and should be sent to [regfinance@ofgem.gov.uk](mailto:regfinance@ofgem.gov.uk).

Yours sincerely,

A handwritten signature in black ink, appearing to be 'Mick Watson', written on a light-colored background.

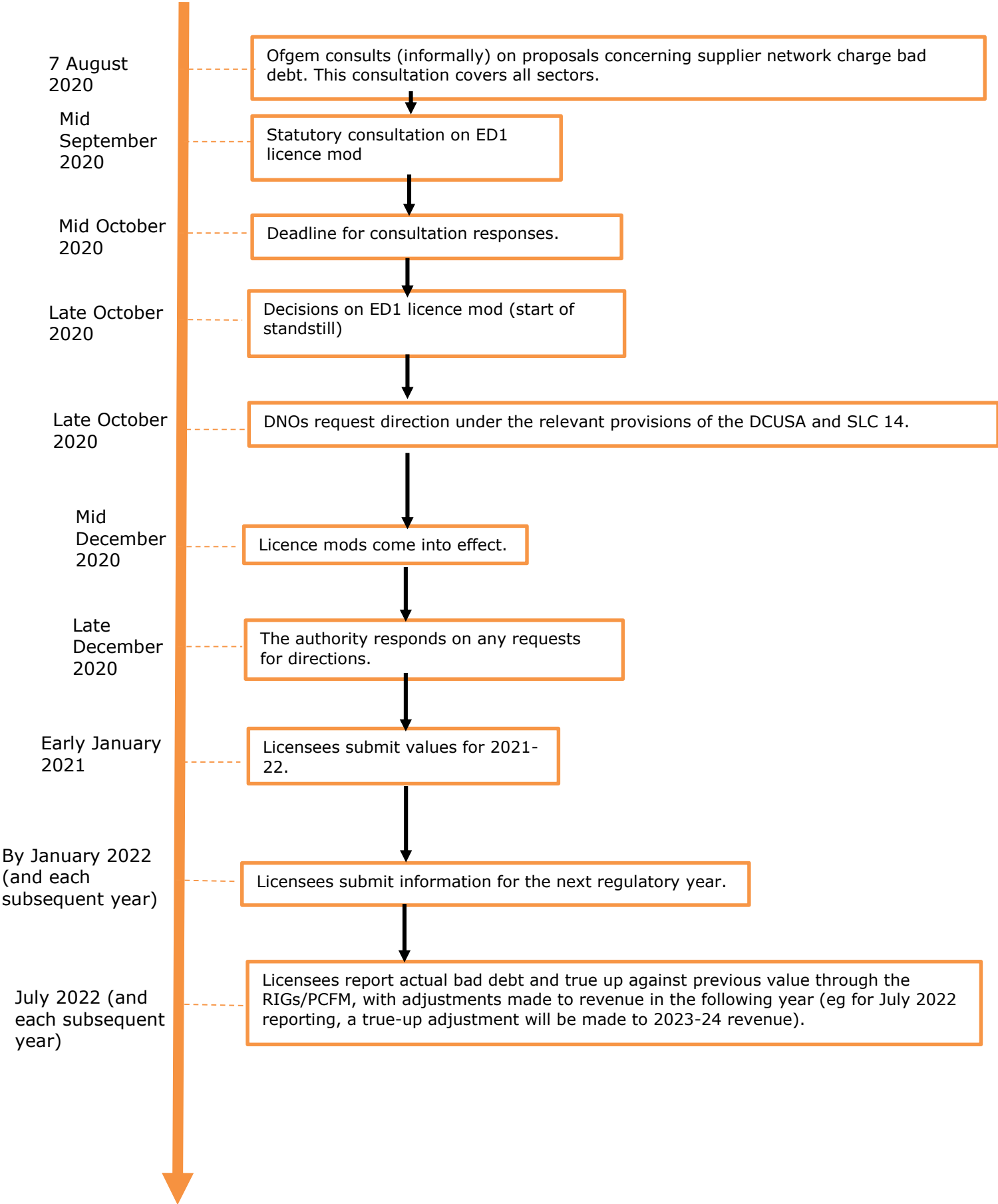
**Mick Watson**

**Head of Regulatory Finance Reporting, Systems & Networks**

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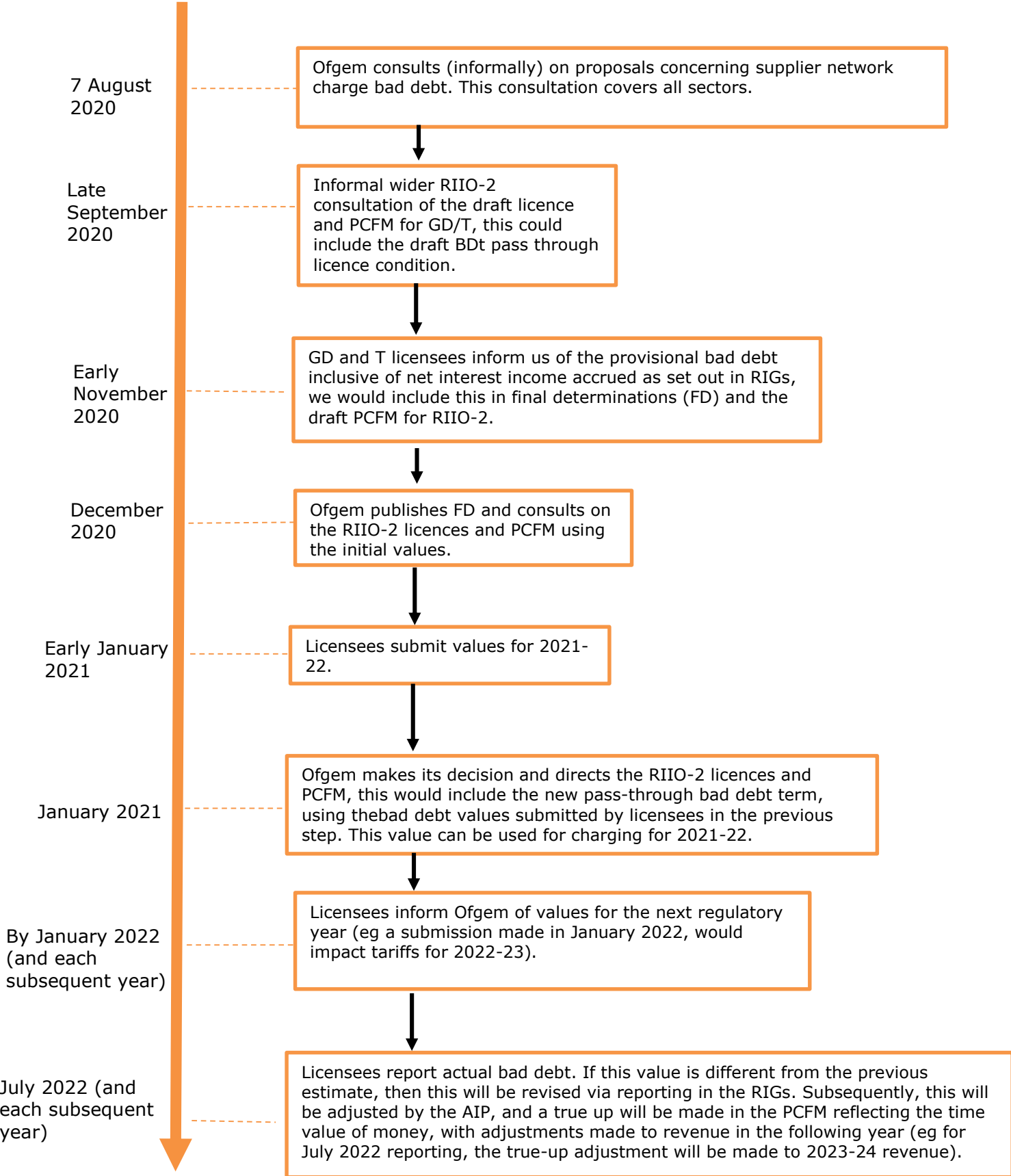
<sup>12</sup> For ED, GD, GT and ESO RIIO-2 licences.

# Appendix 1. – ED Indicative Timeline.<sup>13</sup>



<sup>13</sup> Please note this timeline is indicative and may be subject to change.

# Appendix 2. – GT, GD and ESO Indicative Timeline.<sup>14</sup>



<sup>14</sup> Please note this timeline is indicative and may be subject to change.