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Consultation

Reviewing the potential impact of COVID-19 on the default tariff cap: cap period seven			
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Response deadline:	15/06/2021	**Email:**	retailpriceregulation@ofgem.gov.uk

This is our final consultation on whether and how to update the default tariff cap methodology to account for the impact of COVID-19 on the efficient costs of supplying domestic default tariff customers in cap period seven. We would like views from stakeholders with an interest in the level of the default tariff cap. We particularly welcome responses from domestic energy suppliers, consumer groups and the public.

This document outlines the scope, purpose and questions of the consultation and how you can get involved. Once the consultation is closed, we will consider all responses. We want to be transparent in our consultations. We will publish the non-confidential responses we receive alongside a decision on next steps on our website at **Ofgem.gov.uk/consultations**. If you want your response – in whole or in part – to be considered confidential, please tell us in your response and explain why. Please clearly mark the parts of your response that you consider to be confidential, and if possible, put the confidential material in separate appendices to your response.

Contents

Executive summary

The default tariff cap ('cap') protects default tariff customers, ensuring that they pay a fair price for their energy, reflecting its underlying costs. In our February 2021 decision,[1] we concluded that the COVID-19 pandemic had resulted in additional costs – specifically debt-related costs for credit meter default tariff customers - that were material in cap periods four to six and not allowed for through the existing cap methodology. We therefore included an additional allowance in the cap level for cap period six (which started on 1 April 2021). We set this as a float (which was conservative in favour of consumers), which we would "true-up" later using final costs.

Scope of our assessment

We have considered whether there is clear and significant evidence that suppliers are likely to incur material additional debt-related costs, in particular:

- Bad debt costs for credit customers in cap period seven
- Bad debt costs for prepayment meter (PPM) customers for cap periods four to seven
- Working capital costs for both credit and PPM customers in cap period seven
- Debt-related administrative costs for both credit and PPM customers in cap period seven.

Our methodology

We are proposing to broadly maintain the methodology we have used in our February 2021 decision. However, we are proposing to amend our methodology to include additional filters to assess whether a supplier's forecast should form part of our sample and introduce a sharing factor to equally share the impact of the additional COVID-19 costs between suppliers

[1] Ofgem (2021), Decision on the potential impact of COVID-19 on the default tariff cap, executive summary.
https://www.ofgem.gov.uk/publications-and-updates/decision-potential-impact-covid-19-default-tariff-cap

and customers. This would ensure that our float is conservative, and fairly allocates costs across suppliers and customers.

We are also proposing to assess external forecasts for key economic metrics to form a view on the fundamental need for a float.

Whether a float is necessary

Following our review of suppliers' forecasts for debt-related costs and the forecast of key economic metrics, we propose to not include an additional allowance in cap period seven for costs arising from COVID-19. Suppliers' forecasts of debt-related costs for both credit and PPM customers for all the periods assessed are not materially greater than their pre-COVID levels.

At the same time, current evidence shows a positive economic outlook for cap period seven. The economy is forecast to grow at a faster rate in cap period seven. In addition, unemployment is expected to remain broadly stable and no longer to peak during this period. Our evidence on the financial resilience of customers does not contradict the broader economic metrics.

We only consider a float is necessary if there is significant and clear evidence that suppliers are likely to incur material additional costs due to COVID-19. This is to protect customers' interests. We have not found this to be the case. Therefore, we do not consider that an additional float for debt-related costs in cap period seven is necessary for either credit and PPM customers.

Going forward

In our previous decision for cap periods four to six, we had spread part of the float for credit customers into the additional allowance for cap period seven. Our proposal means that we would not increase this amount for any costs relating to cap period seven.

In line with our previous decisions, our proposal means that there would not be any adjustment for PPM customers.

We invite stakeholder views and supporting evidence on any aspect of this consultation by 15 June 2021. Stakeholders' responses will inform our decision, which we intend to publish in August 2021.

1. Consultation process

Consultation stages

March 2021 working paper

1.1. We published a working paper in March 2021 that set out our initial thinking on reviewing the potential impact of COVID-19 on the default tariff cap, and whether a float for cap period seven was necessary. Stakeholders provided responses in April 2021.

This consultation

1.2. This consultation sets out our revised proposals. We invite stakeholders to submit comments on these proposals and on any aspect of this consultation on or before **15 June 2021**.

Decision

1.3. Subject to consultation, we intend to publish a decision at the beginning of August 2021, so that any changes will have effect from 1 October 2021 (the seventh cap period).

Related publications

1.4. The main documents relating to the cap are:

- Domestic Gas and Electricity (Tariff Cap) Act 2018: http://www.legislation.gov.uk/ukpga/2018/21/contents/enacted.
- Default Tariff Cap Decision: https://www.ofgem.gov.uk/publications-and-updates/default-tariff-cap-decision-overview.

1.5. The main documents relating to reviewing the potential impact of COVID-19 on the default tariff cap are:

- March 2021 working paper on reviewing the potential impact of COVID-19 on the default tariff cap (‘March 2021 working paper’): https://www.ofgem.gov.uk/publications-and-updates/price-cap-working-paper-reviewing-potential-impact-covid-19-default-tariff-cap-cap-period-seven.

- February 2021 decision on the potential impact of COVID-19 on the default tariff cap ('February 2021 decision'): https://www.ofgem.gov.uk/publications-and-updates/decision-potential-impact-covid-19-default-tariff-cap.

- November 2020 consultation on reviewing the potential impact of COVID-19 on the default tariff cap: ('November 2020 consultation'): https://www.ofgem.gov.uk/publications-and-updates/reviewing-potential-impact-covid-19-default-tariff-cap-november-2020-consultation.

- September 2020 policy consultation on reviewing the potential impact of COVID-19 on the default tariff cap: ('September 2020 consultation'): https://www.ofgem.gov.uk/publications-and-updates/reviewing-potential-impact-covid-19-default-tariff-cap-september-2020-policy-consultation.

- Impact of COVID-19 on retail energy supply companies – regulatory expectations from 1 July 2020: https://www.ofgem.gov.uk/publications-and-updates/impact-covid-19-retail-energy-supply-companies-regulatory-expectations-1-july-2020.

How to respond

1.6. We want to hear from anyone interested in this consultation. Please send your response to the person or team named on this document's front page.

1.7. We do not ask specific questions in this document. Rather, we welcome views on any of the matters discussed in this consultation.

1.8. We will publish non-confidential responses on our website at www.ofgem.gov.uk/consultations.

Your response, data and confidentiality

1.9. You can ask us to keep your response, or parts of your response, confidential. We will respect this, subject to obligations to disclose information, for example, under the Freedom of Information Act 2000, the Environmental Information Regulations 2004, statutory directions, court orders, government regulations or where you give us explicit permission to disclose. If you do want us to keep your response confidential, please clearly mark this on your response and explain why.

1.10. If you wish us to keep part of your response confidential, please clearly mark those parts of your response that you *do* wish to be kept confidential and those that you *do not* wish to be kept confidential. Please put the confidential material in a separate appendix to your response. If necessary, we will get in touch with you to discuss which parts of the information in your response should be kept confidential, and which can be published. We might ask for reasons why.

1.11. If the information you give in your response contains personal data under the General Data Protection Regulation 2016/379 (GDPR) and domestic legislation on data protection, the Gas and Electricity Markets Authority will be the data controller for the purposes of GDPR. Ofgem uses the information in responses in performing its statutory functions and in accordance with section 105 of the Utilities Act 2000. Please refer to our Privacy Notice on consultations, see Appendix 5.

1.12. If you wish to respond confidentially, we will keep your response itself confidential, but we will publish the number (but not the names) of confidential responses we receive. We will not link responses to respondents if we publish a summary of responses, and we will evaluate each response on its own merits without undermining your right to confidentiality.

General feedback

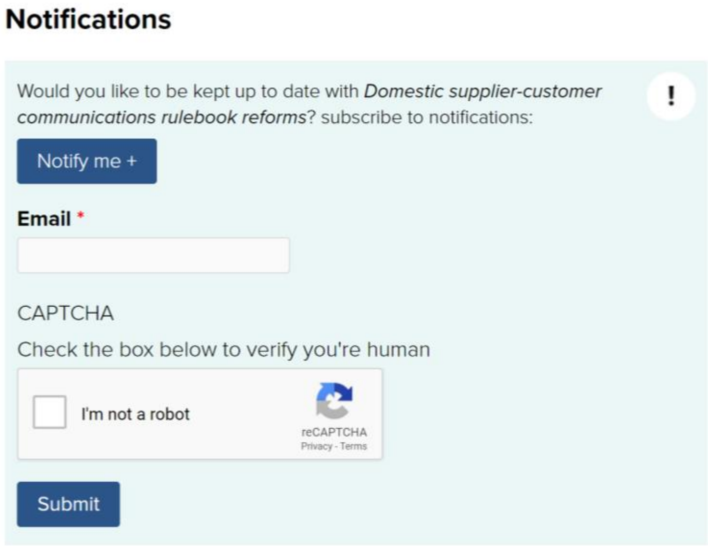
1.13. We believe that consultation is at the heart of good policy development. We welcome any comments about how we have run this consultation. We would also like to get your answers to these questions:

1. Do you have any comments about the overall process of this consultation?
2. Do you have any comments about its tone and content?
3. Was it easy to read and understand? Or could it have been better written?
4. Were its conclusions balanced?
5. Did it make reasoned recommendations for improvement?
6. Any further comments?

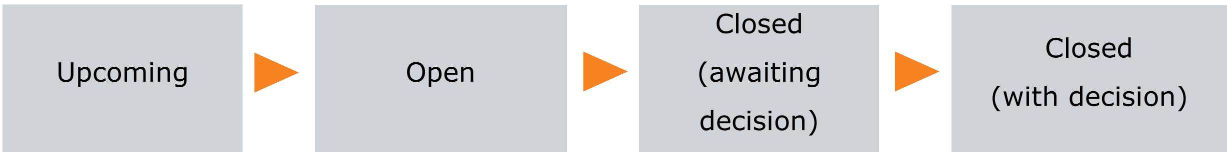
Please send any general feedback comments to stakeholders@ofgem.gov.uk

How to track the progress of the consultation

You can track the progress of a consultation from upcoming to decision status using the 'notify me' function on a consultation page when published on our website. [Ofgem.gov.uk/consultations.](https://www.ofgem.gov.uk/consultations)



Once subscribed to the notifications for a particular consultation, you will receive an email to notify you when it has changed status. Our consultation stages are:



2. Introduction

What are we consulting on?

2.1. The default tariff cap ('cap') protects approximately 15 million domestic customers on standard variable and default tariffs (which we refer to collectively as 'default tariffs'), ensuring that they pay a fair price for their energy, reflecting its underlying costs. The cap is one of the key activities which fall within the outcome "consumers pay a fair price for energy and benefit from rights and protections" within our Forward Work Programme for 2021-22.[2]

2.2. This consultation sets out our proposal to not adjust the cap to account for the potential impacts of the COVID-19 crisis in cap period seven (October 2021 – March 2022) for credit customers and cap periods four to seven for prepayment meter (PPM) customers' bad debt costs.[3] We propose to amend the methodology we used for the COVID-19 adjustment in our February 2021 decision[4] to include additional filters on suppliers' forecast costs before including them in our sample. We also propose to introduce a sharing factor of 50:50 before calculating the amount to recover from customers if a float for cap period seven is necessary. This would ensure that our float estimate is conservative and that we err on the side of customers to protect customers' interests.

2.3. In our February 2021 decision,[5] we concluded that the COVID-19 pandemic had resulted in additional costs – specifically debt-related costs – that were material and not allowed for through the existing cap methodology for credit customers in cap periods four to six. We decided to err on the side of caution when setting the allowance to avoid customers unduly bearing the risk of the cost uncertainty. We set the adjustment using an initial estimate of these costs (a float) that will subsequently be adjusted to reflect the efficient final costs once they are fully known (the true-up).

[2] Ofgem (2021), Forward work programme 2021/22. https://www.ofgem.gov.uk/publications-and-updates/forward-work-programme-202122
[3] We consider other debt-related costs in cap period seven for both credit and PPM customers together.
[4] Ofgem (2021), Decision on the potential impact of COVID-19 on the default tariff cap. https://www.ofgem.gov.uk/publications-and-updates/decision-potential-impact-covid-19-default-tariff-cap
[5] Ofgem (2021), Decision on the potential impact of COVID-19 on the default tariff cap. https://www.ofgem.gov.uk/publications-and-updates/decision-potential-impact-covid-19-default-tariff-cap

2.4. In our March 2021 working paper,[6] we considered that there was significant uncertainty as to whether an adjustment for debt-related COVID-19 costs for cap period seven was needed. We noted that we would only propose an adjustment for cap period seven if there was significant and clear evidence that suppliers were likely to incur material additional costs due to COVID-19.[7] This is to protect customers' interests.

2.5. When determining whether to propose introducing a float for cap period seven, we have considered the evidence on the expected growth in the economy, the outlook of the labour market and customers' financial resilience. In addition, we have considered stakeholders' responses to our March 2021 working paper. We have also analysed the data that suppliers provided on debt-related costs in our mandatory Request for Information (RFI) issued on 25 February 2021.

2.6. This consultation has the following structure:

- Chapter 1 outlines our consultation process.
- Chapter 2 explains the content of this consultation paper and provides a general introduction of the cap.
- Chapter 3 covers the scope for the review of material additional COVID-19 costs. It sets out our proposed methodology for calculating the float if needed and explains our proposals to apply additional filters and sharing factor when determining whether a float for suppliers' estimates of additional costs due to COVID-19 for cap period seven should be included.

[6] Ofgem (2021), Reviewing the potential impact of COVID-19 on the default tariff cap: cap period seven working paper.
https://www.ofgem.gov.uk/publications-and-updates/price-cap-working-paper-reviewing-potential-impact-covid-19-default-tariff-cap-cap-period-seven

[7] Ofgem (2021), Reviewing the potential impact of COVID-19 on the default tariff cap: cap period seven working paper, paragraph 2.3 and 2.9.
https://www.ofgem.gov.uk/publications-and-updates/price-cap-working-paper-reviewing-potential-impact-covid-19-default-tariff-cap-cap-period-seven

- Chapter 4 sets out our overall position and explains our proposal of not having a float for debt-related costs due to COVID-19 for cap period seven. It also outlines our views on key economic metrics and RFI results.

- Appendices contain details on the data we collected through RFI and the calculations which led to our proposal. In addition, there is general information on our privacy notice.

The default tariff cap

2.7. We set the cap with reference to the Domestic Gas and Electricity (Tariff Cap) Act 2018 ('Act'). The objective of the Act is to protect current and future default tariff customers. We consider protecting customers to mean that prices reflect underlying efficient costs. In doing so, we must have regard to four matters:[8]

- the need to create incentives for holders of supply licences to improve their efficiency;

- the need to set the cap at a level that enables holders of supply licences to compete effectively for domestic supply contracts;

- the need to maintain incentives for domestic customers to switch to different domestic supply contracts; and

- the need to ensure that holders of supply licences who operate efficiently are able to finance activities authorised by the licence.

2.8. The cap comprises several allowances, each relating to different costs categories. We update the level of each allowance every six months, to reflect changes in the underlying costs. The Act requires that we set one cap level for all suppliers.[9]

[8] Domestic Gas and Electricity (Tariff Cap) Act 2018, Section 1(6). http://www.legislation.gov.uk/ukpga/2018/21/section/1/enacted
[9] Domestic Gas and Electricity (Tariff Cap) Act 2018; section 2(2). http://www.legislation.gov.uk/ukpga/2018/21/section/2/enacted

3. Scope and methodology

Chapter summary

This chapter sets out our scope for the review of material additional COVID-19 costs. It also sets out the methodology we propose to use to assess the need for an additional allowance (a float) for both credit and PPM customers, and, if needed, set the float.

Summary

3.1. In line with our February 2021 decision,[10] we are focusing our assessment on whether there are material additional debt-related COVID-19 costs.

3.2. In line with our March 2021 working paper, we propose to only introduce a float if there is significant and clear evidence of material additional costs due to COVID-19 for serving domestic default tariff customers.[11]

3.3. We are maintaining the majority of the methodological features we set out in our February 2021 decision. We propose to make the following amendments to our methodology for determining the impact of COVID-19 on debt-related costs for cap period seven:

- to apply additional filters on suppliers' estimates of costs to decide whether to include these forecasts in our sample when calculating any adjustment needed for cap period seven;

- If a float is needed, to apply a sharing factor to any calculated incremental cost ahead of converting the cost increment into a cap adjustment. We propose to equally share any material additional COVID-19 costs between customers and suppliers. This would ensure that our float is conservative, and allocates costs

[10] Ofgem (2021), Decision on the potential impact of COVID-19 on the default tariff cap, paragraph 2.7. https://www.ofgem.gov.uk/publications-and-updates/decision-potential-impact-covid-19-default-tariff-cap

[11] Ofgem (2021), Reviewing the potential impact of COVID-19 on the default tariff cap: cap period seven working paper, paragraph 2.9. https://www.ofgem.gov.uk/publications-and-updates/price-cap-working-paper-reviewing-potential-impact-covid-19-default-tariff-cap-cap-period-seven

equally across suppliers and customers. It would also create incentives on suppliers to lower these costs; and

- to consider external forecasts for key economic metrics when determining whether a float for cap period seven is necessary.

Scope of this review

3.4. This section sets out our scope for reviewing whether there is significant and clear evidence that suppliers are likely to incur material additional costs due to COVID-19 for serving domestic default tariff customers.

3.5. We set out that we intend to consider bad debt, [12] working capital,[13] and debt-related administrative costs[14] for both credit and PPM customers in cap period seven.

3.6. We also discuss our intention to consider whether there is significant and clear evidence that suppliers are likely to incur material additional bad debt costs due to COVID-19 for serving PPM customers throughout the pandemic (cap periods four to seven).

Context

3.7. In our February 2021 decision, we decided to only adjust for debt-related costs for credit meter default tariff customers. We said that this was the only area where we had seen clear evidence of a likely increase in efficient costs of serving default tariff customers that was not addressed in the existing cap methodology or by a separate process.[15] We set the float adjustment in the cap to recover the costs of cap periods four and five over two cap periods, cap periods six and seven, and the costs of cap period six over cap period six itself.[16]

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[12] We define bad debt as the unrecoverable debt that suppliers write off.
[13] We define working capital as current assets minus current liabilities for the domestic supply business, in line with the definition we used in our November 2020 consultation.
[14] The debt-related administrative costs are the costs of chasing debt before it is written off.
[15] Ofgem (2021), Decision on the potential impact of COVID-19 on the default tariff cap, paragraph 2.7. https://www.ofgem.gov.uk/publications-and-updates/decision-potential-impact-covid-19-default-tariff-cap
[16] Ofgem (2021), Decision on the potential impact of COVID-19 on the default tariff cap, paragraph 3.2. https://www.ofgem.gov.uk/publications-and-updates/decision-potential-impact-covid-19-default-tariff-cap

3.8. We also decided not to adjust the PPM cap level in the default tariff cap for 1 April 2021. We considered that evidence at that stage indicated that the effects of COVID-19 on supplying PPM customers were limited. We said we intended to revisit the PPM COVID-19 costs in our next review.[17]

3.9. In our March 2021 working paper, we noted the uncertainties on the extent and speed of the economic recovery in 2021. We said due to these uncertainties, it was unclear whether suppliers would incur material additional debt-related costs as a result of COVID-19 in cap period seven and whether an adjustment would be necessary for either credit and PPM customers.[18]

3.10. We set out that we would only propose an adjustment if there is significant and clear evidence that suppliers are likely to incur material additional costs due to COVID-19 for serving domestic default tariff customers.[19]

Proposal

3.11. We propose to only consider whether there is significant and clear evidence that suppliers are likely to incur material additional debt-related COVID-19 costs for serving default tariff customers (both credit and PPM) as part of this review. This is in line with our February 2021 decision and March 2021 working paper.[20]

[17] Ofgem (2021), Decision on the potential impact of COVID-19 on the default tariff cap, paragraph 5.4 and 5.5.
https://www.ofgem.gov.uk/publications-and-updates/decision-potential-impact-covid-19-default-tariff-cap
[18] Ofgem (2021), Reviewing the potential impact of COVID-19 on the default tariff cap: cap period seven working paper, paragraph 2.8.
https://www.ofgem.gov.uk/publications-and-updates/price-cap-working-paper-reviewing-potential-impact-covid-19-default-tariff-cap-cap-period-seven
[19] Ofgem (2021), Reviewing the potential impact of COVID-19 on the default tariff cap: cap period seven working paper, paragraph 2.9 and 4.4.
https://www.ofgem.gov.uk/publications-and-updates/price-cap-working-paper-reviewing-potential-impact-covid-19-default-tariff-cap-cap-period-seven
[20] Ofgem (2021), Decision on the potential impact of COVID-19 on the default tariff cap, paragraph 2.7 and 3.39.
https://www.ofgem.gov.uk/publications-and-updates/decision-potential-impact-covid-19-default-tariff-cap
Ofgem (2021), Reviewing the potential impact of COVID-19 on the default tariff cap: cap period seven working paper. Paragraph 2.9.
https://www.ofgem.gov.uk/publications-and-updates/price-cap-working-paper-reviewing-potential-impact-covid-19-default-tariff-cap-cap-period-seven

3.12. For credit customers, we propose to consider whether there are likely to be material additional COVID-19 costs for bad debt in cap period seven. This is because we have already considered and provided a float for material additional costs for cap periods four to six in our February 2021 decision.

3.13. We propose to calculate the bad debt cost increment for credit customers at domestic customer level. This approach is unchanged from our February 2021 decision.[21] Using data at domestic customer level enables us to rely on data representing a greater share of the domestic market.

3.14. For PPM customers, we propose to consider whether there are likely to be material additional COVID-19 costs for bad debt throughout the pandemic (cap periods four to seven). This is in line with our February 2021 decision where we noted that we would review PPM costs.

3.15. We propose to keep the bad debt costs for PPM customers separate to credit customers. This is because we consider it is much harder for a PPM customer to incur debt. If a PPM customer does incur debt, it is unlikely to be as much as the amount a credit customer can accrue over time due to the different payment structure and the ability to access credit for PPM customers.

3.16. We propose to consider working capital and debt-related administrative costs for credit and PPM customers together. This is because suppliers cannot provide us with disaggregated data on these costs by payment method. As we have already considered these costs for cap periods four to six as part of our February 2021 decision, we propose to only consider whether there are likely to be material additional COVID-19 costs in cap period seven.

3.17. Table 3.1 summarises these proposals for considering whether there are likely to be material additional COVID-19 costs for credit and PPM customers and which cap periods are being considered.

[21] Ofgem (2021), Decision on the potential impact of COVID-19 on the default tariff cap, paragraph 3.69.
https://www.ofgem.gov.uk/publications-and-updates/decision-potential-impact-covid-19-default-tariff-cap

Table 3.1 Summary of our proposals for cap periods to include for each debt-related cost for credit and PPM customers

Debt-related costs	Bad debt	Working capital costs	Debt-related administrative costs
Credit customers	Cap period seven	Cap period seven	Cap period seven
PPM customers	Cap periods four to seven	Cap period seven	Cap period seven

Stakeholder responses and considerations

3.18. Three stakeholders supported our intention to only propose an adjustment for cap period seven if there was significant and clear evidence that suppliers were likely to incur material additional costs due to COVID-19 for serving domestic default tariff customers.

3.19. Two stakeholders said that our decision should not increase the burden on struggling PPM households. One stakeholder agreed with our previous position, that we would not make an adjustment for PPM customers if there was no significant evidence of a material increase in the bad debt costs due to COVID-19. It further agreed that it was harder for PPM customers to incur debt than credit customers, and it did not think it would be fair for PPM customers to pay for the additional debt incurred by credit customers.

3.20. We consider that an adjustment for additional COVID-19 costs is only required to the extent that these additional costs are material. We continue to expect suppliers to manage ordinary variations in actual costs from forecasts, which can both increase and decrease costs compared to the allowance. We also continue to expect that small changes (increasing and/or decreasing efficient costs) could be covered by existing uncertainty allowances and prudent assumptions in the cap methodology.

3.21. This approach of focusing on debt-related costs is the same as our February 2021 decision. For more detail on our considerations, please see Chapter 2 of our February 2021 decision.[22]

3.22. We discuss the reasons for our use of domestic customer level data for estimating the additional bad debt costs for credit, [23] as well as specific data for PPM customers[24] in Appendix 1 and 3 as well as our February 2021 and March 2021 consultations.

3.23. We set out the reasons for us considering working capital and debt-related administrative costs together for credit and PPM customers in our March 2021 working paper.[25]

Amendments to methodology

3.24. We propose to broadly follow the same methodology as we have used to set the initial float for credit customers for cap periods four to six,[26] but also make following amendments to the existing methodology:

- we propose to include additional filters and introduce a sharing factor; and
- we propose to include an assessment of external forecasts for key economic metrics to form a view on the fundamental need of a float.

[22] Ofgem (2021), Decision on the potential impact of COVID-19 on the default tariff cap, paragraph 2.13 and Table 1.
https://www.ofgem.gov.uk/publications-and-updates/decision-potential-impact-covid-19-default-tariff-cap
[23] Ofgem (2021), Decision on the potential impact of COVID-19 on the default tariff cap, paragraph 3.69 and 3.107.
https://www.ofgem.gov.uk/publications-and-updates/decision-potential-impact-covid-19-default-tariff-cap
[24] Ofgem (2021), Reviewing the potential impact of COVID-19 on the default tariff cap: cap period seven working paper, paragraph 4.5.
https://www.ofgem.gov.uk/publications-and-updates/price-cap-working-paper-reviewing-potential-impact-covid-19-default-tariff-cap-cap-period-seven
[25] Ofgem (2021), Reviewing the potential impact of COVID-19 on the default tariff cap: cap period seven working paper, paragraph 3.25, 4.5 and 4.9.
https://www.ofgem.gov.uk/publications-and-updates/price-cap-working-paper-reviewing-potential-impact-covid-19-default-tariff-cap-cap-period-seven
[26] Ofgem (2021), Decision on the potential impact of COVID-19 on the default tariff cap, Chapter 3.
https://www.ofgem.gov.uk/publications-and-updates/decision-potential-impact-covid-19-default-tariff-cap

3.25. The objective of the Act is to protect current and future default tariff customers.[27] We continue to intend to err on the side of the customer when deciding whether there are material additional costs as a result of COVID-19, and, if necessary, when setting the additional allowance. This would avoid customers unduly bearing the risk of the cost uncertainty. Therefore, we believe it would be more appropriate not to introduce a float unless there is significant and clear evidence that suppliers are likely to incur material additional costs due to COVID-19 for serving domestic default tariff customers.

3.26. This means we will only propose an adjustment for cap period seven when two conditions are met:

- After applying our methodology, the calculation of the incremental debt-related costs at a lower quartile benchmark using the RFI data we collected shows that suppliers are likely to incur material additional costs; and

- The assessment of external forecasts for key economic metrics shows a significant structural break in the direction of economic growth. This means there would need to be clear evidence that the economy will go into recession in cap period seven and that the unemployment rate will significantly rise, so the impact of COVID-19 on customers' ability to pay energy bills will increase. Therefore, the level of debt-related costs would increase significantly.

3.27. If we consider an adjustment for cap period seven is necessary, we propose to introduce a sharing factor of 50:50 before calculating the amount to recover from customers. This will ensure any material additional COVID-19 costs are equally shared between customers and suppliers.

3.28. However, if our calculation of the RFI data shows material incremental debt-related costs for cap period seven, but the forecasts for key economic metrics maintain the current positive outlook for cap period seven, then we will consider whether overall suppliers' forecasts of debt-related costs are fundamentally reasonable. Therefore, we would propose to

[27] Domestic Gas and Electricity (Tariff Cap) Act 2018, Section 1(6). http://www.legislation.gov.uk/ukpga/2018/21/section/1/enacted

not include an adjustment for cap period seven if the evidence from both sources are not consistent.

3.29. We can consider as part of our true-up exercise whether there are any final costs from COVID-19 for cap period seven, though this will be subject to when suitable data becomes available.

Amendments to methodology for calculating the float

Methodology for calculating the float

Context and proposal

3.30. In our February 2021 decision, we said that if we needed to set a float for cap period seven, we intended to broadly follow the same methodology we used to set the initial float for cap periods four to six.[28]

3.31. We are proposing to do so, but also make amendments to the existing methodology.

3.32. We propose to use this amended methodology for our assessment of all costs in scope of this review. We discuss these amendments in this section.

Stakeholder response and considerations

3.33. In responding to our March 2021 working paper, one supplier said that a lower quartile benchmark was not appropriate as the efficiency of a supplier was not the main determinant in a customer's likelihood of falling into debt.

3.34. Our benchmarking approach is the same as our February 2021 decision. For more detail on our considerations, please see Chapter 3 of our February 2021 decision.[29]

[28] Ofgem (2021), Decision on the potential impact of COVID-19 on the default tariff cap, paragraph 3.37.
https://www.ofgem.gov.uk/publications-and-updates/decision-potential-impact-covid-19-default-tariff-cap

[29] Ofgem (2021), Decision on the potential impact of COVID-19 on the default tariff cap, paragraph 3.63-3.108.
https://www.ofgem.gov.uk/publications-and-updates/decision-potential-impact-covid-19-default-tariff-cap

Use of additional filters

Context and proposal

3.35. In our March 2021 working paper,[30] we outlined two main options related to our methodology:

- The first option would be to apply the same methodology we used for setting the initial float in cap periods four to six.
- The second option was to amend the methodology to include additional filters on suppliers' estimates of the costs that are included in our sample.

3.36. We propose to use the second option. We propose to use the following additional filters to scrutinise whether the assumptions underpinning suppliers' forecast costs are updated and reasonable as well as check data consistency:

- completeness and comparability between the baseline period and the relevant cap period;
- appropriateness of supplier's forecast methodology;
- reasonableness and up to date assumptions underpinning suppliers' forecast costs;
- appropriate justification for any inconsistency on supplier forecasts;
- consistency of supplier's forecast with the stock of debt older than six months held by the supplier; and
- comparability of suppliers' forecasts with other suppliers' forecasts.

[30] Ofgem (2021), Reviewing the potential impact of COVID-19 on the default tariff cap: cap period seven working paper, paragraph 3.8. https://www.ofgem.gov.uk/publications-and-updates/price-cap-working-paper-reviewing-potential-impact-covid-19-default-tariff-cap-cap-period-seven

3.37. We also propose to introduce an additional filter to exclude PPM specialists from our calculation of additional costs relating to credit customers. This is because while they may have some credit customers, their specialism means that as a whole, their costs are less relevant for the credit-only cost assessment.

3.38. Given the underlying uncertainty on the need for a float for cap period seven, we would seek to avoid using forecasts when we have concerns that they may not represent reasonable estimates of the likely additional COVID-19 costs that suppliers will incur. This means, we propose to remove these suppliers' unreasonable forecasts or inconsistent data from the sample that we use to benchmark costs.

Stakeholder responses and considerations

3.39. In responding to our March 2021 working paper, one supplier disagreed with applying additional filters and one supplier commented that we should have more confidence in the robustness of suppliers' forecasts, given that suppliers' methodologies for bad debt provisions will be subject to regular scrutiny by auditors. One stakeholder agreed with the amended methodology and commented that we should discard outlier forecasts or data that was not robust.

3.40. We consider that the suppliers' forecasts on debt-related costs still involve an additional degree of judgement beyond that usually required to determine the bad debt charges, which are then reviewed by auditors. This is because suppliers have to set their expectations on future movements of their bad debt charges when providing these forecasts. This involves judgement not only on the wider economy but also of a supplier's own experience through its customers. Therefore, we do not consider that the fact that bad debt provisions are scrutinised by auditors means there is no need for additional filters.

3.41. We consider that applying additional filters will ensure that supplier data used within the float model is consistent and not based on out-of-date assumptions. This will also reduce the incentive for a supplier to provide data which is overly pessimistic in respect to the current economic climate.

3.42. There could be several reasons why suppliers' forecasts do not represent reasonable estimates of the likely additional COVID-19 costs:

- suppliers may have based their debt related costs forecasts on out-of-date economic indicators and information. This could overestimate or underestimate the amount of debt-related costs these suppliers are likely to incur as a result of COVID-19;

- in comparison with other suppliers in our RFI sample, some suppliers may also have an overly simplistic methodology that does not appropriately reflect the underlying uncertainty on the COVID-19 related costs; and

- there may also be an incentive on suppliers to have a higher estimate of the debt-related costs. This is because some suppliers may want to err on the side of caution and not underestimate the impact of COVID-19 on their businesses.

3.43. We consider it is appropriate to introduce additional filters as an additional mitigation to limit the risk that an over inflated sample will lead to an excessive float.

3.44. We recognise that different suppliers may forecast their debt-related costs differently and that the underlying uncertainty will lead to forecasts that may differ to some extent. However, we consider suppliers should make reasonable assumptions when forecasting costs. We also consider these assumptions should be updated when major events appear, for example, the extension of the furlough scheme.

3.45. In responding to our March 2021 working paper, one supplier commented that the movement of debt older than six months old would only capture the short-run impact and did not reflect the longer run impact of COVID-19 on the collectability of debt.

3.46. We consider that debt older than six months old could provide us a sense check on suppliers' assumptions on the collectability of debt. The bad debt charge in a particular period relates to both new provisions (ie provisions for consumption that is happening in that period) and changes to existing provisions (ie provisions for consumption in previous periods). One of the reasons that suppliers make these changes could be their assumption on the collectability of debt.

Sharing factor

Context

3.47. In our March 2021 working paper, we considered, if a float is needed, whether to implement a sharing factor to any calculated incremental cost ahead of converting the cost increment into a cap adjustment. Under this approach, suppliers would bear some of the additional costs due to COVID-19 as well as customers.[31]

3.48. There are three potential reasons to include a sharing factor for the cap adjustment for COVID-19:

- to ensure that the float is conservative, as we decided to err on the side of caution to protect customers' interests in our February 2021 decision;[32]
- to ensure that customers and suppliers share the burden of the additional costs of the pandemic; and
- to create incentives on suppliers to lower these costs.

Proposal

3.49. If a float is needed, we propose to apply a sharing factor to any calculated incremental cost ahead of converting the cost increment into a cap adjustment.

3.50. We propose to equally share any material additional COVID-19 costs between customers and suppliers (ie a 50:50 sharing factor).

3.51. We consider that a sharing factor of 50:50 is an appropriate and fair proportion for customers and suppliers bearing the additional cost due to COVID-19 equally, given the COVID-19 is a one-off shock to both suppliers and customers.

3.52. We also consider that introducing a sharing factor will ensure that any float is conservative and create incentives on suppliers to lower these costs.

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[31] Ofgem (2021), Reviewing the potential impact of COVID-19 on the default tariff cap: cap period seven, paragraph 3.19 & 3.20
https://www.ofgem.gov.uk/publications-and-updates/price-cap-working-paper-reviewing-potential-impact-covid-19-default-tariff-cap-cap-period-seven
[32] Ofgem (2021), Decision on the potential impact of COVID-19 on the default tariff cap.
https://www.ofgem.gov.uk/publications-and-updates/decision-potential-impact-covid-19-default-tariff-cap

Stakeholder responses and considerations

3.53. Three suppliers commented on this aspect of our proposal. They disagreed with introducing a sharing factor. One of them thought a sharing factor would be arbitrary and required further justification for it.

3.54. COVID-19 costs are one-off external shock for both suppliers and customers. They do not represent the underlying fundamental costs of supply in the long run. While a sharing factor would not be appropriate for permanent ongoing costs, it could be used to ensure fairness and create the right incentives on suppliers for such one-off shock.

3.55. A sharing factor would also ensure that our float estimate is conservative so that we err on the side of customers.

3.56. We consider that using a lower quartile already helps us to set a conservative float to protect default tariff customers. The hard-to-predict impact of COVID-19 on the economy and welfare means that the amount of uncertainty in any forecast can be reasonably large. While the use of the lower quartile protects customers, there is a risk that the uncertainty leads to overly pessimistic assumptions across the market, and, therefore, provides a float allowance that is not conservative.

3.57. There are also questions on whether applying a lower quartile benchmark for supplier efficient COVID-19 costs ensures that our float is conservative. In theory, the float could be set by a supplier with a more realistic forecast of the underlying costs, however with costs above the efficient cost level. Such a scenario could not occur at true-up because our benchmark would be based only on the level of efficiency of a supplier and not its ability to forecast future costs. As a result, there is a risk that our float based on a lower quartile may not err on the side of customers as intended by our policy.

3.58. In this context, a sharing factor would be an additional tool which deliberately reduces the amount of the float so that it is a conservative estimate in favour of customers. It would only allow suppliers to recover as part of the float a share of the estimate of the additional COVID-19 costs.

3.59. Two stakeholders argued that the financial resilience of suppliers would be much greater than that of customers, particularly low-income customers. They said no further additional burdens should be placed on already struggling households, particularly struggling PPM customers.

3.60. Three suppliers who disagreed with our proposal of introducing a sharing factor commented that a sharing factor would limit the recovery of efficiently incurred costs. They said that retail supply sector finances continued to be constrained, and it would not be in the interest of consumers to see further supplier insolvencies. They did not see a justification for an arbitrary sharing factor in those circumstances.

3.61. There is significant uncertainty on whether suppliers are likely to incur material additional costs as a result of COVID-19 for serving domestic default tariff customers. Given this uncertainty, we continue to consider that suppliers are better placed to manage cash flow risk than default tariff customers are. Companies typically have better access to capital and at lower cost. Our sharing factor proposal therefore provides a fair balance between allowing suppliers to recover any material additional cost as a result of COVID-19 and being fair to customers.

3.62. We are considering separately the appropriateness of introducing a sharing factor for the true-up stage. We will make a separate decision on whether to introduce a sharing factor for the true-up.

Assessment of forecasts on economic metrics

Context

3.63. In our March 2021 working paper, we noted that we intended to consider the evidence on the expected growth in the economy, the outlook of the labour market and customers' financial resilience, as well as the inherent uncertainty of the forecasts and economic conditions when deciding whether to introduce a float for cap period seven. This would be in addition to our assessment of suppliers' forecasts of additional COVID-19 costs.[33]

Proposal

3.64. We continue to propose to consider external forecasts for key economic metrics when determining whether a float for cap period seven is necessary. This assessment of external

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[33] Ofgem (2021), Reviewing the potential impact of COVID-19 on the default tariff cap: cap period seven, paragraph 2.15
https://www.ofgem.gov.uk/publications-and-updates/price-cap-working-paper-reviewing-potential-impact-covid-19-default-tariff-cap-cap-period-seven

forecasts for key economic metrics will help us to form a view on the fundamental need for a float for cap period seven.

3.65. We consider that given the uncertainty on the speed of the recovery, it is appropriate to develop a balanced view on the need for a float. While our calculation of any float would still be based on supplier data, we consider it appropriate to weigh it against leading institutions' expectations on the impact of COVID-19 in the economy.

3.66. We propose to use the economic and unemployment rate forecasts from the Bank of England, the Office of Budget Responsibility (OBR), and HM Treasury to inform our view on the expected recovery of the economy.

3.67. In addition, we propose to consider evidence on the financial resilience of customers in order to determine the need for a float for cap period seven. As we do not have access to forecasts of financial resilience for cap seven, we propose to consider whether the latest available information to us on financial resilience contradicts or is consistent with the overarching forecasted economic outlook discussed above.

Stakeholder responses

3.68. In responding to our March 2021 working paper, stakeholders agreed with our analysis and views on the use of key economic forecasts and indicators. Some suppliers expressed their concerns that the impacts of COVID-19 would have longer-term implications, while one stakeholder said that COVID-19 has reduced customers' financial resilience, and this should be considered.

3.69. One stakeholder agreed that the impact of the furlough scheme ending in September was hard to assess. They commented that while the ending of furlough would cost some jobs, these might be counter-weighted by growth elsewhere.

3.70. Suppliers had different views on customers' financial resilience for cap period seven. One supplier expected that its customers would start to get out of debt over the next six to twelve months. Two suppliers expected that the financial impact of COVID-19 to customers as well as suppliers' bad debt costs would persist over several years. One supplier commented it was difficult to determine individuals' financial resilience in advance. One supplier commented that customers with older debt led to higher service costs and heightened risk to future write-off levels of bad debt.

3.71. One supplier suggested that Ofgem place real weight on customers' financial resilience when deciding whether a float for cap period seven is needed, given the likelihood of vulnerable customers suffering the greatest impact. It had seen its customers who were financially struggling previously now struggling more.

Considerations

3.72. We continue to consider that there is significant uncertainty over how long the economic disruption of the COVID-19 pandemic will last. The outlook for the economy, and particularly the relative movement in demand and supply, remains uncertain. It continues to depend on the evolution of the pandemic, measures taken to protect public health, and how households, businesses and financial markets respond to these developments.[34] In terms of an adjustment for additional COVID-19 costs for cap period seven, we need to consider how this uncertainty of economic recovery translates into customers' financial resilience and ability to pay their bills.

3.73. Given the uncertainty on the extent that COVID-19 will impact customers in cap period seven, we believe it is appropriate to consider key economic metrics when deciding whether, on balance, there is a need to set a float for material additional costs due to COVID-19 for cap period seven.

3.74. Financial resilience is a more direct measure of the customers' ability to pay, and, as a result, the potential amount of debt suppliers will hold. Therefore, we believe it is appropriate to try and consider it when deciding whether to set a float.

3.75. We do not have forecast information on the financial resilience of customers for cap period seven. This means we cannot compare financial resilience with the other economic metrics in the same way. Our proposal on how to consider financial resilience enables us to use this data source despite the lack of forecasts

3.76. We do not consider that we should introduce a float when our assessment described above does not show the need for a float due to the risk that the impacts of COVID-19 persist in the long-term and are not captured in our methodology. As described in this chapter, we

[34] The Bank of England (2021), Monetary policy summary and minutes of the Monetary Policy Committee meeting, May 2021. https://www.bankofengland.co.uk/monetary-policy-summary-and-minutes/2021/may-2021

intend to err on the side of customers when deciding whether to introduce a float given the uncertainty. Therefore, when there is not significant and clear evidence of material additional costs likely to be incurred by suppliers as a result of COVID-19, we propose not to introduce a float. We can consider as part of our true-up exercise whether there are any final costs from COVID-19 for cap period seven, though this will be subject to when suitable data becomes available.

4. Need for additional adjustment (a float) for COVID-19 costs

Chapter summary

This chapter outlines our evidence that supports our proposal to not to have an additional float for material additional debt-related costs due to COVID-19 for credit or PPM customers. It summarises our analysis of suppliers' forecast debt-related costs which we collected through mandatory Request for Information (RFI) and our review of the economic metrics.

Summary

4.1. We do not consider that there is significant and clear evidence that suppliers are likely to incur material additional costs due to COVID-19 in cap period seven for severing credit customers and across cap periods four to seven for serving PPM customers. Therefore, we are not proposing to introduce an additional float in cap period seven.[35]

4.2. Four stakeholders considered that a float for cap period seven was not necessary in response to our March 2021 working paper. Three of these stakeholders reasoned that customers, especially financially struggling customers, should be protected from unnecessarily high energy prices. One supplier believed that a float for cap period seven would be necessary. One stakeholder said that any adjustment would be speculative.

4.3. Our analysis of suppliers' debt-related forecast costs for cap period seven according to the methodology described in Chapter 3 suggests no additional material costs are likely to be incurred in that cap period for:

- bad debt costs for credit customers[36]
- working capital costs for credit and PPM customers

[35] As part of our February 2021 decision, we provided a float to suppliers to be recovered across cap periods six and seven.
[36] We consider bad debt costs for PPM customers for cap periods four to seven. We discuss it later in this chapter.

- debt-related administrative costs for credit and PPM customers

4.4. This is because suppliers' forecasts of debt-related costs for cap period seven are not materially greater than their pre-COVID levels.

4.5. For the same reasons, our analysis of suppliers' PPM specific bad debt forecast costs for cap periods four to seven according to the methodology described in Chapter 3 also suggests no material additional costs are expected across cap periods four to seven.

4.6. Our analysis of economic growth and unemployment rate forecasts suggest a positive economic outlook in cap period seven. Leading economic indicators suggest a strong growth in the economy in this period and UK GDP is expected to recover strongly over 2021 to pre-COVID levels as restrictions are loosened.[37]

Evidence from supplier forecasts

Context

4.7. We have collected suppliers' forecast debt-related costs through an RFI we sent to suppliers with at least a 1% market share in any fuel in the domestic market segment.

4.8. We have used the methodology (described in Chapter 3) to calculate the additional debt-related costs for cap period seven for credit customers and for cap periods four to seven for bad debt costs of PPM customers.

4.9. We have excluded some suppliers' data from our sample as a result of our additional filters. Most of our data exclusions related to data being incomplete or not comparable between the baseline period (October 2019 to February 2020) and cap period seven (October 2021 to March 2022).

4.10. Please see Appendices 1 to 3 for more detail on how we have applied additional filters on the RFI data and the data quality of our sample for the specific debt-related costs. We also

[37] The Bank of England (2021), Monetary Policy Report - May 2021. https://www.bankofengland.co.uk/monetary-policy-report/2021/may-2021

outline the calculation to convert our calculation of the incremental cost into a potential adjustment allowance for cap period seven.

Bad debt costs for credit customers

Context

4.11. We provided a float for additional bad debt related costs for cap periods four to six in our February 2021 decisions. We have required suppliers to recover the float over two cap periods. Suppliers have recovered £23.69 in cap period six. Suppliers will recover the remaining £8.86 in cap period seven.[38]

Proposal

4.12. We propose to not introduce a float for additional bad debt COVID-19 costs for credit customers in cap period seven as we do not believe that these costs are material.

Considerations

4.13. We are satisfied with the size and quality of the data sample for suppliers' bad debt forecasts at domestic customer level after applying additional filters.

4.14. We have calculated the additional bad debt costs for credit customers for cap period seven. The incremental cost is expected to be approximately £0.04 per customer account.

4.15. We consider this is not a material increase in the bad debt costs of supplying credit customers resulting from COVID-19 for cap period seven.

[38] Ofgem (2021), Decision on the potential impact of COVID-19 on the default tariff cap, Table 3 and Table 4.
https://www.ofgem.gov.uk/publications-and-updates/decision-potential-impact-covid-19-default-tariff-cap

Working capital costs

Context

4.16. As discussed in our March 2021 working paper, suppliers could not provide working capital costs broken down by payment method. Therefore, we had to analyse these costs for both credit and PPM customers together.

Proposal

4.17. We propose to not introduce a float for additional working capital COVID-19 costs for credit and PPM customers as we do not have confidence in the robustness of suppliers' working capital forecasts, and the data available indicates that these costs are not material.

Considerations

4.18. We do not have confidence that the RFI data collected on working capital costs is consistent between suppliers and can provide a robust and meaningful estimate for the impact of COVID-19 on suppliers' working capital costs.

4.19. There are two main data issues associated with suppliers' working capital costs. The first one is that some suppliers' data sets are incomplete because they could not provide data for the periods that we required through the RFI. The second issue is that some suppliers provided their working capital costs for their businesses as a whole, rather than just for domestic customers' energy supply.

4.20. Following the application of our additional filters, our remaining sample represents approximately 23% of the domestic energy market share. We consider that this is insufficient market coverage to provide us with a robust assessment of working capital costs.

4.21. In addition, taking the data at face value, the incremental cost is expected to be approximately £0.18 per customer account.

4.22. We consider this is not a material increase in the working capital costs of supplying credit and PPM default tariff customers resulting from COVID-19 for cap period seven.

Debt-related administrative costs

Context

4.23. As discussed in our March 2021 working paper, suppliers could not provide debt-related administrative costs breakdowns by payment method. Therefore, we had to analyse this cost for both credit and PPM customers together.

Proposal

4.24. We propose to not introduce a float for additional debt-related COVID-19 costs for credit and PPM customers as we do not believe that these costs are material.

Considerations

4.25. We are satisfied with the size and quality of the data sample for suppliers' debt-related administrative costs at domestic customer level.

4.26. We have calculated the additional debt-related administrative costs for credit and PPM customers for cap period seven. The additional cost is expected to be approximately £0.03 per customer account.

4.27. We consider this is not a material increase in the debt-related administrative costs of supplying both credit and PPM customers resulting from COVID-19 for cap period seven.

Bad debt costs for PPM customers

Context

4.28. As discussed in our March 2021 working paper, we are considering bad debt costs for PPM customers over cap periods four to seven.[39]

[39] Ofgem (2021), Reviewing the potential impact of COVID-19 on the default tariff cap: cap period seven, paragraph 4.5
https://www.ofgem.gov.uk/publications-and-updates/price-cap-working-paper-reviewing-potential-impact-covid-19-default-tariff-cap-cap-period-seven

Proposal

4.29. We propose to not introduce a float for additional bad debt COVID-19 costs for PPM customers as we do not believe that these costs are material.

Considerations

4.30. We have calculated the additional bad debt costs for PPM customers for cap periods four to seven. The additional cost is expected to be -£0.12 per customer account.

4.31. We consider this is not a material change in the bad debt costs of supplying PPM customers resulting from COVID-19 over cap periods four to seven.

Key economic metrics

4.32. Since the publication of our March 2021 working paper, vaccines are now helping the UK economy recover rapidly.[40] It is becoming clearer that the economy is set for stronger economic growth and recovery. We consider that the underlying evidence available at the time of the consultation does not suggest a structural break on the UK economy recovery. The expected economic recovery lowers the likelihood that there will be material additional costs in cap period seven.

Considerations

Overall view

4.33. We consider the information available provides a positive outlook for the UK economy for the periods between the last quarter of 2021 and the first quarter of 2022, during cap period seven. The UK economy is expected to rebound in the second half of 2021 at a faster rate than previously expected. In addition, the unemployment rate is projected to increase by less than previously anticipated as a result of the extension of the furlough scheme.

4.34. We do not have forecast data on how the growth in the economy and the lower increase in unemployment will affect customers' financial resilience (ability to pay bills) in cap period seven. Our latest data on current financial resilience suggests that the level of

[40] The Bank of England (2021), Monetary Policy Report - May 2021. https://www.bankofengland.co.uk/monetary-policy-report/2021/may-2021

customer financial resilience has not worsened since October. While we acknowledge the potential that the recovery is uneven, we consider that the evolution of the available data in financial resilience is not contradictory to the wider economic metrics that show a positive outlook for the UK economy.

Economic outlook

4.35. The latest reports from the Bank of England, OBR, and HM Treasury survey show a positive economic outlook by the end of 2021, when a float for cap period seven would be implemented. The UK economy is expected to grow faster in cap period seven than previous forecasts.

4.36. In April 2021, HM Treasury surveyed investment banks, economic research organisations, and other institutions for their GDP forecasts. Its survey showed an average GDP growth forecast of 5.7% for 2021 and 5.6% for 2022.[41] GDP is expected to grow faster in 2021 than previously forecast.[42]

4.37. In the latest May Monetary Policy Report,[43] the Bank of England also predicts that GDP is projected to rise materially over 2021, and to exceed its 2019 Q4 level in 2021 Q4. It projects a GDP growth rate of 7.25% for 2021 and 5.75% for 2022. The Bank of England expects the economic recovery to be earlier and greater than its previous forecasts.

4.38. There has not been a new OBR forecast since our March 2021 working paper. While the last OBR forecast does not reflect the latest information available on economic growth as societal restrictions due to COVID-19 are removed, it already forecasted a strong economic recovery.

4.39. The economic forecasts show an increase in expected economic growth of the economy. To the extent that this economic growth translates into greater income for

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[41] HM Treasury (2021), Forecasts for the UK economy: a comparison of independent forecasts, April 2021.
https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/979184/Forecasts_for_UK_economy_April_2021.pdf

[42] Ofgem (2021), Reviewing the potential impact of COVID-19 on the default tariff cap: cap period seven working paper, paragraph 2.18.
https://www.ofgem.gov.uk/publications-and-updates/price-cap-working-paper-reviewing-potential-impact-covid-19-default-tariff-cap-cap-period-seven

[43] The Bank of England (2021), Monetary Policy Report - May 2021. Table 1.B
https://www.bankofengland.co.uk/monetary-policy-report/2021/may-2021

customers, it lowers the likelihood that customers will enter into debt, and suppliers facing material additional debt-related COVID 19 costs.

Labour market

4.40. We have reviewed the latest information from the Office for National Statistics (ONS), HM Treasury, and the Bank of England on the labour market data and the expected unemployment rate.

4.41. COVID-19 has impacted the labour market. Data from the ONS Labour Force Survey showed the unemployment rate increased from the pre-COVID level of 4% for January to March 2020 to 5.1% for October to December 2020 but decreased to 4.9% for December 2020 to February 2021. While unemployment has improved slightly, the number of people who were on payroll employment and the level of vacancies and working hours have stalled in recent months.[44]

4.42. The HM Treasury April 2021 survey included forecasts of unemployment in the UK. The average of the forecasts suggested that unemployment would be 6.2% in Q4 2021 and would fall by 1 percentage point by Q4 2022 to 5.4%.[45] This is an improvement in the forecasts of unemployment compared to the previous survey (6.6% in Q4 2021 and 5.6% in Q4 2022 in its February survey).[46]

4.43. The extension of the furlough scheme means that it will remain in operation beyond the point at which the UK Government's Roadmap envisages all but a minimal degree of public health measures being removed. The OBR predicts that most of the shortfall in output

[44] ONS (2021), Labour market overview, UK: February 2021 and April 2021.
https://www.ons.gov.uk/employmentandlabourmarket/peopleinwork/employmentandemployeetypes/bulletins/uklabourmarket/february2021
https://www.ons.gov.uk/employmentandlabourmarket/peopleinwork/employmentandemployeetypes/bulletins/uklabourmarket/april2021
[45] HM Treasury (2021), Forecasts for the UK economy: a comparison of independent forecasts, April 2021.
https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/979184/Forecasts_for_UK_economy_April_2021.pdf
[46] Ofgem (2021), Reviewing the potential impact of COVID-19 on the default tariff cap: cap period seven working paper, paragraph 2.26.
https://www.ofgem.gov.uk/publications-and-updates/price-cap-working-paper-reviewing-potential-impact-covid-19-default-tariff-cap-cap-period-seven

relative to pre-pandemic levels over the six months ending September 2021 will result in lower average hours and higher government borrowing rather than higher unemployment.[47]

4.44. In the Bank of England's latest May Monetary Policy report, unemployment in Q4 2021 is projected to be 5% which is less than previously anticipated (6.5%) as a result of the extension of the furlough scheme, as well as the stronger projection for output.[48] It is also only 0.1 percentage point higher than the latest ONS information on unemployment rates.[49]

4.45. We continue to consider that small changes in supplier costs could be covered by existing uncertainty allowances and prudent assumptions in the cap methodology. It is less clear that these changes to unemployment levels can be considered as significant and clear evidence that suppliers are likely to incur material additional debt-related costs as a result of COVID-19 in cap period seven.

Financial resilience

4.46. In our March 2021 working paper, we considered available evidence on the financial resilience of customers in order to determine the need for a float for cap period seven.

4.47. We reviewed the evidence that suggested COVID-19 had a disproportionate impact on the most vulnerable.[50] We summarised the research findings from academics[51], Citizens

[47] OBR (2021), Economic and fiscal outlook, March 2021, paragraph 2.72. https://obr.uk/efo/economic-and-fiscal-outlook-march-2021/
[48] The Bank of England (2021), Monetary Policy Report - May 2021. Table 1.B and page 22 https://www.bankofengland.co.uk/monetary-policy-report/2021/may-2021
[49] ONS, Labour market overview, UK: April 2021. UK unemployment rate was 4.9% for Dec 2020 to February 2021. https://www.ons.gov.uk/employmentandlabourmarket/peopleinwork/employmentandemployeetypes/bulletins/uklabourmarket/april2021
[50] Ofgem (2021), Reviewing the potential impact of COVID-19 on the default tariff cap: cap period seven working paper, paragraph 2.30-2.34. https://www.ofgem.gov.uk/publications-and-updates/price-cap-working-paper-reviewing-potential-impact-covid-19-default-tariff-cap-cap-period-seven
[51] Low et.al. The heterogeneous and regressive consequences of COVID-19: Evidence from high quality panel data, Journal of Public Economics, 193(2021). https://doi.org/10.1016/j.jpubeco.2020.104334

Advice[52] and the Financial Conduct Authority (FCA).[53] These indicate that the COVID-19 pandemic has led to considerable financial impacts for many customers.

4.48. Since then, we have carried out polling of domestic energy consumers to understand the impact of COVID-19 social distancing on domestic energy consumption, financial wellbeing and the concerns of energy consumers around managing bills. The latest March survey[54] results showed similar trends as the previous survey[55] on domestic energy customers' concerns around managing bills and financial wellbeing. Consumers aged 16-34 were the ones that were predominantly affected by the pandemic (in terms of bills, job losses and fears about future income). Around one in five consumers were worried about paying bills. Around a third of the PPM customers were worried about topping up. These results are similar to what we found in our earlier October survey.

4.49. We also received evidence from a supplier's own survey that suggested that two thirds of the customers that had considered themselves financially impacted by COVID-19 in summer 2020 no longer considered themselves financially impacted.

4.50. While forecasts are not available, the data available is consistent with the information on economic forecasts that shows a mostly positive outlook and a stable unemployment level.

Going forwards

4.51. As a result of our proposals, the adjustment allowance in cap period seven for credit customers would remain equal to the recovery of the £8.86 float for costs incurred in the cap period four and five as set out in our February 2021 decision.[56]

[52] Citizens Advice (2020), Recovery, or Ruin? The role of accessible support in helping energy consumers through the crisis, December 2020. https://www.citizensadvice.org.uk/about-us/our-work/policy/policy-research-topics/energy-policy-research-and-consultation-responses/energy-policy-research/recovery-or-ruin-the-role-of-accessible-support-in-helping-energy-consumers-through-the-crisis/
[53] FCA (2021), Financial Lives 2020 survey: the impact of coronavirus, February 2021. https://www.fca.org.uk/publication/research/financial-lives-survey-2020.pdf
[54] This report will be published in June.
[55] Ofgem (2020), Consumers' experiences with energy during the Covid-19 pandemic. October 2020. https://www.ofgem.gov.uk/system/files/docs/2020/11/consumer_experiences_during_the_covid_19_pandemic_october_update.pdf
[56] Ofgem (2021), Decision on the potential impact of COVID-19 on the default tariff cap, Table 4. https://www.ofgem.gov.uk/publications-and-updates/decision-potential-impact-covid-19-default-tariff-cap

4.52. We received updated RFI data on 12 May. Our preliminary analysis suggests no significant change in debt-related costs forecasts that would materially change the results of the analysis described in this document. Therefore, as indicated in our March 2021 working paper, we do not intend to use this data as part of the calculation of the float.

Appendices

Index

Appendix 1 - Bad debt costs for credit customers

Summary

1.1. We discuss in this appendix whether there is significant and clear evidence that suppliers are likely to incur material additional bad debt costs due to COVID-19 for serving credit customers. We outline the suppliers' data we collected and our data sample after applying the additional filters as discussed in Chapter 3.

1.2. We set out our calculation that shows that the incremental forecast cost of the bad debt charge at lower quartile for cap period seven for credit customers is not material.

Data source for bad debt costs

Context

1.3. In our March 2021 working paper, we considered that suppliers' forecasts continued to provide the best available data source for additional COVID-19 debt-related costs.[57]

1.4. We set out in Chapter 3 that we would only propose to set a float if both the analysis of the RFI data and the assessment of external forecasts for key economic metrics are consistent.

1.5. We requested supplier monthly data in our RFI, from January 2019 to March 2022 (including forecasts), on the bad debt charge figure (£m).[58] We collected bad debt charge data broken down by payment method.[59] We were unable to gather this data split by tariff type as well given most stakeholders who responded to our draft RFI noted that they were unable to provide it.[60]

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[57] Ofgem (2021), Reviewing the potential impact of COVID-19 on the default tariff cap: cap period seven, paragraph 3.7.
https://www.ofgem.gov.uk/publications-and-updates/price-cap-working-paper-reviewing-potential-impact-covid-19-default-tariff-cap-cap-period-seven
[58] The bad debt charge reflects movements in provisions for bad debt, including any adjustments for differences between write-offs and previous provisions.
[59] Direct debit (DD), Standard Credit (paid on receipt of bill, PORB) and PPM.
[60] Ofgem (2021), Reviewing the potential impact of COVID-19 on the default tariff cap: cap period

Stakeholder responses and considerations

1.6. One supplier said bad debt provisions represented the best and most reliable source of data on the overall bad debt costs of COVID-19. Another supplier said it had concerns on its increasing debt during the first lockdown.

1.7. Two stakeholders said they had not seen a material increase in the level of bad debt as a result of COVID-19. However, they understood the uncertainty over the scale and timing of bad debt associated with the pandemic.

1.8. One supplier said that accounting provisions rely on estimates of what the default rate would be in the future. It also said that estimates were inherently uncertain. One supplier said that we should use the additional data requested in our March RFI and it thought we should breakdown costs by payment method.

1.9. As set out in our methodology in Chapter 3, we propose to continue to use supplier forecasts to assess whether there is significant and clear evidence that suppliers are likely to incur material additional bad debt costs as a result of COVID-19. This approach of using supplier forecasts is the same as our February 2021 decision.[61] For more detail on our considerations, please see Chapter 4 of our November 2020 consultation.[62] We discuss our considerations on the proposed amendments to the methodology in Chapter 3 of this consultation.

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seven working paper, paragraph 3.39.
https://www.ofgem.gov.uk/publications-and-updates/price-cap-working-paper-reviewing-potential-impact-covid-19-default-tariff-cap-cap-period-seven

[61] Ofgem (2021), Decision on the potential impact of COVID-19 on the default tariff cap, paragraph 4.14.
https://www.ofgem.gov.uk/publications-and-updates/decision-potential-impact-covid-19-default-tariff-cap

[62] Ofgem (2020), Reviewing the potential impact of COVID-19 on the default tariff cap: November 2020 consultation, paragraph 4.25-4.28.
https://www.ofgem.gov.uk/publications-and-updates/reviewing-potential-impact-covid-19-default-tariff-cap-november-2020-consultation

Data sample and analysis

Summary of March RFI

1.10. We have received 11 submissions to the bad debt charge questions from our March 2021 RFI.[63] We applied additional filters before including suppliers' data into our sample to calculate the lower quartile benchmark for incremental cost of bad debt costs in line with the methodology described in Chapter 3.

1.11. After applying our methodology, for the March RFI data, we have excluded data sets that were not complete or not comparable between the baseline period and cap period seven:

- one supplier was unable to provide forecast costs of bad debt charges for cap period seven;
- one supplier provided incomplete data which only covered the first half of cap period seven (October 2021 to December 2021);
- one supplier's bad debt charge costs for the baseline period and forecast period were not comparable because of a business acquisition; and

1.12. We also excluded one PPM specialist from our sample. We excluded the supplier as we consider that the sample without this PPM specialist provides a better reflection of the potential material additional costs for credit customers.

1.13. As a result seven suppliers are included in our sample for calculating the bad debt charge cost increment per customer account following our application of additional filters. This represents approximately 64% of the domestic energy market share.

1.14. We proposed in Chapter 3 to calculate the bad debt cost increment for credit customers at domestic customer level. This was a result of us not having sufficient and good quality data to do so for credit customers only. 3 suppliers were not able to provide us data split by payment method. As a result, the available data only covered approximately 46% of the market share. Given that most bad debt costs are expected to relate to credit customers,

[63] We asked suppliers to submit their bad debt charge baseline (January 2019 – January 2021) and bad debt charge forecast (February 2021 – March 2022).

we consider it more appropriate to use data at domestic customer level to assess whether there are material additional bad debt costs for credit customers. As a result, we have been able to use data representing 64% of the domestic energy market.

1.15. One stakeholder said it would be important that our sample was comprehensive, with no self-selection and a data range was published. We consider data in our sample is adequate to provide a good estimate of additional bad debt costs resulting from COVID-19 for the float for cap period seven.

1.16. We consider that we have not self-selected any suppliers in our sample because we sent out a mandatory RFI to all suppliers with at least a 1% market share in any fuel in the domestic market segment.

1.17. We discuss our sample's data range of bad debt cost increment per customer account for credit customers in the section below.

Incremental bad debt cost analysis

Calculating cost per customer

1.18. We used the same approach to calculating cost per customer as discussed in our November 2020 consultation. For more detail on our considerations, please see Chapter 4 of our November 2020 consultation.[64]

1.19. For cap period seven (October 2021 – March 2022), we used a pre-COVID baseline period of cap period three scaled up (October 2019 – February 2020).[65]

1.20. We used a snapshot customer account data from Ofgem's cap compliance RFI, 'Domestic Customer Account & Tariff RFI'. This approach is unchanged from our February

[64] Ofgem (2020), Reviewing the potential impact of COVID-19 on the default tariff cap: November 2020 consultation, paragraph 4.80-4.90.
https://www.ofgem.gov.uk/publications-and-updates/reviewing-potential-impact-covid-19-default-tariff-cap-november-2020-consultation
[65] We chose not to include March 2020 data in the baseline because the data in this month could be impacted by COVID-19, given restrictions were put in place from late March 2020. Instead, we scaled up the October 2019 to February 2020 period to produce an appropriate six-month baseline.

2021 decision.[66] We have made assumptions on how to apply this snapshot data when calculating the cost per customer account in each month:

- the number of customer accounts for all months in 2019 is set equal to the average of customer accounts from the April and October 2019 snapshot data;
- the number of customer accounts for January 2020 – September 2020 is set equal to the average of customer accounts from April and October 2020 data; and
- the number of customer accounts for October 2020 – December 2020, all months in 2021, and 2022, is set equal to the October 2020 snapshot, as this is the latest available customer account data available to us.

1.21. We are also aware that the April 2021 snapshot of the 'Domestic Customer Account & Tariff RFI' will become available after we publish this consultation.[67] We consider that we should update our calculation to include this in time for the August decision. This approach is unchanged from our February 2021 decision.[68]

1.22. Including the April 2021 snapshot data in our current calculation would change the assumptions slightly so that the number of customer accounts for October 2021 – March 2022 will be set to the April 2021 snapshot. This will impact the number of customer accounts we use when calculating the bad debt cost per customer account.

[66] Ofgem (2021), Decision on the potential impact of COVID-19 on the default tariff cap, paragraph 4.67. https://www.ofgem.gov.uk/publications-and-updates/decision-potential-impact-covid-19-default-tariff-cap

[67] Suppliers submitted data for this RFI on 4 May 2021. We are still engaging with suppliers and performing data quality checks before the customer accounts data can be used in our calculation.

[68] Ofgem (2021), Decision on the potential impact of COVID-19 on the default tariff cap, paragraph 4.62. https://www.ofgem.gov.uk/publications-and-updates/decision-potential-impact-covid-19-default-tariff-cap

Benchmark at lower quartile

1.23. For each supplier, we calculated the bad debt charge cost increment per customer account for cap period seven based on the method above. The lower quartile bad debt benchmark of our sample is approximately £0.04 per customer account for cap period seven.

Statistics of our sample

1.24. One stakeholder expected us to publish more detailed information to allow stakeholders to understand how we reached our decision if a float for cap period seven was necessary.

1.25. We are publishing key statistics of bad debt charge cost increment per customer account of our sample (sample average and standard deviation). This would provide stakeholders an idea of the data range for our sample and how our data points spread out in the range.

- Mean (simple average) = £1.23
- Standard deviation = 2.17

1.26. We are not publishing or disclosing suppliers' individual data because of commercial confidentiality and sensitivity. This approach is unchanged from our November 2020 consultation.[69]

Converting the cost increment into a cap adjustment figure

1.27. We are proposing to follow the same methodology as in the February 2021 decision on how to convert the benchmark incremental bad debt cost per customer account in the adjustment allowance, if an adjustment is required.[70] This was calculated in 'Annex 8 –

[69] Ofgem (2020), Reviewing the potential impact of COVID-19 on the default tariff cap: November 2020 consultation, Appendix 1, paragraph 6.
https://www.ofgem.gov.uk/publications-and-updates/reviewing-potential-impact-covid-19-default-tariff-cap-november-2020-consultation

[70] Ofgem (2021), Decision on the potential impact of COVID-19 on the default tariff cap, paragraph 4.59 – 4.61.
https://www.ofgem.gov.uk/publications-and-updates/decision-potential-impact-covid-19-default-tariff-cap

methodology for adjustment allowance' which was published alongside our February 2021 decision.[71]

1.28. In line with our amended methodology described in Chapter 3, we apply a 50:50 sharing factor on the lower quartile benchmark for bad debt cost increment of £0.04 per customer account ahead of the conversion.

1.29. Table A1.1 shows, how much the default tariff cap for cap period seven would be adjusted due to the impact of COVID-19 if we made an adjustment based on a cost increment of £0.02 per customer account.

Table A1.1: Bad debt scaled increments for cap period seven adjustment level after applying a sharing factor

Scaled levels	Electricity		Gas		Dual Fuel	
	Nil	TDCV	Nil	TDCV	Nil	TDCV
Cap period seven (£)	0.01	0.03	0.01	0.03	0.01	0.06

1.30. An adjustment allowance for the incremental costs identified in our calculations would be approximately £0.06 per typical customer in cap period seven.[72]

[71] Ofgem (2021), Model – Annex 8 – Adjustment allowance v1.32.
https://www.ofgem.gov.uk/system/files/docs/2021/02/annex_8_-_adjustment_allowance_methodology_v1.32.xlsx
[72] Dual fuel, at the typical consumption values used to set the cap (3,100kWh for single-rate electricity and 12,000kWh for gas).

Appendix 2 - Working capital and debt-related administrative costs

Summary

1.1. We discuss in this appendix whether there is significant and clear evidence that suppliers are likely to incur material additional working capital and debt-related administrative costs for both credit and PPM customers resulting from COVID-19. We outline the suppliers' data we collected and our data sample after applying the additional filters as discussed in Chapter 3.

1.2. We set out our analysis that led to our view that we do not have confidence that the RFI data collected on working capital costs is consistent between suppliers and can provide a robust and meaningful estimate for the impact of COVID-19 on suppliers' working capital costs. We also set out how the remaining sample has insufficient market coverage to provide us with a robust assessment of working capital costs.

1.3. We set out our calculation that shows that the incremental forecast debt-related administrative costs at lower quartile for cap period seven for credit and PPM customers are not material.

Working capital costs

Context

1.4. In our February 2021 decision, we decided not to include working capital costs in the float for cap periods four to six. We said we did not have confidence that the data collected through our voluntary RFI was consistent between suppliers. In addition, taking the data at face value did not show a material cost to suppliers.[73]

[73] Ofgem (2021), Decision on the potential impact of COVID-19 on the default tariff cap, paragraph 4.2. https://www.ofgem.gov.uk/publications-and-updates/decision-potential-impact-covid-19-default-tariff-cap

1.5. We outlined in our March 2021 working paper that we were collecting working capital costs through our mandatory March 2021 RFI. We had asked suppliers to provide their baseline and forecast data for cap period seven.[74]

Data source for working capital costs

Context

1.6. As set out in Appendix 1 and Chapter 3, we continue to intend to rely on suppliers' forecasts in our methodology to assess whether there is significant evidence that suppliers are likely to incur material additional costs suppliers as a result of COVID-19 for serving domestic default tariff customers.

1.7. We also requested monthly data, from January 2019 to March 2020 and October 2021 to March 2022 (including forecasts), on their total working capital (£m).[75, 76]

Data sample and analysis

Summary of March RFI

1.8. We have received 11 submissions to the working capital questions from our March 2021 RFI.[77] However, we are not satisfied with the data quality as a whole.

1.9. After applying the additional filters to the March RFI data, we have excluded five suppliers' data that are not complete, not comparable between the baseline period and cap period seven for the same reasons as discussed in Appendix 1.

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[74] Ofgem (2021), Reviewing the potential impact of COVID-19 on the default tariff cap: cap period seven, paragraph 3.24. https://www.ofgem.gov.uk/publications-and-updates/price-cap-working-paper-reviewing-potential-impact-covid-19-default-tariff-cap-cap-period-seven

[75] We defined working capital as current assets minus current liabilities for the domestic supply business, in line with the definition we used in our November 2020 consultation

[76] Ofgem (2020), Reviewing the potential impact of COVID-19 on the default tariff cap: November 2020 consultation, paragraph 4.60. https://www.ofgem.gov.uk/publications-and-updates/reviewing-potential-impact-covid-19-default-tariff-cap-november-2020-consultation

[77] We asked suppliers to submit their working capital baseline (January 2019 – March 2020) and working capital forecast (October 2021 – March 2022).

1.10. We also excluded three suppliers' data as they are not comparable with other suppliers' data. These suppliers provided their working capital for their whole corporate businesses, rather than just for supplying domestic energy customers.

1.11. We consider that it is not appropriate to include any supplier whose working capital cost covers a customer base outside of the domestic energy supply business. This is because we cannot be confident that changes to working capital costs would represent the additional costs of supplying default tariff customers as a result of COVID-19 given that COVID-19 has impacted the wider economy.

Data sample

1.12. Three suppliers are included in our sample for calculating the working capital costs increment per customer account following the application of the additional filters. This represents approximately 23% of the domestic energy market share.

1.13. Three suppliers' data showed a general seasonal trend in working capital, which we would expect. However, there were some large differences in the submitted data. One supplier provided figures that were extremely positive and another provided figures that were extremely negative. There was also notably a significant difference in the scale of monthly working capital between suppliers.

1.14. One reason for these differences in the submitted data could be that suppliers had different accounting practices on how and where they held their cash, assets and liabilities. We consider this should not change our modelling results, as we calculate the cost increment for suppliers against themselves (between baseline period and cap period seven) rather than with a different supplier.

1.15. We consider that data comprising only 23% of the market is insufficient to enable us to adequately assess whether there is significant and clear evidence on material additional working capital costs resulting from COVID-19 for the float in cap period seven. This is because it does not give us confidence that the results would represent the market impact of COVID-19.

Incremental working capital cost analysis

1.16. We used the same steps discussed in Appendix 1 to calculate the working capital cost increment per customer account.

1.17. To convert the amount of working capital into a cost, we applied the 10% cost of capital, this is consistent with our approach in our February 2021 decision.[78]

1.18. Taking the data at face value, the lower quartile benchmark for working capital cost increment per customer account is approximately £0.18 for cap period seven.

1.19. Given the small sample size in our final sample, we cannot provide similar statistics on our sample as in Appendix 1. This would disclose suppliers' individual data which is commercially confidential and sensitive. This approach is unchanged from our November 2020 consultation.[79]

Converting the cost increment into a cap adjustment figure

1.20. We used the same approach as described in Appendix 1 to convert the cost increment benchmark into a cap adjustment figure.

1.21. Table A2.1 shows how much the default tariff cap for cap period seven would be adjusted due to the impact of COVID-19 if we made an adjustment based on working capital cost increment of £0.09 per customer account (post sharing factor).

Table A2.1: Working capital costs scaled increments for cap period seven adjustment level after applying a sharing factor

Scaled levels	Electricity		Gas		Dual Fuel	
	Nil	TDCV	Nil	TDCV	Nil	TDCV
Cap period seven (£)	0.03	0.16	0.03	0.13	0.06	0.30

[78] Ofgem (2020), Reviewing the potential impact of COVID-19 on the default tariff cap: November 2020 consultation, paragraph 4.62.
https://www.ofgem.gov.uk/publications-and-updates/reviewing-potential-impact-covid-19-default-tariff-cap-november-2020-consultation
[79] Ofgem (2020), Reviewing the potential impact of COVID-19 on the default tariff cap: November 2020 consultation, Appendix 1, paragraph 6.
https://www.ofgem.gov.uk/publications-and-updates/reviewing-potential-impact-covid-19-default-tariff-cap-november-2020-consultation

1.22. An adjustment allowance for the incremental costs identified in our calculations would be approximately £0.30 per typical customer in cap period seven.

Debt-related administrative costs

Context

1.23. In our February 2021 decision, we decided to not include debt-related administrative costs in the float. We did not have confidence that the RFI data collected was consistent between suppliers.[80] In addition, taking the data at face value, the data did not show any material cost to suppliers.

1.24. We outlined in our March 2021 working paper that we were collecting debt-related administrative costs through our RFI. We asked suppliers to provide their baseline and forecast data for the total debt-related administrative costs.[81] Suppliers also provided cost breakdowns for internal collections, external collections, and warrant costs.

Summary of RFI

1.25. We have received 11 submissions to the debt-related administrative costs questions from our March 2021 RFI.[82]

1.26. After applying the additional filters to the March RFI data, we have excluded three suppliers' data sets that are not complete or not comparable between the baseline period and cap period seven for the same reasons as discussed in Appendix 1.

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[80] Ofgem (2021), Decision on the potential impact of COVID-19 on the default tariff cap, paragraph 4.25.
https://www.ofgem.gov.uk/publications-and-updates/decision-potential-impact-covid-19-default-tariff-cap

[81] Ofgem (2021), Reviewing the potential impact of COVID-19 on the default tariff cap: cap period seven, paragraph 3.24.
https://www.ofgem.gov.uk/publications-and-updates/price-cap-working-paper-reviewing-potential-impact-covid-19-default-tariff-cap-cap-period-seven

[82] We asked suppliers to submit their debt-related administrative costs baseline (January 2019 – March 2020) and debt-related administrative costs forecast (October 2021 – March 2022).

Data sample

1.27. Eight suppliers are included in our sample for calculating the debt-related administrative cost increment per customer account for cap period seven. This represents approximately 48% of the domestic energy market share.

1.28. Some suppliers were unable to provide the required breakdown we requested; they could not provide a figure for warrant costs separate from external collections. The cost breakdown was requested to provide a sense check of the general trend of each component. For the purpose of determining whether a float is required for cap period seven this is not an issue, since our calculation uses the total debt-related administrative cost for each supplier.

Incremental debt-related administrative cost analysis

1.29. We used the same methodology as discussed in Appendix 1 to calculate the debt-related administrative cost increment per customer account in our sample and convert the lower quartile benchmark of our sample into the adjustment allowance.

1.30. The lower quartile benchmark for the incremental debt-related administrative costs is approximately £0.03 per customer account for cap period seven.

Converting the cost increment into a cap adjustment figure

1.31. We used the same approach as described in Appendix 1 to convert the cost increment benchmark into a cap adjustment figure.

1.32. Table A2.2 shows how much the default tariff cap for cap period seven would be adjusted due to the impact of COVID-19 if we made an adjustment based on a debt-related administrative cost increment of £0.017 per customer account (post sharing factor).

Table A2.2: Debt-related administrative costs scaled increments for cap period seven adjustment level after applying a sharing factor

Scaled levels	Electricity		Gas		Dual Fuel	
	Nil	TDCV	Nil	TDCV	Nil	TDCV
Cap period seven (£)	0.01	0.03	0.01	0.02	0.01	0.06

1.33. An adjustment allowance for the incremental costs identified in our calculations would be approximately £0.06 per typical customer in cap period seven.

Appendix 3 - Bad debt costs for PPM customers

Summary

1.1. In this appendix, we outline the data we collected on suppliers' bad debt and our data sample after applying the additional filters as discussed in Chapter 3.

1.2. We consider there is no significant and clear evidence that suppliers are likely to incur material additional bad debt costs as a result of COVID-19 for serving PPM customers. We propose that a float for bad debt costs for PPM customers for cap periods four to seven is not necessary. Our calculation shows the incremental cost of the bad debt charge at lower quartile for cap periods four to seven for PPM customers is not material.

Data source for bad debt costs

Context

1.3. We collected the bad debt charge data for PPM customers from January 2019 to March 2022 through our RFI. We asked for this data for the purpose of analysing whether there were material additional costs for PPM customers for cap periods four to seven.

1.4. We also asked suppliers to provide their working capital and debt-related administrative costs for cap periods four to seven for PPM customers, when responding to our March 2021 working paper.[83] However, we did not receive any submissions for these cost data.

Stakeholder responses and considerations

1.5. Two suppliers welcomed our consideration of whether an adjustment for PPM customers was necessary. One of them said that we needed to take account of the support it had offered to vulnerable PPM customers to prevent self-disconnection.

[83] Ofgem (2021), Reviewing the potential impact of COVID-19 on the default tariff cap: cap period seven working paper, paragraph 4.5.
https://www.ofgem.gov.uk/publications-and-updates/price-cap-working-paper-reviewing-potential-impact-covid-19-default-tariff-cap-cap-period-seven

Discretionary credit granted

1.6. One supplier said that we should issue further RFIs on discretionary credit and administrative costs for PPM customers as it noticed higher costs through these areas due to an increased number of customer contacts and PPM key replacement requests.

1.7. We discussed discretionary credit in our February 2021 decision. For more detail on our considerations, please see Chapter 5 of our decision.[84] In our March 2021 working paper, we also discussed that we intended to identify whether there was significant and clear evidence of material additional bad debt as a result of suppliers providing discretionary credit during the COVID-19 pandemic, rather than just the discretionary credit granted.[85]

1.8. We are considering the additional debt-related administrative costs for credit and PPM customers together in Appendix 2.

Customer mix

1.9. One supplier said that it had seen an increase in PPM debt over a year old which was usually not repaid in full. It believed new market entrants were able to avoid these costs. It also said that the vulnerable customers were not distributed equally across suppliers, so some suppliers would end up bearing a higher proportion of the increased costs to serve, and that this should be taken into account within the price cap.

1.10. We have discussed customer mix in our February 2021 decision. For more detail on our considerations, please see Chapter 3 of our decision.[86]

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[84] Ofgem (2021), Decision on the potential impact of COVID-19 on the default tariff cap, paragraph 5.18-5.22.
https://www.ofgem.gov.uk/publications-and-updates/decision-potential-impact-covid-19-default-tariff-cap

[85] Ofgem (2021), Reviewing the potential impact of COVID-19 on the default tariff cap: cap period seven working paper, paragraph 4.18.
https://www.ofgem.gov.uk/publications-and-updates/price-cap-working-paper-reviewing-potential-impact-covid-19-default-tariff-cap-cap-period-seven

[86] Ofgem (2021), Decision on the potential impact of COVID-19 on the default tariff cap, paragraph 3.83-3.89.
https://www.ofgem.gov.uk/publications-and-updates/decision-potential-impact-covid-19-default-tariff-cap

Data sample and analysis

Summary of March RFI

1.11. We received 7 submissions to the bad debt charge questions from our March 2021 RFI for PPM.[87] We received less responses for PPM than for the bad debt charge of all payment methods combined (total), this is because some suppliers were unable to breakdown the bad debt charge to provide a figure for the payment method the customer was on at the point the debt was incurred.

1.12. After applying our methodology, for the March RFI data, we have excluded data sets that are not complete or comparable between the baseline period and relevant cap period:

- one supplier provided incomplete data which only covered the forecast periods, without a pre-COVID baseline period;
- one supplier provided data which did not meet our RFI guidance requirement. We asked suppliers to provide the bad debt charge by payment method at the point when customers incurred debt other than the customers' current payment method. This supplier submitted the bad debt charge data for PPM customers when they were on credit meters and incurred debt. Therefore, we exclude this supplier from our sample as we consider it does not represent PPM costs.

1.13. We have not found any suppliers' forecast costs that we deem unreasonable.

1.14. Five suppliers are included in our sample for calculating the bad debt charge cost increment per customer account for PPM customers. This represents approximately 59% of the PPM market share.

1.15. We consider data in our sample is adequate to provide a good estimate of additional bad debt costs for PPM customers resulting from COVID-19 for the float for cap periods four to seven.

[87] We asked suppliers to submit their bad debt charge baseline (January 2019 – January 2021) and bad debt charge forecast (February 2021 – March 2022) for PPM customers.

1.16. We discuss our sample's data range of bad debt cost increment per customer account for PPM customers in the section below.

Incremental bad debt cost analysis

Which cap periods to include

1.17. In responding to our March 2021 working paper, one stakeholder said that Ofgem should not be providing a float to cover the costs of previous periods which were under the control of a separate body.[88]

1.18. We continue to consider appropriate that we consider an adjustment for the exceptional impact of COVID-19 within the cap for PP customers since March 2020. As a result we describe in Chapter 3 that the scope of our review for bad debt for PPM customers includes all the cap periods likely to be affected by COVID-19 (cap periods four to seven). For more detail on our considerations, please see Chapter 5 of our September 2020 consultation.[89]

Calculating cost per customer

1.19. For each cap period we used a pre-COVID baseline period to calculate the bad debt cost increment per customer account. Table A3.1 shows the dates we used for our cap periods and respective baseline. Cap periods four to six are consistent with our February decision, and cap period seven is consistent with our approach described in Appendix 1.[90]

[88] This stakeholder was referring to the Competition and Markets Authority, their PPM cap ended on 31 December 2020. Since 1 January 2021 default tariff PPM customers have been protected by a specific PPM cap level in the default tariff cap.
[89] Ofgem (2020), Reviewing the potential impact of COVID-19 on the default tariff cap: September 2020 policy consultation, paragraphs 5.6 – 5.8. https://www.ofgem.gov.uk/publications-and-updates/reviewing-potential-impact-covid-19-default-tariff-cap-september-2020-policy-consultation
[90] Ofgem (2021), Decision on the potential impact of COVID-19 on the default tariff cap, table 4.5. https://www.ofgem.gov.uk/publications-and-updates/decision-potential-impact-covid-19-default-tariff-cap

Table A3.1: Cost increment calculation details

	Cap period 4 (April 2020 – September 2020)	Cap period 5 (October 2020 – March 2021)	Cap period 6 (April 2021 – September 2021)	Cap period 7 (October 2021 – March 2022)
COVID-19 scenario	April 2020 – September 2020	October 2020 – March 2021	April 2021 – September 2021	October 2021 – March 2022
Baseline	April 2019 – September 2019	October 2019 – February 2020 (scaled up)	April 2019 – September 2019	October 2019 – February 2020 (scaled up)

1.20. The remainder of our approach for calculating the bad debt cost increment per customer account is unchanged from our calculating cost per customer section in Appendix 1.

Benchmark at lower quartile

1.21. For each supplier, we calculated the bad debt charge cost increment per customer account for each cap period for PPM. We then selected the lower quartile benchmark for each cap period as shown in Table A3.2. The total lower quartile bad debt benchmark for cap periods four to seven is approximately -£0.12 per customer account.

Table A3.2: Lower quartile benchmark for PPM bad debt cost increment for each cap period

Cost item	Unit	Cap period 4	Cap period 5	Cap period 6	Cap period 7	Total
Bad debt charge	£/customer	1.00	-0.31	0.24	-1.05	-0.12

Statistics of our sample

1.22. For the same reason set out in Appendix 1, we are publishing key statistics of our sample (sample average and standard deviation).

Table A3.3: Breakdown of the mean and standard deviation for each cap period

	Cap period 4	Cap period 5	Cap period 6	Cap period 7
Mean (simple average)	£1.85	£0.34	£1.43	-£0.44
Standard deviation	2.54	2.27	3.01	1.17

Converting the cost increment into a cap adjustment figure

1.23. We used the same approach as described in Appendix 1 to convert the cost increment benchmark into a cap adjustment figure.

1.24. Table A3.4 shows, how much the default tariff cap for cap period seven would be adjusted due to the impact of COVID-19 if we made an adjustment based on a cost increment of -£0.06 per customer account (post sharing factor).

Table A3.4: Bad debt scaled increments for cap period seven adjustment level after applying a sharing factor

Scaled levels	Electricity		Gas		Dual Fuel	
	Nil	TDCV	Nil	TDCV	Nil	TDCV
Cap period four (£)	0.16	0.90	0.16	0.71	0.32	1.61
Cap period five (£)	-0.05	-0.28	-0.05	-0.22	-0.10	-0.51
Cap period six (£)	0.04	0.22	0.04	0.17	0.08	0.39
Cap period seven (£)	-0.17	-0.94	-0.17	-0.75	-0.33	-1.69
Total (£)	**-0.02**	**-0.11**	**-0.02**	**-0.09**	**-0.04**	**-0.20**

1.25. An adjustment allowance for the incremental costs identified in our calculations would be approximately -£0.20 per typical customer.

Appendix 4 – Disclosure

Overview of information provided to stakeholders

1.26. Table A4.1 summarises the information we have published. This is to help stakeholders understand how we have used the RFI data to calculate a float for COVID-19 costs in the cap.

Table A4.1: Information published on COVID-19 adjustment

Information published	Explanation
Proposed cap adjustment	We have provided stakeholders with the total proposed cap adjustment (for cap period seven, our proposed adjustment is zero). Stakeholders are able to assess the level of the proposed adjustment and compare it with the incremental change in costs that they have incurred as a result of COVID-19. (To do this, a stakeholder would need to convert its costs into cap level terms, using the Annex 8 model).
Explanation of the calculations	In Chapter 3, we have explained that we are using the same methodology we used for setting the initial float in cap periods four to six, plus additional filters on suppliers' estimate of costs that are included in our sample. We have explained the reasons for any exclusions of data. This enables stakeholders to understand the steps we have taken to calculate the adjustment if needed. We have also explained how we are introducing a sharing factor for calculation of any float.
Data sources	We have explained in this consultation the types of data that we have used to calculate our proposed adjustment. Stakeholders have the opportunity to comment and provide comments on the data sources used. (The suppliers who received the mandatory RFI received the template we used to gather data).
Adjustment Allowance (AA) calculation	We published the AA model with our February 2021 decision.[91] This shows how we convert the incremental change in debt-related costs in a given cap period to an adjustment in cap level terms. This should enable stakeholders to understand the impact of the design decisions within this model.

[91] Ofgem (2021), Model – Annex 8 – Adjustment allowance v1.32.
https://www.ofgem.gov.uk/system/files/docs/2021/02/annex_8_-_adjustment_allowance_methodology_v1.32.xlsx

Overview of data that has not been published or disclosed to stakeholders

1.27. Suppliers submitted data through the mandatory RFI sent 25 February 2021. As discussed in this consultation, we use the data to determine whether a float was necessary.

1.28. We have decided not to publish or disclose suppliers' individual data.

Considerations

1.29. We consider that the information we have published sufficiently allows stakeholders to make meaningful comments on our approach and methodology for determining whether a float is necessary.

1.30. We are not publishing suppliers' individual data because it is confidential to each supplier and given its sensitivity, we do not consider it to be in the interests of customers to publish such information.

1.31. We are also not disclosing suppliers' individual data. This is because of the following main reasons, among others:

- we are calculating a potential adjustment and considering whether a float is necessary, so the numbers are not definitive and will be subject to a true-up process, though this will be subject to when suitable data becomes available;.
- the calculations we have carried out on suppliers' individual data are straightforward and similar to what we have done when setting the initial float for cap periods four to six;
- we do not consider there is a need for suppliers or their advisors to be able to QA our calculations; and
- in the context of this data not being essential to the process, we do not consider it appropriate or proportionate to disclose the data we have used to determine whether a float is necessary.

1.32. Separately, as part of the true-up process, we are considering whether or not a disclosure process is required.

Appendix 5 – Privacy notice on consultations

Personal data

The following explains your rights and gives you the information you are entitled to under the General Data Protection Regulation (GDPR).

Note that this section only refers to your personal data (your name address and anything that could be used to identify you personally) not the content of your response to the consultation.

1. The identity of the controller and contact details of our Data Protection Officer

The Gas and Electricity Markets Authority is the controller, (for ease of reference, "Ofgem"). The Data Protection Officer can be contacted at dpo@ofgem.gov.uk

2. Why we are collecting your personal data

Your personal data is being collected as an essential part of the consultation process, so that we can contact you regarding your response and for statistical purposes. We may also use it to contact you about related matters.

3. Our legal basis for processing your personal data

As a public authority, the GDPR makes provision for Ofgem to process personal data as necessary for the effective performance of a task carried out in the public interest. i.e. a consultation.

4. With whom we will be sharing your personal data

We may share consultation responses with BEIS.

5. For how long we will keep your personal data, or criteria used to determine the retention period.

Your personal data will be held for six months after the project, including subsequent projects or legal proceedings regarding a decision based on this consultation, is closed.

6. Your rights

The data we are collecting is your personal data, and you have considerable say over what happens to it. You have the right to:

- know how we use your personal data
- access your personal data
- have personal data corrected if it is inaccurate or incomplete

- ask us to delete personal data when we no longer need it
- ask us to restrict how we process your data
- get your data from us and re-use it across other services
- object to certain ways we use your data
- be safeguarded against risks where decisions based on your data are taken entirely automatically
- tell us if we can share your information with 3rd parties
- tell us your preferred frequency, content and format of our communications with you
- to lodge a complaint with the independent Information Commissioner (ICO) if you think we are not handling your data fairly or in accordance with the law. You can contact the ICO at https://ico.org.uk/, or telephone 0303 123 1113.

7. Your personal data will not be sent overseas

8. Your personal data will not be used for any automated decision making.

9. Your personal data will be stored in a secure government IT system.

10. More information

For more information on how Ofgem processes your data, click on the link to our "Ofgem privacy promise".