Consultation

Price cap – Statutory consultation on introducing an allowance for bad debt associated with Additional Support Credit

Publication date:	**28 June 2023**
Response deadline:	**26 July 2023**
Contact:	Marcus McPhillips
Team:	Price Protection Policy
Telephone:	020 7901 7000
Email:	priceprotectionpolicy@ofgem.gov.uk

This is a statutory consultation on our proposed approach to introducing an initial 12-month allowance in the default tariff cap ('the cap') for bad debt costs associated with Additional Support Credit (ASC) given to Prepayment meter (PPM) customers. We will consider whether this should become an enduring change to the cap as part of our Operating Costs review. We welcome views from all stakeholders with an interest in the domestic retail energy supply market, including consumer groups, charities and suppliers, on any of the proposals and considerations set out in this consultation.

This document outlines the scope and purpose of the consultation, as well as how you can get involved. Once the consultation is closed, we will consider all responses. We want to be transparent in our consultation and 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.

Any enquiries related to the text of this publication should be sent to Ofgem at:

10 South Colonnade, Canary Wharf, London, E14 4PU.

This publication is available at www.ofgem.gov.uk. Any enquiries regarding the use and re-use of this information resource should be sent to: psi@nationalarchives.gsi.gov.uk

Foreword

Ensuring a fair deal for consumers, particularly vulnerable consumers, is at the heart of what we do at Ofgem.

This includes the decisive action to tighten up the rules on when and where prepayment meters (PPMs) can be installed, including through the Code of Practice on Involuntary PPMs ('the Code') published in April 2023, and further steps we have set out today in our statutory consultation on Involuntary PPM. This aims to ensure protections for the most vulnerable customers, for whom a PPM may not be a suitable option, alongside better support for those customers who are currently on a PPM or may be moved to a PPM.

It also includes ensuring that customers receive appropriate support from their suppliers. One of the ways in which suppliers support PPM customers is by issuing Additional Support Credit (ASC). These customers may have already exhausted alternative options, such as emergency or friendly hours credit, and this ASC is critical to keeping them on supply.

ASC is repayable but as energy prices have increased in recent years, alongside wider cost of living pressures, we have seen customers' demand for ASC increase and, in turn, the levels of non-repayment increase. We expect the level of ASC to increase further this winter, given continued affordability pressures and our increased expectations on suppliers, including issuing £30 to every new customer moved onto a PPM involuntarily.

To ensure that those expectations of support are delivered in reality, it is important that we recognise suppliers' efficient costs within the price cap. Currently, there is no specific allowance within the price cap for bad debt associated with ASC, as historically it was very low. So today, we are launching a consultation on introducing an initial 12-month allowance to cover ASC bad debt costs. We will consider whether this should become an enduring change to the price cap as part of our Operating Costs review.

We propose in this consultation that the allowance will be around £13 per typical dual fuel PPM customer in total over 12 months. This allowance would be added to the PPM cap only, to ensure that the suppliers who serve PPM customers are financially able to issue support credit where needed this winter. In practice, we do not expect this allowance to lead to PPM customers paying more on their bills than comparable direct debit (DD) customers in 2023/24. This is because at the Spring Budget, government made a commitment to align charges for comparable DD and PPM customers using the Energy Price Guarantee (EPG) until April 2024, to ensure that PPM customers no longer pay a premium for their energy costs. We are actively working with government to ensure this proposal is aligned with that continued commitment to remove the PPM premium.

Once that government commitment ends, we recognise this allowance would impact PPM customers' bills directly. However, subject to the completion of wider Ofgem work on the relative costs of all payment methods, the cost of the ASC bad debt allowance may be recovered across other payment methods as well, not solely PPM. In either case, given the significant benefits of ASC to some of the most vulnerable consumers, we believe this intervention is justified.

We recognise that any addition to the price cap, no matter the merits, is rightly an area of significant public interest. We will be closely monitoring provision of ASC by suppliers, including through existing monitoring and compliance measures, to ensure that consumers, and particularly vulnerable consumers, benefit as intended. This consultation is also a key part of us getting this important intervention right and the team and I look forward to your responses.

Neil Kenward
Acting Director for Markets, Ofgem

Executive Summary

Additional Support Credit (ASC) is credit provided by energy suppliers to prepayment meter (PPM) customers who may have exhausted alternative options (ie emergency or friendly hours credit) to avoid self-disconnection.[1] ASC helps vulnerable consumers to stay on supply, reducing the physical and emotional harm that can result from rationing their heating, cooking and hot water.

While ASC is repayable, some of it will not be able to be recovered by energy suppliers, and therefore is ultimately written off. This is referred to as 'ASC bad debt'. While the default tariff cap (the 'cap') currently provides an allowance to recover many debt-related costs, this does not include a specific allowance for ASC bad debt. This is because historically ASC bad debt levels were minimal.

As part of our wider debt-related costs review[2], we have seen evidence of what we consider to be a material increase in 2022/23, both in the overall level of ASC issued and the level of ASC bad debt. We consider it is reasonable to expect demand for ASC to increase this coming winter (2023/24), given continued affordability pressures associated with energy and the wider cost of living. Additionally, the Code of Practice on Involuntary PPM (the 'Code')[3] published in April, and the further steps we are consulting on today in relation to Involuntary PPM[4], mean there are a number of further conditions and measures which could increase the level of ASC that suppliers are expected to issue.

In view of this anticipated increase in ASC bad debt costs, we consider it is in customers' interests to ensure that suppliers have confidence that when they issue ASC, there is a provision to recover notionally efficient costs of bad debt associated with it. Given we consider these increased costs to be material and systematic for the purposes of the cap, such a provision is considered appropriate and necessary to support full compliance with suppliers' ASC obligations, which is in customers' interests. Without such a provision, there may be an increased risk of self-disconnection for vulnerable customers, which can

[1] Ofgem (2023), Standard conditions of electricity supply licence & Standard conditions of gas supply licence, https://www.ofgem.gov.uk/publications/licence-conditions
[2] An update on the wider debt-related costs review has been published on 28 June 2023. We refer to this as the 'wider' review as we are considering all debt-related costs, including those from non-PPM or credit payment methods. https://www.ofgem.gov.uk/publications/price-cap-update-debt-related-costs-review
[3] Ofgem (2023), Involuntary PPM – Supplier Code of Practice, https://www.ofgem.gov.uk/publications/involuntary-ppm-supplier-code-practice
[4] Ofgem (2023), Involuntary PPM – Statutory Consultation, https://www.ofgem.gov.uk/publications/statutory-consultation-involuntary-ppm

cause serious harm. Additionally, if a notional supplier incurs ASC bad debt costs which are not reflected in cap allowances, this could have a negative impact on its financeability.

We therefore propose to introduce an initial 12-month allowance to the cap for ASC bad debt, from October 2023, with any enduring or permanent change considered as part of the Operating Costs review.[5] This would also be implemented through a 'float and true-up' approach, which means initially setting an ex-ante allowance based on anticipated costs of ASC bad debt, with the option to adjust this at a later stage if evidence suggests the actual costs differ significantly from the ex-ante allowance.

For determining the proposed level of the initial 12-month adjustment allowance, we have considered three scenarios for 2023/24 ASC bad debt. We propose to set the allowance based on our central scenario, which sees the level of ASC issued increase by the proportionate increase in ASC from winter 2021/22 to winter 2022/23, while the proportion of ASC which becomes bad debt remains constant. Under this scenario, the allowance is approximately £13 per typical dual fuel PPM customer.[6]

We propose that the full allowance would be allocated to the PPM cap only, rather than allocating across all, or a wider portion of, default tariff customers. This is because the particular nature of ASC means all ASC bad debt would have been incurred on the PPM payment method. Allocating the allowance to the PPM cap also permits suppliers with more PPM customers to recover a larger amount, given they are likely to incur higher ASC bad debt costs.

At the Spring Budget, the government committed to align charges for comparable direct debit (DD) and PPMs to ensure that those on PPMs no longer pay a premium for their energy costs. This will be delivered using the Energy Price Guarantee (EPG) until April 2024, and we are actively working with government to ensure the proposals in this consultation are aligned with that continued commitment to remove the PPM premium. This means that in practice, we do not expect this ASC bad debt allowance to lead to PPM customers paying more on their bills than comparable DD customers in 2023/24.

---

[5] Ofgem (2023), Price cap - Call for Input on the Operating Cost Allowances Review, https://www.ofgem.gov.uk/publications/price-cap-call-input-operating-cost-allowances-review
[6] This is at benchmark Typical Domestic Consumption Values (TDCV) split evenly between gas and electricity. TDCV are 3,100 KWh per year for electricity (single register), 4,200 KWh per year for electricity (multi-register) and 12,000 KWh per year for gas.

The costs of the allowance would fall directly to customers from April 2024. The government has asked Ofgem to report by this autumn (2023) on options for permanently ending the PPM premium, so that a mechanism is ready for implementation in April 2024. If such a mechanism was in place, it would spread the remaining costs related to this allowance across other payment types, not solely on PPMs, leading to a significantly lower cost per dual fuel customer. We are publishing a consultation on this issue later this summer, following our Call for Evidence on levelisation of payment method cost differentials in April 2023.[7]

We welcome views on any of the proposals and considerations set out in this consultation, including on the value, methodology and implementation of the proposed allowance for ASC bad debt. The deadline for submitting views on the proposals contained in this consultation is **Wednesday 26 July 2023**.

[7] Ofgem (2023), Levelisation of payment method cost differentials: a call for evidence https://www.ofgem.gov.uk/publications/levelisation-payment-method-cost-differentials-call-evidence

1 Consultation process

What are we consulting on?

1.1 This statutory consultation seeks views on our proposals for introducing an initial 12-month allowance to the default tariff cap (the cap) for bad debt costs associated with Additional Support Credit (ASC).

1.2 This document is split into nine chapters:

- Chapter 1: Consultation process;
- Chapter 2: Introduction;
- Chapter 3: Rationale for introducing an initial 12-month allowance for ASC bad debt to the cap from October 2023
- Chapter 4: Calculating the allowance;
- Chapter 5: Implementing the allowance;
- Chapter 6: Interaction with other workstreams;
- Chapter 7: Impact Assessment;
- Chapter 8: Next steps
- Chapter 9: Appendices

Related publications

1.3 The main general documents relating to the cap are:

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

1.4 The main documents relating to this statutory consultation are:

- April 2023 - Call for Input on the allowance for debt-related costs: https://www.ofgem.gov.uk/publications/price-cap-call-input-allowance-debt-related-costs
- April 2023 - Levelisation of payment method cost differentials: a call for evidence: https://www.ofgem.gov.uk/publications/levelisation-payment-method-cost-differentials-call-evidence

- June 2023 - Update on debt-related cost review: https://www.ofgem.gov.uk/publications/price-cap-update-debt-related-costs-review
- June 2023 – 'Statutory Consultation – Involuntary PPM': https://www.ofgem.gov.uk/publications/statutory-consultation-involuntary-ppm

Consultation stages

1.5 This is a statutory consultation which is open from 28 June 2023 – 26 July 2023. We will consider all responses to inform our decision, which we intend to publish by 25 August 2023.

1.6 We have been conducting a wider review of debt-related costs.[8] In January and April 2023, we issued two Requests for Information (RFIs) to gather evidence from energy suppliers on their debt-related costs. We also published a Call for Input (CFI) in April 2023 to seek views on our initial considerations and options around all debt-related costs.[9] In addition, we hosted a workshop with consumer groups and charities during the CFI window.

1.7 The evidence received as part of the CFI and RFIs, and other stakeholder engagement, will inform our ongoing review of debt-related costs. We have published a letter in parallel to this statutory consultation setting out an interim update on the wider review.[10] It sets out that we have decided not to consult on a price cap adjustment for credit debt-related costs this summer. Instead, we will issue a third RFI this summer and, depending on the evidence received in response, we may consult in autumn 2023, at the earliest, on a price cap adjustment.

How to respond

1.8 We want to hear from anyone interested in this consultation. We welcome views on any of the proposals and considerations discussed in this consultation, including on

[8] We refer to this as the 'wider' review as we are considering all debt-related costs, including those from non-PPM or credit payment methods.
[9] Ofgem (2023), Price cap - Call for Input on the allowance for debt-related costs, https://www.ofgem.gov.uk/publications/price-cap-call-input-allowance-debt-related-costs
[10] Ofgem (2023), Price cap – Update on debt-related costs review https://www.ofgem.gov.uk/publications/price-cap-update-debt-related-costs-review

the value, methodology and implementation of the proposed allowance for ASC bad debt.

1.9 Please send your response to priceprotectionpolicy@ofgem.gov.uk **on or before Wednesday 26 July 2023**.

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

Your response, data and confidentiality

1.11 You can ask us to keep your response, or parts of your response, confidential. We'll 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.

1.12 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'll 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.

1.13 If the information you give in your response contains personal data under the General Data Protection Regulation (Regulation (EU) 2016/679) as retained in domestic law following the UK's withdrawal from the European Union ("UK GDPR"), 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 in Appendix 2.

1.14 If you wish to respond confidentially, we'll keep the response itself confidential, but we will publish the number (but not the names) of confidential responses we receive. We won't 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

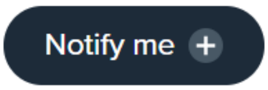
1.15 We believe that consultation is at the heart of good policy development. We welcome any comments about how we've run this consultation. We'd also like to get your answers to these questions:

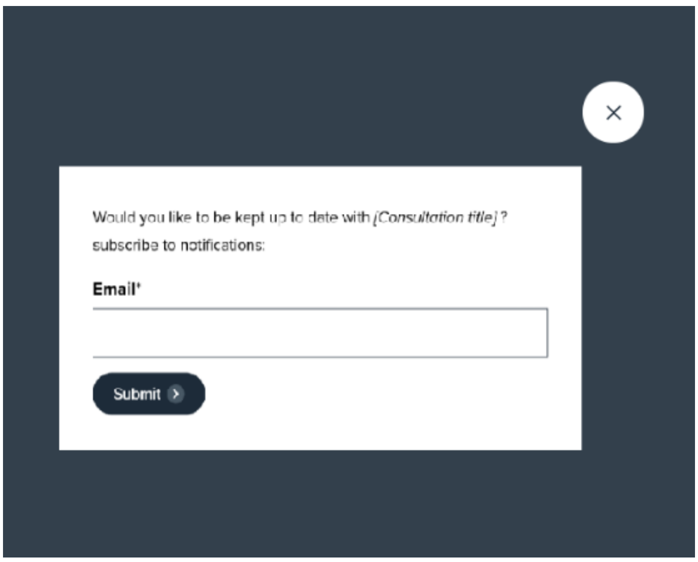
- Do you have any comments about the overall process of this consultation?
- Do you have any comments about its tone and content?
- Was it easy to read and understand? Or could it have been better written?
- Were its conclusions balanced?
- Did it make reasoned recommendations for improvement?
- Any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





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:

Upcoming > **Open** > **Closed** (awaiting decision) > **Closed** (with decision)

2 Introduction

Chapter summary

This chapter introduces our proposed approach to introducing an initial 12-month allowance to the cap for bad debt associated with ASC ('ASC bad debt').

Background

The default tariff cap

2.1 The cap was introduced on 1 January 2019 and protects existing and future domestic customers on standard variable and default tariffs (which we refer to collectively as 'default tariffs'), ensuring that customers pay a fair price for their energy that reflects the efficient underlying cost to supply that energy. The cap is set out in legislation through the Domestic Gas and Electricity (Tariff Cap) Act 2018 (the 'Act').[11]

2.2 Under the Act, we must have regard to five matters when setting the cap:

- 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;
- the need to ensure that holders of supply licences who operate efficiently are able to finance activities authorised by the licence;
- the need to set the cap at a level that takes account of the impact of the cap on public spending.[12]

2.3 The requirement to have regard to the five matters identified in section 1(6) of the Act does not mean that we must achieve all of these. In setting the cap, our primary consideration is the protection of existing and future customers who pay default tariffs. In reaching decisions on particular aspects of the cap, the weight

[11] Domestic Gas and Electricity (Tariff Cap) Act 2018. https://www.legislation.gov.uk/ukpga/2018/21
[12] Domestic Gas and Electricity (Tariff Cap) Act 2018, section 1(6)(e) as inserted by Schedule 3 to the Energy Prices Act 2022. In performing the duty under section 1(6)(e) we must have regard to any information provided by the Secretary of State, or any guidance given by the Secretary of State on this matter (section 1(6A)).

to be given to each of these considerations is a matter of judgement. Often, a balance must be struck between competing considerations.

2.4 The cap sets the maximum amount a supplier can charge default tariff customers for energy. It varies based on a number of different parameters, including fuel type, benchmark consumption, meter types, regional differences and payment methods. We calculate the cap using a bottom-up assessment of a notional supplier's costs (ie we calculate each cost component individually and then add them together) and set it to reflect the notionally efficient energy supply costs. In the aggregate, this approach ensures our benchmark (and cap) reflects the underlying efficient costs of supplying customers with energy.

Debt-related costs – definition and overview

2.5 Some energy bills are never paid, and therefore have to be written off by energy suppliers. This is referred to as bad debt, and all energy suppliers accumulate some bad debt. It is usual for businesses in many industries, not just energy, to make a provision for bad debt and to cover this through the pricing of their goods and services. Therefore, the cap provides an allowance to account for these costs. This means all customers pay for the cost of bad debt incurred by customers who do not pay.

2.6 The term 'bad debt' is commonly used as an overarching term to refer to all debt-related costs. However, for clarity in this document, we use 'debt-related costs' when referring to the three components of the costs (bad debt charge, debt-related administrative costs and associated working capital costs) and name the individual component when referring to it specifically.

2.7 The largest debt-related cost relates to the value of bills which are never paid. This cost is reflected in suppliers' accounts through the bad debt charge, which is an entry in the income statement. Suppliers make estimates (known as provisions) for the amount which will never be paid. They then adjust these estimates over time, and eventually finalise them through write-offs.

2.8 The other debt-related costs are debt administration costs (the administrative costs to suppliers from dealing with customers in debt) and working capital costs (the cost to suppliers of raising capital for day-to-day operations and funding customers paying in arrears).

Debt-related costs in the cap

2.9 The cap currently includes an allowance for the three debt-related costs. The allowance broadly scales linearly with the overall level of the cap. Therefore, it is now significantly greater than it was several years ago, given increases in the overall cost of energy.

2.10 The allowance varies significantly by payment type. From the initial design of the cap and our subsequent work on COVID-19 related debt, we know debt-related costs are generally higher for standard credit customers than direct debit customers, and much lower for PPM customers. PPM is the payment method least associated with accrual of bad debt, given customers use a PPM to top up their meter in advance of energy use, rather than in arrears.

2.11 We estimate that for cap period 10a (April 2023 – June 2023), debt-related costs represent approximately 6% of typical dual fuel standard credit bills, 1% of typical dual fuel direct debit bills and 0.4% of typical dual fuel PPM bills. The overall debt-related cost allowance is split between the unit rate and the standing charge, with the standing charge proportion counting for around a quarter of the overall allowance in cap period 10a (April 2023 – June 2023).

2.12 We are required to set a single cap level across suppliers and the cap is not designed to 'true-up' the actual costs of individual suppliers. However, we adjusted the cap to reflect additional debt-related costs during the cap periods corresponding with the main COVID-19 period (cap periods four – seven, April 2020 – March 2022), given the systemic and market wide impacts.[13]

Update on debt-related costs review

2.13 There have been several exceptional market-wide changes since the period covered by our COVID-19 adjustment, including the gas price crisis and government interventions such as the Energy Price Guarantee (EPG) and the Energy Bills Support Scheme (EBSS). We have therefore been reviewing the debt-related cost allowance in the cap to determine whether a further adjustment to the allowance may be required. The review has been looking in the round at 2022/23 costs and allowances, and anticipated costs and allowances in 2023/24.

[13] Ofgem (2023), Price Cap – Decision on the true-up process for COVID-19 costs, https://www.ofgem.gov.uk/publications/price-cap-decision-true-process-covid-19-costs

2.14 We issued two RFIs in January and April 2023[14] to collect information from suppliers about their debt-related costs. We also published a CFI in April 2023 to seek views from all stakeholders about various aspects of debt-related costs.[15] This included how we calculate debt-related costs for the purposes of the cap, the impact of a number of factors which may have a bearing on debt-related costs and the potential role of non-price cap mechanisms.

2.15 As set out in the update on the wider debt-related costs review published on 28 June 2023[16], given the data and evidence we have received so far, we consider that there is not a material or systematic gap between the allowance within the price cap for debt-related costs and actual costs. We have therefore decided not to consult on a price cap adjustment for credit debt-related costs this summer. Instead, we intend to issue a third RFI this summer, and depending on the evidence received in response to that RFI, we may consult in autumn 2023 at the earliest on a price cap adjustment. We intend to publish an update letter at the appropriate stage accordingly.

Additional Support Credit (ASC)

2.16 We have seen, however, significant evidence of a material increase in non-repayment of ASC provided by suppliers to PPM customers. The allowance for debt-related costs in the price cap does not currently include a specific allowance for ASC bad debt. This consultation therefore considers whether, and if so how and when, to introduce an initial 12-month allowance for ASC bad debt costs into the cap. Any enduring change to the cap for ASC bad debt costs would be considered as part of the Operating Costs review.[17]

2.17 The definition of ASC is set out in supplier Standard Licence Conditions (SLCs).[18] It is a fixed amount of credit provided to a domestic customer in a vulnerable

[14] In our January RFI, we requested data on bad debt, debt-related administration and working capital costs up to the end of cap period 9a. The second RFI requested data on additional support credit and the PPM moratorium, in addition to data on the three debt-related cost categories up to the end of cap period 9b.
[15] Ofgem (2023), Price cap - Call for Input on the allowance for debt-related costs, https://www.ofgem.gov.uk/publications/price-cap-call-input-allowance-debt-related-costs
[16] Ofgem (2023), Price cap – Update on debt-related costs review, https://www.ofgem.gov.uk/publications/price-cap-update-debt-related-costs-review
[17] Ofgem (2023), Price cap - Call for Input on the Operating Cost Allowances Review, https://www.ofgem.gov.uk/publications/price-cap-call-input-operating-cost-allowances-review
[18] Ofgem (2023), Standard conditions of electricity supply licence & Standard conditions of gas supply licence, https://www.ofgem.gov.uk/publications/licence-conditions

situation when that domestic customer's PPM credit runs low or runs out, to ensure continuity of electricity supply or return on supply. In practice, ASC is credit provided by energy suppliers to PPM customers in vulnerable circumstances, who may have exhausted alternative options (ie emergency or friendly hours credit which are generally applied automatically to PPMs) to avoid self-disconnection.

2.18 The gas and electricity supplier SLCs set out the obligations around the provision of ASC.[19] They both state that:

"*27A.5 Subject to paragraph 27A.7, on each and every occasion on which a licensee identifies that a Domestic Customer who uses a Prepayment Meter and who is in a Vulnerable Situation has Self-Disconnected or is Self-Disconnecting and/or the licensee becomes aware or has reason to believe that a Domestic Customer who uses a Prepayment Meter and who is in a Vulnerable Situation has Self-Rationed or[i] is Self-Rationing, the licensee must offer Additional Support Credit to that Domestic Customer in a timely manner in addition to the support offered in paragraph 27A.2.*

27A.6 Where paragraph 27A.5 applies, on each occasion on which the licensee offers Additional Support Credit, the licensee must assess the sum of Additional Support Credit it offers to the Domestic Customer and calculate the instalments for the Domestic Customer to repay the Additional Support Credit it offers to the Domestic Customer in accordance with SLC 27.

27A.7 Should the licensee, acting reasonably and having fully considered and complied with its obligation in paragraph 27A.5 and 27.A6 (apart from actually offering the Domestic Customer Additional Support Credit), determine that the provision of Additional Support Credit to the Domestic Customer is not in the best interest of the Domestic Customer the licensee shall not be obliged to provide Additional Support Credit under SLC27A.5 to that Domestic Customer on that occasion, however, the licensee must provide alternative appropriate support to that Domestic Customer in accordance with SLC 0 and SLC 31G.2."

[19] Ofgem (2023), Standard conditions of electricity supply licence & Standard conditions of gas supply licence, https://www.ofgem.gov.uk/publications/licence-conditions

2.19 The statutory consultation on Involuntary PPMs[20] sets out further steps in relation to the Involuntary PPM Code of Practice[21] ('the Code') which are likely to impact the level of ASC issued. There are several relevant measures and these are reflected through proposed changes to the SLCs and guidance in relation to Involuntary PPMs. These are:

- £30 repayable credit should be added to the meters of consumers who are subject to an involuntary PPM. This is to mitigate the risk that they go off supply in the short term after the PPM is installed.[22]
- That suppliers must apply existing ASC support where a customer is self-disconnecting. The Code and statutory consultation on Involuntary PPM refer to existing ASC support requirements, and, for Involuntary PPMs, adds guidance about offering appropriate support including sufficient ASC amounts and frequencies.
- Where a customer is reliant on ASC to remain on supply, suppliers must assess if a PPM remains safe and reasonably practicable.

2.20 Under the gas and electricity supplier SLCs, suppliers are required to give other forms of credit as well.[23] Emergency credit is a fixed amount of credit provided to customers when their meter runs low, or runs out, to ensure continuity of supply. Friendly hours credit is provided overnight, at weekends and public holidays, when top up points may be closed, and a customer's PPM runs low or runs out.

Other work related to the debt-related costs

2.21 This consultation relates to whether we should make an initial 12-month adjustment to the cap for ASC bad debt. As well as our wider review of debt-related costs, the review of operating cost allowances of the price cap and levelisation of payment method workstream are also relevant to this work.

[20] Ofgem (2023), Involuntary PPM – Statutory Consultation, https://www.ofgem.gov.uk/publications/statutory-consultation-involuntary-ppm
[21] Ofgem (2023), Involuntary PPM – Supplier Code of Practice, https://www.ofgem.gov.uk/publications/involuntary-ppm-supplier-code-practice
[22] We note that this is defined separately as 'Involuntary PPM Credit' but given the purpose and nature of the payment, we consider it reasonable to consider this requirement as, in practice ASC. It therefore forms part of our overall assessment of ASC levels and for the purposes of this document, we therefore refer to this as an additional ASC requirement.
[23] Ofgem (2023), Standard conditions of electricity supply licence & Standard conditions of gas supply licence, https://www.ofgem.gov.uk/publications/licence-conditions

2.22 The review of operating costs is looking at the core operating costs allowance, smart metering cost allowances and allowances for cost differences between payment methods. The intention of the review is to consider whether enduring changes to the allowances are appropriate, and if the allowances still reflect the efficient costs of a notionally efficient supplier.

2.23 The levelisation of payment method cost differentials workstream explores whether Ofgem could, and should, make charges more equitable (but less cost-reflective), by 'levelising' across customer payment types (DD, SC and PPM).[24] The government has asked Ofgem to report by this autumn on options for ending the PPM premium in the longer term (including options for ending the PPM standing charge premium), so that a mechanism is ready for implementation in April 2024.

[24] Ofgem (2023), Levelisation of payment method cost differentials: a call for evidence, https://www.ofgem.gov.uk/publications/levelisation-payment-method-cost-differentials-call-evidence

3 Rationale for introducing an initial 12-month allowance for ASC bad debt to the cap from October 2023

Chapter summary

In this chapter we set out our rationale for introducing an allowance for ASC bad debt into the cap from October 2023, for 12 months initially.

Proposals

3.1 We propose to introduce a temporary allowance into the cap for ASC bad debt costs, from October 2023, for 12 months initially.[25]

3.2 We propose this would be done by a 'float and true-up' approach. This would initially be an ex-ante allowance for anticipated costs of ASC bad debt only, between October 2023 and September 2024, with the option to adjust at a later stage, if evidence suggests the allowance materially differs from actual costs.

Considerations

Recent trends in ASC bad debt

3.3 In our April 2023 CFI we considered it was possible that suppliers had issued more ASC credit on PPMs than normal in 2022/23, due to affordability pressures associated with high energy bills.[26]

3.4 The evidence we have gathered shows a significant increase in ASC being issued in 2022/23, compared to previous years. We estimate that the ASC level increased by 259% between 2021/22 and 2022/23. There has been a broadly commensurate increase in supplier provisions for ASC bad debt, which we estimate to have averaged around 19% of the level of ASC across 2022/23, with suppliers using different methods for calculating these provisions.

[25] We will consider whether this should become an enduring change to the cap as part of our Operating Costs review.

[26] Ofgem (2023) Price cap - Call for Input on the allowance for debt-related costs, page 10-11, para 4.13. https://www.ofgem.gov.uk/publications/price-cap-call-input-allowance-debt-related-costs

3.5 The changes to PPM practice as a result of the Code and the further action set out in the statutory consultation on Involuntary PPM[27] could reasonably increase the demand for ASC and/or mean suppliers are expected to issue more of it. This would in turn be likely to increase the level of associated bad debt. Additionally, forward energy prices remain around double the historical average and there are continued cost of living and wider affordability pressures. We therefore consider that there is little prospect of ASC bad debt levels falling materially relative to last year.

Material and systematic costs

3.6 When considering adjustments to the cap, we need to consider the materiality of anticipated costs. In our 2018 decision on the design and implementation of the cap, we said, "if in the future we consider there are material systematic issues that require correction, we might modify the licence. The Act includes specific provision for us to make supplemental modifications to the licence conditions. This would allow us to make any changes required to correct how the cap was updated, if it systematically and materially departed from an efficient level of costs". We also said, "The type of specific systematic errors for which we would adjust the cap would need to be unforeseen, clear, material, and necessitate changes".[28]

3.7 We have applied this test when considering changes to the cap since. As set out in our November 2021 wholesale consultation: "We broadly consider the case for amending the cap methodology against the test of whether a change in the costs facing suppliers is material and systematic, considering the market as a whole".[29]

3.8 Applying that test in relation to ASC bad debt, we consider that the anticipated costs are material and systematic. We consider the costs associated with all three scenarios identified for ASC bad debt in 23/24 (set out in Chapter 4) to represent a material change in PPM costs, and we anticipate these costs to be systematic, particularly given the relevant changes being made through the action we are

[27] Ofgem (2023), Involuntary PPM – Statutory Consultation, https://www.ofgem.gov.uk/publications/statutory-consultation-involuntary-ppm
[28] Ofgem (2018), Default tariff cap: decision – overview, page 40-41, para 3.14, https://www.ofgem.gov.uk/publications/default-tariff-cap-decision-overview
[29] Ofgem (2021), Price Cap: Consultation on the potential impact of increased wholesale volatility on the default tariff cap, page 34, para 4.16, https://www.ofgem.gov.uk/publications/price-cap-consultation-potential-impact-increased-wholesale-volatility-default-tariff-cap

taking on involuntary PPM. As such, and given there is currently no specific allowance for these costs, we consider they should be reflected in the cap.

Allowing for recovery of ASC bad debt through the price cap

3.9 As noted in Chapter 2, SLCs set out the obligations around the provision of ASC. ASC ultimately helps some of the most vulnerable consumers at times of need and helps ensure they do not self-disconnect from their energy supply. It is critical that customers who use PPMs are able to access support, such as ASC, when needed.

3.10 We consider it is therefore in consumers' interest, including vulnerable consumers, to ensure that suppliers fully adhere to SLC obligations in relation to ASC. This will be particularly important in the coming winter, given, as noted above, forward energy prices remain double historical averages and there are continued cost of living and wider affordability pressures.

3.11 While ensuring compliance with SLCs, we also need to consider whether efficient costs associated with that compliance are recognised within the cap. Historically, ASC bad debt costs have been minimal, as it has been difficult for PPM customers to become indebted (as they pay in advance for energy). As such, there is currently no defined mechanism within the cap for suppliers to recoup their costs for ASC bad debt. Some suppliers may recoup their costs indirectly through, for example, pricing of fixed tariffs or other services.

3.12 However, in view of the current market circumstances, and the Code and measures set out in the associated statutory consultation on involuntary PPM, we consider it is in customers' interests to ensure that suppliers have confidence that when they issue ASC, there is a provision to recover notionally efficient costs of bad debt associated with it. Given we consider these increased costs to be material and systematic for the purposes of the cap, such a provision is considered appropriate and necessary to support full compliance with suppliers' ASC obligations, which is in customers' interests. Without such a provision, there may be an increased risk of more self-disconnections for vulnerable customers, which can cause serious harm. Additionally, if a notional supplier incurs ASC bad debt costs which are not reflected in cap allowances, this could have a negative impact on its financeability.

Scope of adjustment

3.13 We consider the vast majority of the anticipated additional debt-related costs resulting from increased ASC issuance in 2023/24 will be ASC bad debt. Our proposed adjustment is therefore focused on ASC bad debt.

3.14 We recognise that suppliers may incur some increased administrative costs when issuing ASC. In particular, suppliers are required to conduct more compliance and customer engagement for ASC approval and issuance than for emergency credit, which can often be done at the meter. However, we do not have specific evidence to suggest that debt administration costs will materially increase above the existing allowance for PPM debt-related costs.

3.15 We also recognise that customers will take time to repay ASC, leading to a working capital impact. ASC is repaid over a longer period than emergency credit, with most customers having some degree of flexibility as to how quickly the debt is repaid. However, we do not have specific evidence to suggest that working capital costs will materially increase above the existing allowance for PPM debt-related costs.

Anticipated costs and float and true-up adjustment

3.16 We propose the allowance will be for forthcoming ASC bad debt. This means we consider it appropriate to initially set an ex-ante allowance based on anticipated costs rather than actual spend, as was the case with the COVID-19 'float' decision in February 2021[30], and with certain other allowances in the cap (for example, the Smart Metering Net Cost Change, or 'SMNCC', allowances). We propose to include the temporary allowance in the cap from October 2023 (cap period 11a) onwards for 12 months[31]. We would then true-up (adjust) the allowance at a later stage if evidence suggests the actual costs differ significantly from the ex-ante allowance.

3.17 We consider providing an initial ex-ante 'float' allowance to be appropriate for several reasons. Primarily, we anticipate an increase in costs of ASC bad debt in 23/24 relative to 22/23, primarily as a result of requirements set out in the Code

[30] Ofgem (2021), Decision on the potential impact of COVID-19 on the default tariff cap, https://www.ofgem.gov.uk/publications/decision-potential-impact-covid-19-default-tariff-cap
[31] We will consider whether this should become an enduring change to the cap as part of our Operating Costs review.

and associated statutory consultation on Involuntary PPM, and sustained high energy bills. Additionally, this approach enables us to more closely align the cap level in a specific time period to the costs incurred in that period (if a reasonable approximation can be made). We consider this means the allowance can support timely issuance of ASC during the forthcoming 23/24 winter period, which we consider to be in consumers' interests given the benefits of ASC.

3.18 The provision to adjust at a later stage mitigates the risks associated with an under or over allowance being provided initially. It is likely that any true-up would not commence before spring 2024, and this will be subject to internal workstream prioritisation decisions at the time.

3.19 The alternative, an ex-post adjustment for costs from October 2023, would have the benefit of using actual data. However, in these circumstances, the length of time it would take to obtain that data (given it takes a period of time for debt to turn in to bad debt) would, we consider, negate the intended benefits of the allowance over the winter period in particular. If we took such an approach, it is likely to be at least April 2024 before these costs would be recoverable in the cap.

Previous ASC bad debt costs

3.20 Additionally, while ASC bad debt costs were non-zero in winter 2022/23, we do not consider it appropriate to include an ex-post allowance for these previous costs for several reasons. First, we do not carry out ex-post adjustments as a matter of course, and as noted above, we do not automatically true-up costs. Additionally, bad debt costs resulting from ASC have been included in our assessment of total debt-related costs in 2022/23, with no evidence of a material or systematic gap between the aggregate allowance within the price cap for debt-related costs, and actual costs.

3.21 We recognise that individual suppliers may under or overperform this notional supplier benchmark for any given allowance, depending on their customer bases. However, we can only set one cap across all suppliers. While having due regard to the five matters identified in section 1(6) of the Act in our decision-making process (when exercising our functions under the Act), we do not consider that it would be appropriate to provide an over allowance to suppliers in aggregate, in light of the Act's overarching customer protection objective.

3.22 We will continue to consider debt-related costs from 2022/23, including those associated with ASC, in the round as part of our wider debt-related costs review.

4 Calculating the allowance

Chapter summary

This chapter sets out the options for how we could calculate an allowance in the cap for ASC bad debt. We explain our low, central, and high scenario options and set out our proposal.

Proposals

4.1 We propose to use our central scenario to calculate the ASC bad debt allowance. The central scenario is calculated using a method which scales the level of ASC in 2022/23 by the proportionate increase in ASC level from winter 2021/22 to winter 2022/23, and assumes that the proportion of this ASC level, which becomes bad debt, remains constant. This allowance value would be around £13 per typical dual fuel PPM customer.[32]

4.2 We also propose to include the raw weighted average[33] cost without subtracting any baseline.

Considerations

Methodology options

4.3 We have considered three scenarios for trends in ASC bad debt, when calculating the allowance for bad debt costs associated with ASC level for the 2023/24 winter. In each scenario, we assume that there is no comparable government bill support to EBSS this winter, and that the EPG remains at its current level (£3,000).

4.4 We detail the specific calculations used to calculate the ASC bad debt scenarios in Appendix 1. These methods use a weighted average approach and attempt to estimate the level of ASC bad debt from October 2023 to September 2024. As an overview:

---

[32] This is at benchmark Typical Domestic Consumption Values (TDCV) split evenly between gas and electricity. TDCV are 3,100 KWh per year for electricity (single register), 4,200 KWh per year for electricity (multi-register) and 12,000 KWh per year for gas. We explain how this would be allocated across the different cap levels in Chapter 5.

[33] A weighted average takes into consideration the size each supplier. This means that a supplier with a higher number of PPM customers will be given more weight in our calculation than a supplier with fewer PPM customers.

- **Low scenario:** Both ASC level and ASC bad debt rate remain constant as a percentage of effective customers' bills[34] between 2022/23 and 2023/24.

- **Central scenario**: ASC level increases by the percentage increase of ASC between 2021/22 and 2022/23 and the ASC bad debt rate remains constant. This increases the amount level of ASC but assumes that the proportion of this ASC which becomes bad debt does not increase.

- **High scenario**: ASC level and ASC bad debt rate increase by their respective percentage increase between 2021/22 and 2022/23. This increases the amount of level of ASC and assumes that the ASC bad debt rate (ie, the proportion of all ASC which is written off) also increases.

Table 4.1: Estimated ASC bad debt allowance, by scenario

	Low	**Central**	**High**
ASC bad debt allowance	5.02	13.00	17.90
ASC level scaling factor	1.00	2.59	2.59
ASC bad debt rate	19%	19%	26%

Note: numbers are £ per typical dual fuel PPM customer

Consideration of options

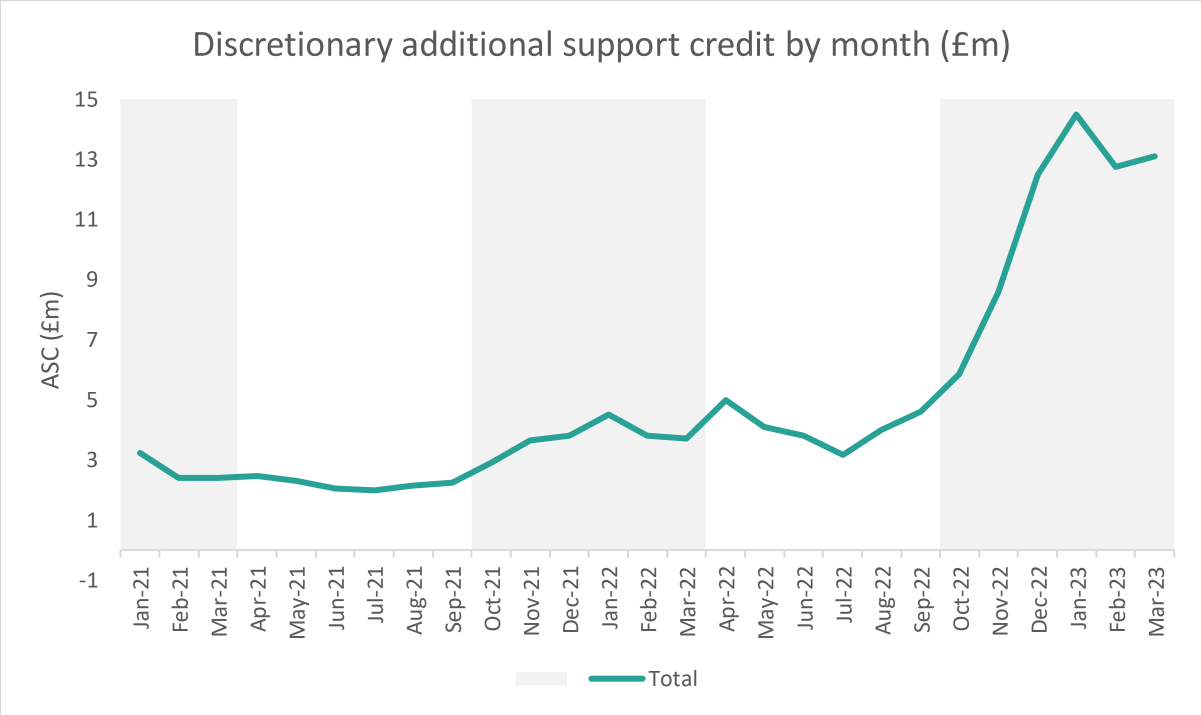
Customer demand

4.5 Figures 4.1 and 4.2 show that since 2021/22 there have been significant increases in both the level of ASC and the level of ASC bad debt. Trends in the ASC level and ASC bad debt both exhibit seasonality, plateauing during the summer months before increasing again in the winter months.

4.6 These both follow our expectations on ASC level. Firstly, as ASC rises, so will the debt associated with it, given that a subset of ASC level will not be repaid by customers and will become bad debt. This is intuitive, the value of ASC level will increase most during months when energy consumption is highest (winter months), as customers will need to top up their PPM more often and energy will be a larger part of PPM households' budgets in winter.

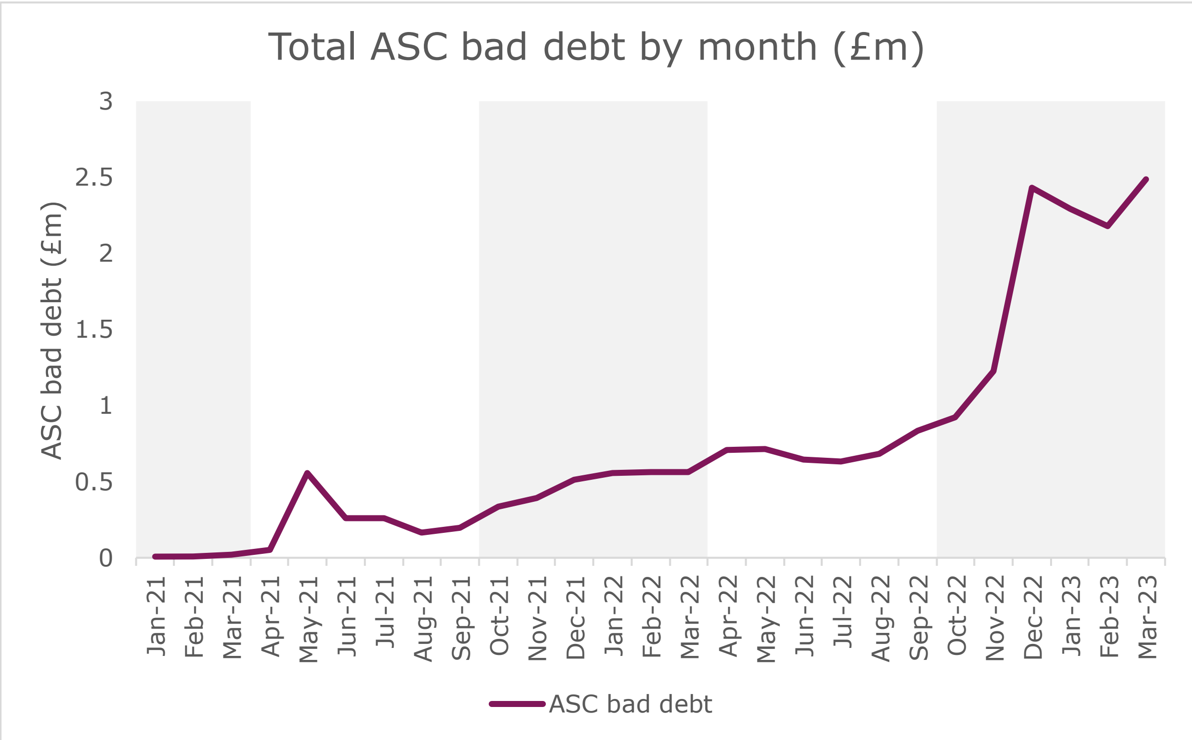
[34] By effective customer bills, we mean the amount that customers paid. Given the government support packages (EBSS and EPG) last winter, customers did not pay the cap level from Oct-22 – Apr-23. We therefore subtract the value of the government support package from the cap level to identify costs faced by customers, rather than solely the cap level which reflects the revenue suppliers received.

Figure 4.1: ASC level by month



Note: This line graph shows the value of approved ASC applications by month, across ten suppliers (97% of the PPM market). It indicates that the value of ASC has risen significantly from winter 2021 onwards. We have used a sample of ten suppliers in this. Greyed out chart areas represent winter months.

Figure 4.2: Bad debt[35] associated with ASC by month



Note: *This line graph shows the value of ASC bad debt by month, we have used a sample of five suppliers in this (63% of PPM market). It indicates that the value of ASC bad debt has risen significantly from winter 2021 onwards. Greyed out chart areas represent winter months.*

4.7 The overall ASC level is primarily driven by increased customer demand due to the nature of how ASC is issued by suppliers, ie customers generally need to request ASC, rather than suppliers proactively offering it to customers. However, the Code and associated proposals in the Involuntary PPM statutory consultation introduce a requirement for suppliers to proactively issue it in certain scenarios relating to the installation of involuntary PPM.

4.8 The value of ASC provided per application has been increasing since 2021 alongside the increase in the energy prices. This is intuitive because a flat payment would not last as long, given the higher cost of energy now relative to

[35] We requested suppliers submit data on bad debt provisions and not write offs. This means the data will be based on suppliers' expected bad debt, and they will use assumptions to calculate these provisions.

2021. Therefore, suppliers have compensated for this by increasing the value per approved application.

4.9 If ASC levels rise due to increased demand from customers, increased issuance from suppliers in line with the action we are taking on Involuntary PPMs and/or suppliers begin to issue a higher ASC payment per application, it is reasonable to also expect the level of ASC bad debt to rise as well.

4.10 Based on past survey data (which should not be construed as a prediction of this coming winter), the percentage of people facing financial difficulty, has been increasing.[36] Other factors will affect the level of demand for ASC, for example weather variations, and the level of non-repayable support provided by suppliers and charities.

4.11 Furthermore, even if effective bills are at the same or similar levels this coming winter, we expect the continued affordability pressures associated with energy and the wider cost of living, may also increase demand for ASC. We therefore anticipate that the level of ASC will increase this winter relative to winter 2022/23, due to the combination of these factors.

4.12 We do not, however, consider that we have clear evidence currently regarding the evolution of the bad debt rate this winter. As the level of effective customer bills is expected to be similar to last winter, it may be that the bad debt rate stays flat or falls closer to market-wide bad debt levels of around 2%.

4.13 It is also possible that the rate increases further upon 2022/23 levels, depending on the interaction with continued high energy bills with wider cost of living pressures. However, given this uncertainty on the evolution of the bad debt rate, we consider it reasonable to assume for the purposes of this float allowance that the bad debt rate remains constant in 2023/24.

[36] Financial difficult was measured by missed bill payments and credit commitments. FCA (2023): Financial Lives January 2023: Consumer experience of the rising cost of living – the burden of bills and ways to get support https://www.fca.org.uk/publications/financial-lives/financial-lives-january-2023-consumer-experience

Moral hazard and unintended consequences

4.14 The nature of the cap and ASC means that suppliers may have an incentive to adopt a restrictive approach, limiting how much ASC they issue, when it comes to interpreting their obligations in respect of ASC provision under the SLCs.

4.15 For example, energy suppliers could be incentivised to keep their costs lower, compared to the notional supplier, simply by issuing less ASC, and therefore reducing the risk of ASC bad debt being incurred. While under the cap suppliers are expected to seek to be as efficient as possible, reducing costs in this way would run counter to the intended benefits for consumers from including this allowance in the cap.

4.16 We will therefore closely monitor provision of ASC by suppliers, including through existing RFIs and compliance measures, to ensure that any behaviour of this sort is addressed.

4.17 Equally, exact ASC demand in 2023/24 is inherently uncertain, given the factors outlined above. This means that it is possible that any allowance set in advance could be insufficient to cover ASC costs.

4.18 The level of the allowance therefore needs to increase the likelihood that the allowance is used as intended and benefits customers, as well as mitigating the risks of there being a material under or over allowance for what are anticipated costs.

4.19 We consider that setting an allowance based on the central scenario, with the potential to adjust the allowance at a later stage if costs differ significantly from the allowance, most effectively mitigates the moral hazard risk, thus protecting customers. This approach would also help mitigate the risk of setting the allowance too low, which could lead to underfunding suppliers in relation to the requirement to help vulnerable customers.

Baseline

4.20 Given there is currently no specific allowance for ASC bad debt in the PPM cap, we consider that we should provide a temporary allowance for the full weighted average ASC bad debt costs to ensure that suppliers can recover these efficient costs from October 2023 to September 2024. As set out in Chapter 6, any enduring change to the cap for ASC bad debt costs would be considered as part of the Operating Costs review

Conclusion

4.21 We propose to use the central scenario to calculate our estimate of bad debt costs associated with ASC this winter. This is because, as set out earlier in this chapter, we consider the amount of ASC is likely to increase this winter given the ongoing cost of living pressures[37] and the additional Code measures relevant to ASC which could both increase the ASC level. However, the evidence we are relying on is necessarily uncertain and we do not consider there is currently sufficiently clear evidence to expect that the proportion of bad debt will increase more than commensurately. As we explained in Chapter 3, this is a float allowance so could be subject to a later true-up adjustment if the allowance materially differs from actual costs.

4.22 We recognise our assessment about ASC bad debt levels and ASC bad debt rate is finely balanced and by its nature, relies on forecasts. We welcome specific evidence from stakeholders on our proposed methodological approach and any alternative approaches that we should consider to calculating expected costs from October 2023 onwards. Given the uncertainty presented, we also welcome evidence on the rationale for us to set a float which is different from expected costs that is still in the customers' interest.

[37] The FCA noted that the number of adults who missed payments on any domestic bills went up by 1.4million from May 2022 to January 2023. FCA (2023): Financial Lives January 2023: Consumer experience of the rising cost of living – the burden of bills and ways to get support https://www.fca.org.uk/publications/financial-lives/financial-lives-january-2023-consumer-experience

5 Implementing the allowance

Chapter summary

This chapter sets out our proposals for how we intend to implement an allowance in the cap for ASC bad debt costs.

Payment method allocation

Proposals

5.1 We propose to allocate the full allowance for ASC bad debt to PPM customers only. This means not allocating any of the allowance to credit customers.

Considerations

5.2 As noted in Chapter 2, the cap provides an allowance to account for many debt-related costs. This means all customers pay for the cost of bad debt incurred by customers who do not pay. It is not possible to allocate additional bad debt costs to the individual customers who drive these costs, but there are choices about how these costs are allocated across customer groups based on their payment type (SC, DD and PPM).

5.3 In the case of ASC, it is clear by its nature (being only available to customers using a PPM) that any ASC bad debt incurred, happened on a PPM payment method. For other debt-related costs, however, it may be less apparent where and when the debt was incurred because, for example, debt may have occurred on one payment type and been moved to another when the customer changed payment type.

5.4 Therefore, given the specific nature of ASC bad debt, we consider it is appropriate to allocate all ASC bad debt costs to PPM customers. This also ensures that the adjustment allowance more closely reflects the variances across suppliers in their customer base, supporting supplier financeability.

5.5 If we do not allocate all costs to PPM, it may lead to suppliers who have a higher-than-average proportion of PPM customers, not recovering their efficient costs, which would impact their ability to use the allowance to fund ASC bad debt this forthcoming winter. Allocating across other customer groups would also mean SC and DD customers, who already pay higher levels of debt-related costs, would see costs increased further.

Allocating costs over the other cap components

Context

5.6 We do not have data on ASC or ASC bad debt broken down by the cap components of either fuel or meter type. We therefore considered two options for allocation:

(1) Equally allocate across each cap component. This means that we would use the same weighted average figure for each fuel and meter type cap component allowances.

(2) Allocate costs across cap components based on the estimated revenue or customer numbers.

Proposals

5.7 We propose to adopt equal allocation across fuel and electricity meter types (ie the same pound uplift to each fuel and electricity meter type).[38]

5.8 We propose to align our apportionment, where possible, with the government's approach to levelising.

Considerations

Recovery over fuel type

5.9 We expect customers will request ASC proportional to the cost of their energy consumption and the cost of energy. The level of the PPM cap at typical consumption is currently higher for electricity than gas over a year. Therefore, ASC and ASC bad debt could be higher for electricity meters than for gas meters.

5.10 However, the nature of PPMs means that the customer's cost is proportional to consumption by month, as the cost is not spread evenly throughout a year as with DD consumers. As referenced in Chapter 4, higher levels of ASC are requested in winter. As gas consumption has higher seasonality[39] when compared to electricity, it would therefore be plausible that customers may need more gas ASC than electricity (although electricity only customers would also consume

[38] The cap has two fuel type cap levels: one for gas and another for electricity. Within the electricity cap level there are two electricity meter type cap levels: one for single-rate and another for multi-register.
[39] 73% of gas is consumed in winter, compared to 56% of electricity.

more energy in the winter months, akin to gas demand). Any increase in ASC would, all else being equal, increase the risk of bad debt.

5.11 We consider that requesting more detailed data including the fuel split would not be proportionate, given that we do not have strong reasons to expect that an uneven split would be more accurate. We also consider that ASC and ASC bad debt split by fuel type from last winter would not be representative of the cost splits for 2023/24, given that the full EBSS support vouchers were applied to electricity meters only. Finally, since most customers are dual fuel, cost allocation between fuels should also have a relatively limited impact on individual customers.

5.12 Therefore, while we recognise that suppliers with a non-average fuel mix split potentially could be disadvantaged by us not controlling for fuel type (to the extent that costs vary between fuels), we consider that equal allocation of costs between fuel types is the simplest and most robust approach. It avoids us introducing potentially circumstantial and complex assumptions which we could not evidence, or relying on data from 2022/23 which is biased by the EBSS.

Recovery over electricity meter type

5.13 The cap has two levels for electricity: one for single-rate meters, and another for multi-register meters. Multi-register meter customers tend to use more energy on average, so the typical consumption benchmark for the multi-register meter cap is set at a higher level of consumption.

5.14 The levels of ASC and ASC bad debt are likely to be proportional to customers' bills. This means that multi-register customers could incur a higher ASC bad debt per customer than single-rate meter customers (driven by the amount of their bill, rather than their propensity to request ASC or incur bad debt from ASC). In all scenarios, we intend to ensure our proposal to introduce an allowance for ASC bad debt does not run counter to, or undermine, government's commitment to levelising across payment method types and therefore intend to align our apportionment (where possible) with the government's approach on this. We recognise a higher allowance for multi-register customers could penalise low or nil consumption users if the allowance is applied to the standing charge only.

5.15 Similar to fuel type, we could not control for any differences in the propensity to incur ASC bad debt by meter type, as we did not request the data at a granular level. We also consider that there are not any strong reasons to expect that an even split would be inaccurate.

Recovery over the unit rate and standing charge element of the cap

5.16 The government has made a commitment to align charges for comparable DD and PPM customers, which will be implemented in Q3 2023 by adjusting PPM unit rates. ASC and ASC bad debt is likely to be proportional with customers' bills, which would, in principle, lead us to recover the cost on the unit rate. In all scenarios, we intend to ensure our proposal to introduce an allowance for ASC bad debt does not run counter to, or undermine, this commitment. We therefore intend to align our apportionment (where possible) with the government's approach to levelising across payment method types.

5.17 In our considerations, we have therefore had regard to the need to set the cap at a level that takes account of the impact of the cap on public spending. As noted elsewhere, we do not expect this allowance to lead to PPM customers paying more on their bills than comparable DD customers in 2023/24.

How the cap is adjusted

Context

5.18 The adjustment allowance is included in 'Annex 8 – Adjustment allowance methodology' of SLC 28AD of the electricity and gas supply licences.

Proposals

5.19 We propose to use the existing cap adjustment allowance ('Annex 8 – Adjustment allowance methodology') to set the allowance for ASC bad debt.

Considerations

5.20 We consider that using the adjustment allowance is the simplest and most flexible method for adjusting the cap for this allowance. We are also not aware of any compelling reason to use any other component of the cap to implement the allowance. This is consistent with other one-off adjustments, such as the one-off

COVID-19 true-up adjustment allowance.[40] We will publish a final version of Annex 8 alongside our decision.

[40] Ofgem (2023), Decision on the true-up process for COVID-19 costs, https://www.ofgem.gov.uk/publications/price-cap-decision-true-process-covid-19-costs

6 Interaction with other workstreams

Chapter summary

This chapter sets out how the proposals in this consultation relate to and interact with other relevant workstreams.

6.1 The ASC allowance adjustment is intended to be initially temporary, and in place between October 2023 and September 2024, for PPM customers only.

6.2 At the Spring Budget, the government committed to align charges for comparable DD and PPMs to ensure that those on PPMs no longer pay a premium for their energy costs. This will be delivered using the EPG until April 2024, and we are actively working with government to ensure the proposals in this consultation are aligned with that continued commitment to remove the PPM premium. This means that, in practice, we do not expect this ASC bad debt allowance to lead to PPM customers paying more on their bills than comparable DD customers in 2023/24.

6.3 The costs of the allowance would fall directly to customers from April 2024. The government has asked Ofgem to report by this autumn (2023) on options for permanently ending the PPM premium, so that a mechanism is ready for implementation in April 2024. If such a mechanism was in place, it would spread the remaining costs related to this allowance across other payment types, not solely on PPMs, leading to a significantly lower cost per dual fuel customer. We are publishing a consultation on this issue later this summer, following our Call for Evidence on levelisation of payment method cost differentials in April 2023.

6.4 While this allowance would be initially temporary for 12-months, we are currently reviewing the price cap’s enduring treatment of operating costs, with a current expected decision in winter 2024/25. The Operating Cost review will consider the treatment of debt-related costs, including whether and how this allowance is set on an enduring basis.

6.5 As set out throughout this consultation, the action we are taking on Involuntary PPMs has a direct impact on our considerations around ASC bad debt. We currently have a statutory consultation open on these measures.[41] Therefore, if there are any material changes as a result of that consultation, we will consider the implications for the proposed allowance for ASC bad debt in the cap.

[41] Ofgem (2023), Involuntary PPM – Statutory Consultation, https://www.ofgem.gov.uk/publications/statutory-consultation-involuntary-ppm

7 Impact Assessment

Chapter summary

In this chapter we summarise how we assessed the impact of the proposals in this consultation.

Context

7.1 As outlined in Chapter 2, when setting the cap, we act with a view to protecting existing and future consumers who pay standard variable and default rates. In doing so we must have regard to the five matters identified in section 1(6) of the Act in our decision-making process.

7.2 In reaching our proposals in this consultation, we have been mindful of the trade-offs between customers' interests in minimising the immediate impact on energy bills and their interests in a resilient supply market, including to reduce the costs of supplier failures. As part of developing our proposals, we have conducted an impact and equalities assessment.

7.3 In this chapter, we focus on the analysis of the impacts of including an allowance for ASC bad debt from cap period 11a (October 2023 - December 2023) for 12 months. This would apply to PPM customers only.

7.4 We have carried out three assessments:

- High-level qualitative analysis: we assess the potential impact of the ASC bad debt on PPM customers and PPM suppliers.
- Bill impact analysis: we assess the potential impact on bills for PPM customers.
- The potential impact on public spending.

Considerations

Policy context

7.5 The existing price cap methodology contains a small positive allowance (around 0.4% of average bill levels in June 2023) for debt-related costs associated with PPMs. This allowance includes elements for debt administration and working capital, but there is no specific allowance for PPM bad debt, and therefore it does not reflect the expected increases in ASC bad debt. In this consultation, we set out proposals to introduce an allowance for ASC bad debt in the cap.

7.6 Looking ahead, energy prices are forecast to remain around double historical averages and there are continued cost of living and wider affordability pressures. The further steps we are consulting on today in relation to Involuntary PPMs could also mean there are a number of further conditions and measures which could increase the level of ASC that suppliers are expected to issue. This would in turn be expected to increase the amount of ASC bad debt.

7.7 As previously set out, at the Spring Budget, the government committed to align charges for comparable direct debit (DD) and PPMs to ensure that those on PPMs no longer pay a premium for their energy costs. This will be delivered using the Energy Price Guarantee (EPG) until April 2024, and we are actively working with government to ensure the proposals in this consultation are aligned with that continued commitment to remove the PPM premium. This means that in practice, we do not expect this ASC bad debt allowance to lead to PPM customers paying more on their bills than comparable DD customers in 2023/24.

7.8 The costs of the allowance would fall directly to customers from April 2024. The government has asked Ofgem to report by this autumn (2023) on options for permanently ending the PPM premium, so that a mechanism is ready for implementation in April 2024. We are publishing a consultation this summer, following our Call for Evidence on levelisation of payment method cost differentials in April 2023. If such a mechanism was in place, it would spread the remaining costs related to this allowance across other payment types, not solely on PPMs, leading to a significantly lower cost per dual fuel customer. We are publishing a consultation this summer, following our Call for Evidence on levelisation of payment method cost differentials published in April 2023.

Qualitative assessment

7.9 We have considered introducing an allowance for ASC bad debt, against the counterfactual scenario of not introducing one. There is an interaction with government's commitment to levelising between PPM and DD payment types, as noted above.

7.10 As we expect the costs for this allowance between October 2023 and April 2024 to be funded by public spending rather than consumer bills, for the purposes of this impact assessment, we have assumed that that is the case. If a different approach to levelising is taken and/or PPM prices fall below DD prices before the end of 2023/24, the proposed ASC allowance could be partly funded by PPM customers rather than government, up until the point that the two prices achieved parity.

7.11 In the factual scenario of introducing an ASC bad debt allowance to the cap, suppliers would be able to fully recover the expected efficient costs of the notional supplier. We do not consider that it would be in customers' interests to prevent suppliers from recovering their efficiently incurred additional costs. In general, we seek to set the cap to reflect notionally efficient costs, and under-recovery could ultimately have negative impacts on customers, including via lower supplier resilience and increasing the future additional costs that they would incur due to the Supplier of Last Resort ('SoLR') and/or Special Administration Regime ('SAR') processes. As supplier failures during the gas crisis cost each household an average of £83[42], we consider this not to be in customers' interests, as ultimately it could add costs to customers' bills in the future.

7.12 We also consider that PPM customers who request ASC will benefit from this allowance, as they will be at the point of disconnection from supply. By definition, these customers are likely to be more vulnerable than the average consumer. In the counterfactual, we consider that the absence of an allowance in the cap creates an increased risk of self-disconnection for these vulnerable customers, leading more customers to incur the physical and emotional harm that can result from rationing their heating, cooking and hot water.

7.13 From the customers' perspective, as noted above, we do not expect this ASC bad debt allowance to lead to PPM customers paying more on their bills than comparable DD customers in 2023/24. The costs of the allowance would fall directly to customers from April 2024. As previously mentioned, the government has asked Ofgem to report by this autumn (2023) on options for permanently ending the PPM premium, so that a mechanism is ready for implementation in April 2024. We are publishing a consultation this summer, following our Call for Evidence on levelisation of payment method cost differentials in April 2023. If such a mechanism was in place, it would spread the remaining costs related to

[42] Ofgem (2023), Customers to pay less for energy bills from summer, https://www.ofgem.gov.uk/publications/customers-pay-less-energy-bills-summer

this allowance across other payment types, not solely on PPMs, leading to a significantly lower cost per dual fuel customer.

7.14 In light of the above qualitative assessment, we consider that the net benefits of introducing an allowance for ASC bad debt in the cap, outweigh the costs of not including one.

Bill impact analysis

7.15 We have carried out a distributional analysis of introducing the ASC bad debt allowance into customers' bills.

7.16 We do not expect this ASC bad debt allowance to lead to PPM customers paying more on their bills than comparable DD customers in 2023/24. The costs of the allowance would fall directly to customers from April 2024 as set out above. There would be no significant bill impact for credit customers, although precise impacts will depend on the outcome of the levelisation workstream from April 2024.

7.17 We consider this cost to government is justified on the basis that the allowance funds support for PPM customers at the point of self-disconnection. A higher proportion of PPM customers are vulnerable than customers at large, and those who are at the point of disconnection may be seen to be a particularly vulnerable subset of PPM customers. The allowance would also cover a material cost of supply not currently covered by the cap, strengthening the financial stability of suppliers, particularly suppliers with an above average PPM customer base.

7.18 Under the Equality Act 2010 we are required to have regard to the public sector equality duty and consider how our policies or decisions affect those groups protected under the Equality Act 2010.

7.19 Although the adjustment would be an additional cost for government spending, these costs are efficient costs suppliers would not otherwise recover. Therefore, as noted earlier, if these costs are not recovered, it would increase the risk of supplier failure, and reduce suppliers' ability to manage risks and support customers. Such failures would result in additional costs to future and current customers, including customers with protected characteristics.

7.20 From April 2024, the costs of the allowance would fall directly to customers with the precise split between PPM and credit customers being dependent on the outcome of the levelisation workstream from April 2024.

7.21 PPM customers are more likely to be households with incomes lower than the UK median. Data from Ofgem's Consumer Impacts of Market conditions survey also shows that PPM consumers are more likely to have a long-term illness, physical or mental health problem or disability (43% of PPM customers compared to just 31% of all GB households) and are more likely to be pregnant or have children under 5 (18% of PPM customers compared to 14% of all households).[43] Adding a cost to PPM bills will therefore have a financial impact on these households.

7.22 However, research from Citizens Advice shows that 63% of PPM customers who self-disconnected reported a negative impact on their mental health, and nearly half (47%) reported a negative impact on their physical health.[44]

7.23 PPM customers who request ASC and benefit from this allowance are likely to be at the point of self-disconnection. It is therefore reasonable to consider them as more vulnerable than the average PPM or energy consumer, at least on a financial basis, but also in the risk of further harm to mental and physical health. Given this evidence on costs and harms, we consider the inclusion of an initial 12-month allowance to be justified, having due regard to our public sector equality duty, given it would be likely to reduce the risk of mental and physical harm resulting from self-disconnections.

Potential impact on public spending

7.24 We are required to exercise our functions under the Act with a primary focus on protecting consumers on default rates, while having regard to specified considerations (see S. 1(6) of that Act). Following the Energy Prices Act 2022 coming into force, those specified considerations to be taken into account include "the need to set the cap at a level that takes account of the impact of the cap on public spending".

[43] Ofgem, Consumer Impacts of Market Conditions survey of 3,457 GB energy consumers (fieldwork conducted in Nov/Dec 2022)
https://www.ofgem.gov.uk/publications/consumer-impacts-market-conditions-survey-wave-3-novdec-2022
[44] Citizens Advice, 2023: Kept in the Dark: The urgent need for action on prepayment meters | Citizens Advice - https://www.citizensadvice.org.uk/Global/CitizensAdvice/Energy/Kept%20in%20the%20dark%20-%20the%20urgent%20need%20for%20action%20on%20prepayment%20metersV2.pdf

7.25 The specified considerations reflect the fact that, while the government's EPG is in force, the cap level affects the levels of payments by government to energy suppliers. While the EPG is in place, and the cap level remains above the EPG, some of the excess costs of energy bills would be covered by the government.

7.26 In most scenarios, the level of adjustment is expected to directly impact on public spending between October 2023 and March 2024. As previously noted, we are actively working with government to ensure the proposals in this consultation are aligned with the government's continued commitment to remove the PPM premium. This means that in practice, we do not expect this ASC bad debt allowance to lead to PPM customers paying more on their bills than comparable DD customers in 2023/24.

7.27 Through this consultation, we are providing the opportunity for the Department for Energy Security and Net Zero (DESNZ, previously the Department for Business, Energy and Industrial Strategy (BEIS)) and HM Treasury to provide any further representations on the impact of any aspect of our proposed decision on public spending, having regard to the new consideration in the Act.

7.28 Table 7.1 shows our estimate of the potential impact of this decision on government spending.[45] We have presented this as a range, given our proposals in Chapter 5 to align our apportionment (where possible) with the government's approach to levelising, means we have not decided whether this allowance would be apportioned to the unit rate or standing charge element of the cap.

7.29 If the ASC bad debt allowance was applied to the unit rate element of the cap, then there would be a higher cost to the exchequer, given that there is higher electricity and fuel consumption in the winter months.[46] If the allowance was applied to the standing charge element of the cap, then the costs would be spread equally across each quarter.

[45] We have calculated this range by calculating the cost if it was applied to the standing charge (lower bound) and unit rate (upper bound). This unit rate calculation weights the allowance with quarterly gas and electricity demand shares from Annex 2 of the model for the default tariff price cap. We have also assumed that the number of default tariff credit customers is constant throughout the recovery period of our allowance using numbers from the January 2023 customer account and tariff RFI. The outturn cost would depend on several factors, such as changes in customers numbers, and seasonal weather variations.

[46] 56% of electricity and 73% of gas demand are in the winter months respectively.

7.30 We do, however, note that even if this cost is paid for by the exchequer, then it will ultimately impact taxpayers who are also domestic energy customers as well.

Table 7.1: Estimated impact on public spending[47] from the ASC bad debt allowance (central scenario)

Cap Period	**Cost per individual cap period (£m)**
11a (October 23 – December 23)	12-14
11b (January 24 – March 24)	12-16
Total	24-31

7.31 We consider that this consultation takes proper account of the impact the proposed ASC bad debt allowance may have on public spending. Overall, this consultation is intended to enable suppliers to recover efficient costs of supplying energy (which include higher ASC bad debt). The adjustment proposed is no more than appropriate for that purpose. Furthermore, enabling suppliers to recover the efficient costs of their supply activities is likely to reduce the risk of suppliers failing and becoming insolvent, which otherwise would impact public spending eg through the cost to the taxpayer of a SAR.

[47] Our calculation does not include any net gain in corporation (if applicable) or value added tax that the exchequer would receive as a result of our proposed allowance, when compared to the counterfactual of no allowance.

8 Next steps

8.1 We welcome views on any of the proposals and considerations discussed in this consultation, including on the value, methodology and implementation of the proposed allowance for ASC bad debt. Please send your response to priceprotectionpolicy@ofgem.gov.uk **on or before Wednesday 26 July 2023**.

8.2 Following this statutory consultation, we currently intend to publish our decision by 25 August 2023.

9 Appendices

Index

Appendix 1 – Detailed explanation of our calculation of initial 12-month allowance

Overview

1. In this appendix, we explain the method which was used to calculate the allowance options (low, central and high scenario) described in Chapter 4 'Calculating the allowance'.

2. These methods use a weighted average approach and attempt to estimate the level of ASC bad debt from Oct 2023 to Sep 2024.

3. For each method, we used the same data request (detailed in next section), however we change the assumption on how much ASC and ASC bad debt scale by between 2022/23 and 2023/24.

Data request

4. We have used data collected from the April 2023 debt-related costs RFI[48] to calculate the ASC allowance. This RFI was sent out to domestic suppliers who had at least 100,000 default tariff customer accounts in cap period 9b:

    - We requested the value of approved ASC applications per month.
    - We requested the amount of ASC bad debt per month.
    - We requested the number of customer accounts split by fuel, tariff and payment method per month.

5. We have considered three scenarios when calculating the allowance for bad debt costs associated with ASC for the 2023/24 winter. As an overview:

    - **Low scenario:** Both ASC level and ASC bad debt rate remain constant as a percentage of effective customers' bills[49] between 2022/23 and 2023/24.

[48] In this RFI, we also collected data on bad debt, debt-related administrative costs, working capital costs and the PPM moratorium.
[49] By effective customer bills, we mean the amount that customers paid. Given the government support packages (EBSS and EPG) last winter, customers did not pay the cap level from Oct-22 – Apr-23. We therefore subtract the value of government support package from the cap level to identify costs faced by customers, rather than solely the cap level which reflects the revenue suppliers received.

- **Central scenario**: ASC level increases by the percentage increase of ASC between 2021/22 and 2022/23 and the ASC bad debt rate remains constant. This increases the level of ASC but assumes that the proportion of this ASC which becomes bad debt does not increase.
- **High scenario**: ASC level and ASC bad debt rate increase by their respective percentage increase between 2021/22 and 2022/23. This increases the level of ASC and assumes that the ASC bad debt rate (ie the proportion of all ASC which is written off) also increases.

ASC allowance calculation assumptions

6. Below, we detail the calculations and assumptions which we made to calculate the estimated ASC bad debt allowance for each scenario.

Table 4.1: Estimated ASC bad debt allowance, by scenario

	Low	**Central**	**High**
ASC bad debt allowance	5.02	13.00	17.90
ASC level scaling factor	1.00	2.59	2.59
ASC bad debt scaling factor	1.00	2.59	3.56
ASC bad debt rate	19%	19%	26%

Note: Allowance numbers are £ per typical dual fuel PPM customer.

7. Firstly, we multiply the Apr-2022 – Mar-2023 ASC and ASC bad debt by their respective scaling factors, in the table above, for each scenario.

8. We calculate the bad debt due to ASC per PPM customer account using a sample of five suppliers and a weighted average benchmark. This uses only the five suppliers who were able to provide ASC bad debt figures (equal to 63% of the PPM market). This is calculated by dividing the value of ASC bad debt by the number of PPM customer accounts for our sample for each month.

9. We calculate the ASC per PPM customer account for a sample of five suppliers (this is the same sample as in paragraph 8). This is calculated by dividing the value of ASC by the number of PPM customer accounts for our sample for each month.

10. We calculate the ASC per PPM customer to account for the full sample of ten suppliers (equal to 97% of the PPM market. This is calculated by dividing the value of ASC by the number of PPM customer accounts for our sample for each month.

11. We then calculate the ASC bad debt provision rate using the sample of five suppliers who provided ASC bad debt charge data. To calculate this, we divide the ASC bad debt per customer by the total ASC per customer for Oct 2022 – Sep-2023 (ie, paragraph 8/9).

12. We then calculate the ASC bad debt for a larger sample of ten suppliers who provided ASC data. This is calculated by multiplying the ASC bad debt provision rate by the weighted average ASC per customer for the full ten suppliers (ie paragraph 10*11).

13. Finally, we scale up this estimation by the relative change in effective customer bills from October 2022 – April 2023 to the cap level for this winter. To calculate the 2022/23 effective customer bills, we used demand and time weights and took into consideration EPG & EBSS to calculate the amount customers paid last year (rather than how much suppliers received). Our best estimate of the 2023/24 effective bills is currently the cap period 10b DD cap level (we use DD, due to government's commitment to levelisation until April 2024).

Appendix 2 - Privacy notice

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 ie, a consultation.

4. With whom we will be sharing your personal data

We may share consultation responses with officials from the Department for Energy Security and Net Zero

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 6 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".