Making a positive difference
for energy consumers

Suppliers, consumer groups and
other interested parties

Email: priceprotectionpolicy@ofgem.gov.uk

Date: 14 June 2024

Response deadline: 12 July 2024

Dear stakeholder,

Price Cap - Consultation on ASC Bad Debt Costs Allowance Extension

The purpose of this letter is to consult on our proposed approach to allocating the bad debt related costs associated with Additional Support Credit (ASC) under the price cap. Specifically, we propose to extend the existing ASC bad debt allowance beyond September 2024. The price cap currently allows for the recovery of these efficiently incurred costs, but the initial 12 month allowance is currently due to come to an end in September 2024.[1] As part of the Operating Costs review we are considering whether, and how this allowance is set on a more enduring basis. However, we do not expect that the Operating Costs review will be implemented in time for this winter. This means that a gap will exist between the end of the temporary ASC bad debt allowance and when an enduring allowance can be in place, if needed, within the core price cap methodology.[2]

We set out below some background into how ASC interacts with the price cap, an analysis of the latest ASC data, and a discussion around potential options for the costs associated with

[1] Ofgem (2023), Allowance for additional support credit bad debt costs (Decision).
[Allowance for additional support credit bad debt costs | Ofgem]
[2] Ofgem (2024), Price cap - call for input on operating costs allowance review.
[Price cap - call for input on the operating cost allowances review | Ofgem]

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ASC bad debt until the Operating Costs review provides a more enduring solution, if needed, for the costs associated with ASC bad debt.

Context

For more than two years, households across Great Britain have been feeling the effects of the global cost of living crisis, and this has placed increased strain on people's ability to afford energy. While the energy market has stabilised and the energy price cap has fallen further, energy bills remain significantly higher than we have been used to. Many households have been struggling to pay for the energy they need.

We have observed that household energy debt and arrears has risen to record levels. From, Q4 2022 to Q4 2023, total energy debt and arrears has increased by about 50% from roughly £2bn to £3bn. The number of households in debt and arrears rose by 20% from 1.9 million to 2.3 million over the same period, and the amount of individual debt increased at a faster rate. This means those who are in debt or arrears, are getting deeper into debt or arrears and are struggling to pay it off, even with prices falling.[3]

Getting into debt or arrears can be harmful to the individual customer. It also generates additional costs, and can be detrimental to the market and broader customer base, particularly if it reaches unsustainable levels. With the price cap in place for default tariff customers (and currently covering most energy customers), these issues surface through the cap.

ASC is a credit offered by suppliers to prepayment meter (PPM) customers. It helps vulnerable PPM customers to stay on supply, who may have exhausted alternative options (such as emergency or friendly hours credit) to avoid self disconnection and return them to supply. This credit is repayable. It is however, not always paid back and a certain element of this becomes unrecoverable and is written off as 'bad debt' by suppliers. We refer to this as 'ASC bad debt'. As explained in the next section, we have observed both higher issuance levels of ASC, and a higher value of ASC being issued. This suggests that more PPM customers are struggling to pay their energy bills.

This ASC bad debt has become a material cost for suppliers, due to the increased levels of ASC being issued. In August 2023, we published our decision to introduce a specific allowance for bad debt associated with ASC into the price cap from 1 October 2023, for an initial 12-month

[3] Ofgem (2024), Affordability and debt in the domestic retail market – a Call for Input. [Affordability and debt in the domestic retail market – a Call for Input | Ofgem]

period, worth £8.77 per typical PPM customer, levied on the 'nil consumption' or standing charge element of prepayment bills.[4]

The ASC bad debt allowance along with the Operating Costs review should be viewed in the context of our current work on affordability and debt, which aims to review the challenges around affordability and debt management more broadly. We discuss this and interactions with other workstreams below.

In this letter we explore options for how we could approach the ASC allowance in the cap beyond September 2024, and invite views on our proposals in this respect.

Analysis

We have been reviewing ASC bad debt and other debt-related costs based on the latest data provided by industry. We also regularly observe the levels of debt and arrears of domestic customers, which help us to understand the overall context of bad debt. [5]

We discuss below how the latest data shows that both have risen since we set the ASC bad debt allowance, likely being driven by wider cost of living crisis resulting in some customers facing affordability challenges. We also assessed the performance of the current ASC bad debt allowance introduced in October 2023 against suppliers latest ASC bad debt provisions data.

<u>Recent trends of debt and arrears</u>

The latest debt and arrears data for Q4 2023 is published on our data portal.[6] This data represents all domestic consumers covering all payment methods. It shows a material increase since the end of Q4 2022 across most debt and arrears-related parameters. For example, total financial value of domestic customer debt and arrears, average debt level where there is no arrangement to repay the debt (arrears), number of accounts in arrears where there is no arrangement to repay the debt and the proportion of customers repaying a debt to their supplier, among other parameters.

We have observed seasonally high levels of debt persisting into Q4 2023. Previously, debt generally fell towards the end of the year when customers were billed for the warmer months, and then rose in the spring as customers fell into arrears following higher energy usage during

[4] Prior to the August 2023 decision, we also consulted on our proposed approach to introducing an initial 12 month ASC bad debt allowance - [Price cap - Statutory consultation on introducing an allowance for bad debt associated with ASC]
[5] Taken from both the Monthly Household RFI and Debt Related Costs RFI
[6] Ofgem (2023), Debt and Arrears Indicators.
[Debt and Arrears Indicators | Ofgem]

the winter months. This change could have been driven by higher retail prices and increasingly difficult financial circumstances faced by households.

Specifically for PPM customers, the proportion of domestic PPM customers repaying debt to their suppliers has increased significantly. By Q4 2023, this has risen to 58%, up from 51% in Q3 2023.

Recent trends of ASC issuance and non-repayment ASC levels

We set the initial ex-ante allowance for ASC bad debt based on anticipated costs of ASC bad debt between October 2023 and September 2024, and the likely difference between winter 2022/23 and winter 2023/24 while considering the level of government support (e.g. the Energy Bill Support Scheme (EBSS)).

The latest data from industry gives us a view of costs associated with ASC for up to the end of March 2024. This indicates an increase in ASC issuance levels offered by suppliers to PPM customers, and an increase in the value of ASC provided per application compared to the previous year. This is likely due to affordability pressures associated with both high energy bills and wider cost of living pressures.

The latest ASC data we have gathered continues to show an increasing year on year trend of ASC being issued. We estimate that the ASC level increased by 162% between 2022/23 and 2023/24, with a broadly commensurate increase in suppliers' provisions for ASC bad debt of 133% between the same periods.

Trends in the ASC level and ASC bad debt both exhibit seasonality, with higher levels of ASC requested in the winter before levelling off in the summer. This is likely due to higher levels of energy demand during the winter. Since we began recording ASC data, on average the value of ASC issued has increased by 102% from the winter 2021/22 to the winter 2023/24, and the value of ASC bad debt has increased on average by 92% between the same periods.

The Involuntary PPM Supplier Code of Practice[7] statutory consultation on Involuntary PPM could have increased demand for ASC and/or meant suppliers issued more of it. This would in turn be likely to have increased the level of associated bad debt. Additionally, forward energy prices remain high relative to historical figures and the continued cost of living and wider affordability pressures.

[7] Ofgem (2023), Involuntary PPM – Supplier Code of Practice.
Involuntary prepayment meter energy supplier Code of Practice | Ofgem

Performance of the ASC Bad debt allowance – October 2023 to March 2024

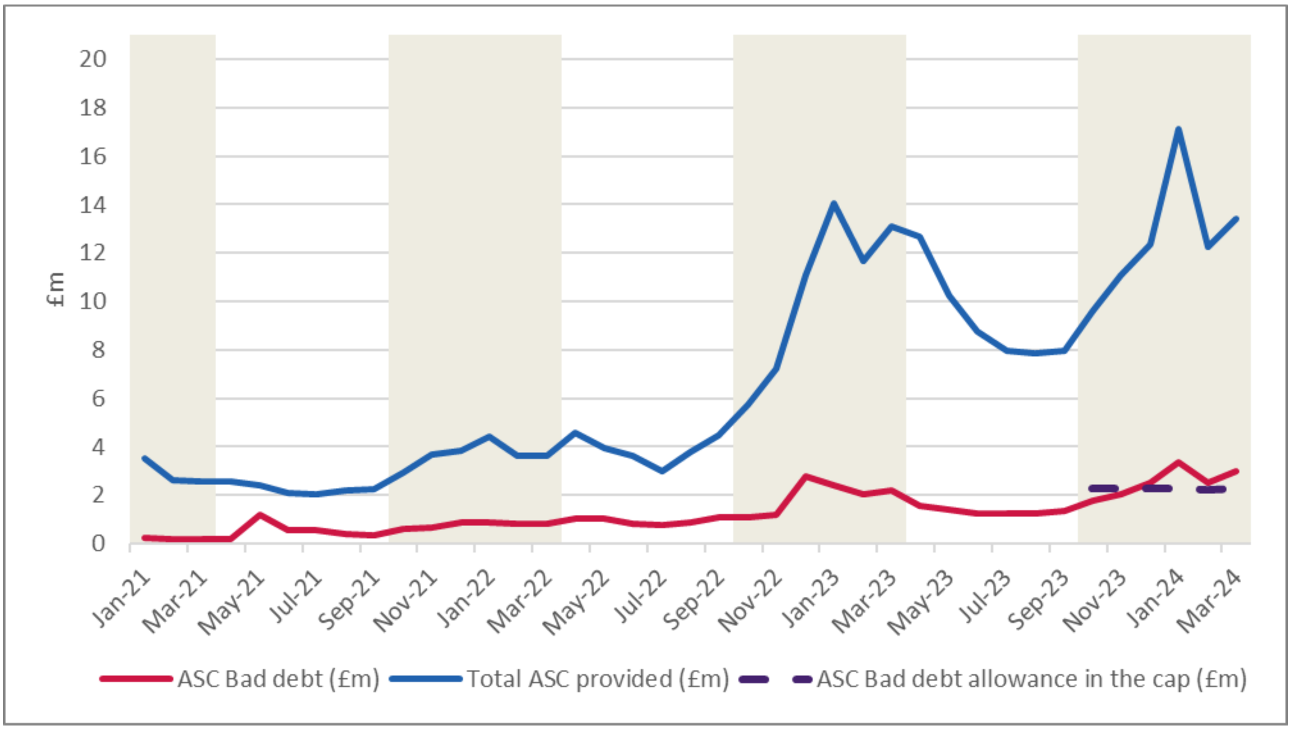

Figure 1 - Estimated impact of total ASC provided & ASC bad debt provisioned

Figure 1 shows the increasing trend in total ASC provided and non-repayment of ASC levels. The increase broadly reflects our expectations on ASC bad debt provision, which we previously estimated as 18% monthly ASC bad debt provisioned by suppliers. So far, we observe that the provisioned ASC bad debt costs from winter 2023/24 have not materially deviated from the ex-ante ASC bad debt allowance currently in the cap. It is likely the level of ASC issuance and the level of associated bad debt will follow typical seasonal trends by decreasing in summer 2024, potentially increasing again through winter 2024/25.

It is worth noting that the data used for this analysis is based on actual data from ASC issuance provided to customers and provisional ASC bad debt cost data which will only be fully known once all ASC repayments have been accounted for in the data. However, we consider that the most appropriate expectation of future ASC debt related costs broadly aligns to the level provided for in the current ASC bad debt allowance value of £8.77 per typical PPM customer.

Overall consideration of the ASC analysis

The provisional ASC bad debt data we received currently supports the allowance set in our August 2023 decision as being an appropriate estimate of costs incurred across winter 2023/2024. There is uncertainty around how levels of bad debt will materialise over time. However, given the trends and analysis set out above we consider it reasonable to expect ASC levels to continue to be higher than historical levels beyond September 2024. This means the costs associated with ASC bad debt will likely continue to be material and systematic. We consider the current ASC allowance continues to be appropriate to address the efficiently incurred costs associated with ASC bad debt.

Therefore, we are proposing to extend the existing ASC allowance, at its current level, so that it continues in place from the end of the current allowance in September 2024 and remains in place until the outcome of the operating cost review is implemented. This is discussed further below.

Compliance and Monitoring

In our August 2023 decision, we stated that we would take a multifaceted approach to ensuring the ASC bad debt allowance is used appropriately and helps ensure the right level of ASC will be provided to customers during the winter of 2023/24.[8]

We stated that we will also explore which further measures that may be appropriate to ensure the allowance is used effectively, and more broadly, continues to drive best practice in relation to ASC and debt management by suppliers.

We have engaged with suppliers on their provision of ASC to understand any barriers to issuing the allowance, as well as alternative mechanisms that may be in place which also mitigate the risk of self-disconnection. We will continue to monitor compliance in this area and take appropriate action where we determine Ofgem's expectations are not being met. Our aim is to ensure that the ASC bad debt allowance is being used effectively by suppliers to drive the consumer benefits it was designed to deliver - ensuring that valuable ASC support is available for the customers who need it.

We will consider supplier performance and practices in this area, particularly if there is evidence the allowance is not driving the benefits it was intended to deliver, in determining the need for and /or level of any ASC extension.

Policy consideration and proposals

The allowance for ASC bad debt within the price cap was set initially for 12 months, from October 2023 to September 2024. This was planned to be in place until the review of

[8] Ofgem (2023), Allowance for additional support credit bad debt costs. [Allowance for additional support credit bad debt costs | Ofgem]

Operating costs within the price cap was implemented, as this review intends to take into consideration a more enduring solution for costs associated with ASC bad debt.

However, given that we now expect to complete the operating cost review later than planned, there will be a gap in the allowance for costs associated with ASC until the review is completed. This presents us with the question of what we do with ASC during this period. Below we discuss three possible options:

- **Do nothing** – let ASC allowance in the cap end in September 2024
- **Extend** – Extend the current ASC allowance
- **Review** – Extend and refine the size of the ASC allowance using latest data

Do nothing

In August 2023 we decided to set the allowance for an initial 12 month period until September 2024. This currently means that the ASC allowance will cease to be reflected in the price cap from October 2024. The allowance was set based on the expectation that ASC bad debt costs would be material and systematic. As discussed in the analysis section above, we have observed that levels of debt and arrears have remained high.

We expect levels of ASC issued to remain high across next winter also. Due to ongoing affordability pressures, it's likely consumers will continue to require ASC, especially during the winter period due to seasonal demand.

Under the Tariff Cap Act 2018 we are required to have regard to the ability of efficient suppliers to finance their licensed activities.[9] Not allowing for the costs associated with ASC bad debt beyond September 2024 means the price cap may not reflect efficiently incurred costs, at least until the Operating costs review is implemented. We consider that if the cap level does not reflect efficient costs, it is reasonable to consider that consistent application of the best practice in relation to ASC may be adversely affected, the impact of which would be to affect PPM customers who need ASC, including those in vulnerable circumstances. However, we are clear that suppliers are, regardless of the cap level, obliged to provide ASC in line with the relevant SLCs.

Extend

As discussed above, we expect wider cost of living issues to continue to put pressure on households' ability to pay their energy bills. We consider it was in the consumer interest to introduce this allowance, given the benefits of ASC for the most vulnerable consumers.

[9] Domestic Gas and Electricity (Tariff Cap) Act 2018

Extending the current allowance would continue to best support suppliers to continue to assist vulnerable consumers through issuing appropriate levels of ASC beyond September 2024.

We consider the ASC allowance currently in the cap has been broadly in line with costs incurred. As set out above, our latest view of the data across winter 2023/2024 indicates bad debt provisions have not deviated materially from our estimation when setting the allowance.

Review

Similar to the 'Extend' option, this would include extending an ASC allowance, but with the additional step of refining the size of the allowance using the latest data. This option could potentially provide a benefit in terms of accuracy of the allowance. However, as indicated above we consider that the ASC allowance has been appropriate. By carrying out an additional review of the allowance methodology, there is a risk of delay in implementation for October 2024, due to timings around availability of newer data and undertaking an appropriate consultation process.

Any benefit to this approach would likely be incremental and given the impending implementation of the Operating costs review, there are risks around re-opening a methodology that would only be implemented for a limited period of time and we do not consider this exercise would be proportionate to the benefits that might be realised relative to the second option discussed above.

Rationale for proposal

Our minded to approach is the second option outlined above i.e. to extend the current ASC allowance beyond September 2024, until the outcome of the Operating costs review is implemented, or until we decide to carry out a review of the ASC allowance. This would be an extension of the current methodology as set out in our August 2023 decision. The data shows there has been a sustained higher level of ASC bad debt across the winter, and that this is a recognised material and systematic cost to suppliers that will likely continue at current levels for some time. We consider ASC is an important mechanism to provide help for some of the most vulnerable consumers, and ensuring suppliers can recover efficient costs best supports suppliers to continue to assist vulnerable consumers through issuing appropriate levels of ASC.

In our recent debt-related cost adjustment decision, we indicated that we would review the need for a true-up of the ASC allowance from October 2023 to September 2024. We intend for this to take place as part of the review of wider debt-related cost adjustment. Any extension of the ASC allowance is separate to this. We consider that the appropriateness of any true-up of the extension period to the ASC allowance, should be viewed in the round with the setting of any enduring allowance.

Implementation

In terms of implementing an ASC extension in the price cap, we would continue to use 'Annex 8 - methodology of adjustment allowance', as set out in our decision in August 2023.[10] We have published an amended version of the model alongside this letter to demonstrate the potential changes required for implementation of the ASC extension. We intend to publish a finalised version of the model alongside the decision letter.

Interaction with other workstreams

In our August 2023 decision we stated that there are interactions between the ASC bad debt allowance and a range of other Ofgem workstreams and work across government. This includes our work on levelisation, the Operating costs review, and our work around debt and affordability.

Levelisation

In the August 2023 decision, we stated that the decision on ASC allowance has important interactions with the Government's Energy Price Guarantee (EPG). The EPG aligned charges for comparable direct debt (DD) and PPM customers to ensure that those on PPMs did not pay a premium for their energy costs where the PPM price cap level was higher than the equivalent DD level.

Since April 2024, Ofgem has introduced the levelisation mechanism which adjusts the standing charge costs between PPM and DD customers, so that PPM customers do not pay a premium, following the conclusion of the Government's EPG support.[11] As the ASC Allowance is on the standing charge element of the PPM cap, ASC costs are spread across both PPM and DD customers through this mechanism. This means that the cost of ASC extension will continue to be shared across DD and PPM customers.

Operating Costs Review

As outlined in our August 2023 decision, we introduced the ASC allowance to the cap for 12 months initially whilst the ongoing Operating Costs review considered whether it should provide a more enduring allowance for PPM customers.

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[10] Ofgem (2023), Annex 8, adjustment allowance methodology.
Allowance for additional support credit bad debt costs | Ofgem

[11] Ofgem (2024), Decision on adjusting standing charges for prepayment customers.
Decision on adjusting standing charges for prepayment customers | Ofgem

In reviewing the ASC bad debt allowance in 2024 to determine whether a true-up is necessary, we intend to assess ASC bad debt costs over the year, which will provide evidence for consideration in the Operating Costs review.

Debt and Affordability

In the Affordability and debt in the domestic retail market, Call for Input (CFI), published in March 2024,[12] we recognised the impact that increasing energy debt has on consumers, suppliers and consumer groups.

In setting the price cap, we must have regard (amongst other things) to the need to ensure suppliers who operate efficiently are able to finance their licensed activities. Given the levels of debt across the industry we recently made the difficult decision to allow suppliers to temporarily recover the additional costs associated with bad debt. In practice, this meant increasing the costs some consumers pay to recoup the cost of bad debt in the energy system. This reflects that we can move costs between customers, but we cannot remove them.

The Affordability and debt CFI was issued to understand several aspects of the Affordability and debt challenge, its size, its impact across all parties, whether it is temporary or enduring and systematic feature of the market, and whether we have the right policy and regulatory tools to protect those in debt and struggling to pay their bills on an enduring basis. We want to develop solutions that ensure a sustainable, investable market that protects and supports those customers in debt in a compassionate way.

Next Steps

We invite stakeholder views on any aspect of this letter by 12 July 2024. Stakeholders' responses will inform our decision, which we intend to publish by the end of August 2024.

Yours faithfully

Chris McDermott
Deputy Director, Retail

[12] Ofgem (2024), Affordability and debt in the domestic retail market – a Call for Input.
[Affordability and debt in the domestic retail market – a Call for Input | Ofgem]

Appendix 1: Privacy note on consultations

Personal data

The following explains your rights and gives you the information you are entitled to under the General Data Protection Regulation (GDPR) Note that this section only refers to your personal data (your name, address, and anything that could be used to identify you personally) not the content of your response to the consultation.

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

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

2. Why we are collecting your personal data

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

3. Our legal basis for processing your personal data

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

4. With whom we will be sharing your personal data

We may share consultation responses with DESNZ.

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

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

6. Your rights

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

You have the right to:

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

7. Your personal data will not be sent overseas

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

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

10. More information

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