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Additional debt-related costs allowance policy consultation

Whilst we agree that it is in the interest of customers to allow suppliers as a whole to recover efficiently incurred costs, this consultation does not provide evidence that funding for debt-related costs is not adequate. Most of the options presented show a small over-allowance. We recognise that this could change as more recent data is included.

If further evidence does support an additional allowance, it is important that funding is only provided for efficiently incurred costs. In line with regulatory precedent, lower quartile should be maintained as the efficiency benchmark wherever possible. Weighted averages are not appropriate for bad debt due to the risk of outliers in supplier estimates.

This consultation overlaps with a number of other Ofgem work areas. Generally, we believe the policy issues contained should be addressed in those other areas as this consultation is largely technical in nature. Differentials between payment types can be better resolved through levelisation to avoid the commercial distortions created by adjusting how costs are allocated. The balance between standing charges and unit rates should be left to the forthcoming standing charge review.

Answers to selected consultation questions are provided below.

Yours sincerely,

Andy Manning

Principal Economic Regulation Specialist

Responses to selected questions

1. Do you consider that we should make a temporary adjustment to the price cap to account for additional debt-related costs?

We agree that it is important to ensure that suppliers are adequately funded for the services they provide, so it is in the interest of customers to allow suppliers as a whole to recover efficiently incurred costs.

However, this consultation does not provide evidence that suppliers are not being adequately funded. A temporary adjustment is justified by comparing the weighted average of 'actual' debt-related costs to the assumed allowance. We do not believe that the weighted average is representative of efficiently incurred costs and so is not sufficient evidence. We note that most of the benchmarking options presented indicate a small over-allowance. On that basis, no additional debt-related costs have been identified.

We recognise that this could change as more recent data is included.

2. Do you think that suppliers cost due to the moratorium on involuntary PPM?

Any additional costs associated with the moratorium, but driven by poor supplier practices prior to the moratorium should not be included in how any adjustments are made.

4. Do you have any views on whether it would be appropriate to explore a specific levy mechanism for DNI ('do not install') customers?

We believe that it would be appropriate to explore a specific levy mechanism for DNI customers. There are potential benefits for consumers that are worth considering, including improving the service for these customers, but challenges also exist particularly related to ensuring only efficiently incurred costs are recovered from consumers.

Q12. Which, if any, of the benchmarking options do you favour?

Efficiency should continue to be defined as lower quartile unless there is compelling evidence to move away from this. This is well-established regulatory practice, across both the original price cap and network regulation, and is consistent with a focus on improving cost efficiency.

We accept there is more evidence to move away from this for bad debt due to the suppliers having less control over the levels of bad debt. However, we do not believe that a weighted average can be used instead. This is because bad debt costs are mostly not 'actual' costs but are supplier estimates. Suppliers will take different approaches to making these estimates and a weighted average will be skewed by outliers amongst these approaches. Any 'true-up' cannot be expected to fully address this as all the relevant bad debt will not have been written off by that stage. So, if lower quartile is not to be used then median should be the preferred approach as it reduces the impact of outliers.

Q13. Do you have any views on which payment method allocation option would be preferable?

We agree that bad debt attributed to PPM customers is likely to have been incurred before the customers moved to PPM (apart from Additional Supply Credit which is being dealt with elsewhere). So, no bad debt should be allocated to PPM.

Due to the higher proportion of customers in fuel poverty amongst Standard Credit (SC) customers, we agree that changes which increase the differential between Direct Debit (DD) and SC should be avoided. As we explained in our responses regarding payment type levelisation[1], our preferred approach is for bad debt for SC customers to be included within the levelisation process. This is preferable to adjusting the allocation of costs by payment method as it avoids creating distortions, which in turn may create unhelpful incentives on suppliers.

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[1] Citizens Advice response to the Ofgem consultation on levelling the cost of standing charges on prepayment meters

Q15. How should we apportion any debt-related costs allowance over the unit rate and standing charge elements of the cap only?

It remains true that debt covers the whole energy bill and so cannot be attributed to either unit rate and standing elements. The current approach of applying across the bill should be continued.

We are aware of significant concerns related to the current size of standing charges, and welcome the standing charge review that Ofgem has signalled it will bring forward shortly. That review will be the most appropriate place to explore the impact of standing charges on consumers in the round.