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Additional debt-related costs review 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 sufficient evidence that the additional funding proposed for debt-related costs is justified. This is because proposals rely upon suppliers' own estimates of bad debt without proposing any checks or controls on how these estimates are produced. A lower-quartile approach to benchmarking would provide some protection around this, however it is also suggested that this approach to benchmarking could be relaxed at the true-up stage.

In order to ensure consumers have protections against suppliers being funded beyond the level of efficiently incurred costs, the following changes are required:

- Review suppliers' method of estimating bad debt.
- Confirm lower-quartile approach to assessing efficiency will be maintained throughout.
- Review any changes made to suppliers' method of estimating bad debt at the true-up stage and make any necessary adjustments.

Estimates of bad debt costs (provisions)

The proposals do not fully recognise that bad debt 'costs' are different from other costs that suppliers face. This is because bad debt costs are mostly not 'actual' costs but are supplier estimates. Suppliers will take different approaches to making these estimates. This means, as supplier estimates are used to create the benchmark, suppliers can have a direct influence on the allowance they receive. 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. It also creates an incentive to, at the very least, ensure provisions do not underestimate actual bad debt. Ofgem should review all the approaches to estimating bad debt and, where methods are identified that are likely to overstate bad debt, exclude those suppliers from the benchmarking. The results of this review should be published to allow full scrutiny. Any true-up should include a further review of how estimates are produced. Any changes made to these methodologies should be specifically assessed.

Level of efficiently incurred costs

We agree that lower-quartile is the appropriate approach to ensuring only efficiently incurred costs are allowed. 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. It should also give some limited protection against suppliers' overestimating bad debt.

However, this is undermined by the commitment in the consultation to review *'whether the lower quartile approach remains appropriate'* when considering the true-up of costs. As it is the true-up that will determine the overall additional allowance for suppliers, this means the claims of taking a *'stringent'* approach are meaningless, other than relating to short-term bill impacts.

We are concerned that the 'float and true-up' approach may, in practice, be being used to spread any additional allowance across 2 decisions. This would reduce the impact of each individual decision and so could reduce the attention paid by stakeholders to the decisions and so also reduce scrutiny. Unless Ofgem commits to putting checks and controls around approaches to estimation, including applying lower-quartile benchmarking at all stages, we believe that any 'true-up' would not be in the interest of consumers.

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 would 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 ongoing standing charge review. As 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.

Yours sincerely,

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