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Email only to: priceprotectionpolicy@ofgem.gov.uk

RECCo response to Ofgem's Additional debt-related costs allowance policy consultation

Thank you for the opportunity to respond to your consultation on an additional debt-related costs allowance within the default tariff cap. Our non-confidential response represents the views of the Retail Energy Code Company Ltd (RECCo) and is based on our role as operator of the Retail Energy Code (REC).

RECCo is a not-for-profit, corporate vehicle ensuring the proper, effective, and efficient implementation and ongoing management of the REC arrangements. We seek to promote trust, innovation, and competition retail energy whilst keeping positive consumer outcomes at its heart. Through the code, the services we manage and the programmes we run, we're dedicated to building a more effective and efficient energy market for the future. We are committed to ensuring that RECCo is an "intelligent customer", ensuring efficacy and value-for-money of the services we procure and manage on behalf of REC Parties, including those which constitute the REC Code Manager.

Summary of key points:

- We recognise that high energy costs and the wider cost-of-living crisis are contributing to an unprecedently high volume of energy debt that may pose a risk to the financial stability of some suppliers. While these should be mitigated in part by Ofgem's recently introduced financial stress tests and other policies such as the allowance for Additional Support Credit, it is reasonable to make a temporary adjustment to the price cap to account for the anticipated increase in bad debt.
- Any additional allowance for bad debt should be designed to ensure appropriate suppliers behaviours in terms of the balance between effective credit and debt management, and the forgiveness of debt or provision of other financial support. Getting that balance wrong could incentivise the wrong behaviours.
- We are concerned that the recovery of a bad-debt allowance through the standing charge would compound the regressive effect of such charges and may distort competition between those suppliers who apply a standing charge and those who do not; we would welcome a wider Ofgem review of standing charges.

Conclusion

Whilst we recognise that these proposals are primarily intended to, in Ofgem's words, "reduce the risk of energy firms going bust leaving the market as a result of unrecoverable debt" they will have the inevitable consequence of increasing the burden upon those consumers who manage to pay their energy bills, including those who settle any accrued debts. While the additional allowance may be temporary, the estimated £17 a year cost will be unwelcome.

However, we recognise that not all energy suppliers will seek to pass through the additional costs and instead offer tariffs below the allowance. It is therefore important that the energy retail market is working as effectively as possible, for instance through enabling fast and efficient consumer switching to better tariffs. RECCo will fulfil our part in that.

One of the energy industry processes we govern is the Debt Assignment Protocol (DAP), which facilitates the transfer of indebted prepayment meter (PPM) consumers between suppliers. However, that protocol only applies to debt of £500 or less, as set out in Standard Condition 14 of the Gas and Electricity Supply Licences. That value has not been revised since May 2015, when typical domestic energy bills were much lower than they are today. We consider that it would be appropriate for Ofgem to ensure a balanced approach to the treatment of debt, including more measures which may directly benefit consumers. It may be timely to revise the DAP threshold as one example, perhaps bringing it either into line with the c.6-month average bill it represented in 2015, or possibly more dynamically indexing it to the prevailing tariff cap value. This may at least enable indebted PPM consumers to seek a more competitive tariff, allowing them to make a greater contribution towards reducing any arrears while remaining within the same budget, and potentially mitigate against them adding to the debt burden these proposals seek to allow for.

We are happy to discuss further any of the points raised in this response.

Yours sincerely,

Jon Dixon

Director of Development and Strategy

Appendix

Q1. Do you consider that we should make a temporary adjustment to the price cap to account for additional debt-related costs?

It seems reasonable to provide an adjustment to the price cap to account for the likely increase in bad-debt arising from a combination of factors, including the high cost of energy over the past couple of years, combined with a wider cost-of-living crisis and regulatory restrictions on suppliers' ability to install PPMs.

The over-riding aim of the adjustment should not simply be to protect supplier revenues by allowing bad debt to be socialised across bill paying consumers, but to encourage an appropriate balance in supplier decision making and behaviours. For instance, if the allowance is too generous, suppliers may be inclined to write off debt prematurely rather than employ reasonable but costly credit management and debt-collection practices. However, if the allowance does not adequately reflect the cost of debt, suppliers may be unwilling or lack financial headroom to write off debt or offer other financial support where the consumer's circumstances genuinely warrant it. We therefore consider that an appropriate allowance for debt-related costs should be a more explicit and integral part of Ofgem's policy in respect of consumer vulnerability.

Q2. Do you think that suppliers cost due to the moratorium on involuntary PPM installation should be included in the adjustment?

We do consider that it would be reasonable for the impact of both the PPM installation moratorium and the subsequent mandatory code of practice to be taken into account. Whilst both measures may be an appropriate reaction to some of the shocking behaviours exposed by *The Times* earlier this year, they have both restricted the discretion that a supplier could previously apply in deciding whether or not the installation of a PPM is appropriate.

In the case of the moratorium itself, the impact will be finite, potentially being limited to the additional bad debt accruing from those consumers who would otherwise have had a PPM installed in that period and any subsequent installation, to the extent that they still fall within the parameters set out in the Code of Practice. However, there will be households where it is no longer possible to install a PPM in accordance with the Code of Practice. It should be practicable to assess the numbers of households that would fall outside of permitted installation circumstances, together with the typical debt for such households and rates of default.

We note and agree with Ofgem's caveat that the allowance may be subject to a determination of whether or not the supplier's exposure to costs results from poor practice before, during, or after the moratorium. However, it should not be assumed that all suppliers' portfolios are comparable and that any metrics associated with PPM installation alone are necessarily indicative of inappropriate behaviour.

Q3. Do you agree that any adjustment should be made using the existing price cap mechanism, rather than a bespoke levy or other new mechanism?

We have no view on whether the additional adjustment should be made under the existing mechanism, other than noting that the various costs associated with consumer debt are already covered and additional complexity should be avoided wherever practicable.

Q4. Do you have any views on whether it would be appropriate to explore a specific levy mechanism for DNI ('do not install') customers? This would be separate to any adjustment for additional debt-related costs.

As set out in response to Q2, we do consider that it would be appropriate to fully assess the impact of the '*do not install'* policy. We have no view on whether this would be better done under an existing or bespoke levy mechanism.

Q5. Do you agree that we should make an initial float adjustment in April 2024, followed by a later true-up? Do you agree it should be included within the cap for a 12-month period? Do you agree that this allowance should be temporary only?

It seems appropriate to make an initial allowance for the period in which data is available, which Ofgem indicates to be April 2024 to March 2025. To the extent that the circumstances behind these policy proposals change, it would be appropriate to reconsider the approach, though we note that the default tariff cap itself was only expected to be temporary and has now exceeded its originally expected life. Given the limitations of data and certainty, an initial 12-month period seems reasonable, though it would be necessary for the basis of the allowance to be temporary if it could simply be adjusted (including to zero) as circumstances require.

Q6. Should the debt-related costs allowance, if introduced for the April 2024 price cap, be subject to a later true-up, and if so, when should this adjustment occur?

April 2024 seems an appropriate start data for the allowance, particularly given the other changes which will have effect from that date, not least the removal of subsidies via the Energy Price Guarantee mechanism. It seems reasonable too that this allowance should be subject to a 'true-up' mechanism as with others within the default tariff cap calculation, which can only be proxy for the sort of dynamic cost-assessment and pricing that would be possible in an effective competitive market.

Whilst understanding the intended meaning of the term 'true up', such an adjustment should of course be available for any '*true down*' once debt-related costs can be evidenced.

Q7. Do you agree that we should carry out only one wider debt-related costs true-up?

The default tariff cap as a whole places an artificial constraint on the normal functioning of the retail market, which goes beyond its original intent of mitigating the 'loyalty premium'. Whilst it is reasonable to take into account the administrative burden upon both Ofgem and stakeholders when making revision to the tariff cap calculations, these should not be given undue weight as compared to the interests of consumers and effect on competition. We do not know whether it will be proportionate to undertake a single review and 'true up' of debt-related costs but recognise there may be benefits in doing so; these should be set against any foregone benefit to consumers if any downward adjustment is delayed pending that wider review.

Q8. Should the float allowance be uprated to account for inflation, or should we make no additional adjustments?

As we are in a period of relatively high inflation it seems appropriate that any allowance takes account of inflation, though these assumptions should themselves form part of a future review and 'true up' of actual cost.

Q9. Do you agree with the proposed overarching methodological approach for estimating the existing debt-related costs allowance, and using it to determine whether there has been an over or under-allowance for debt-related costs in 2022/23?

We have no comment on this question.

Q10. Do you have any other suggestions of alterative methodologies or other factors we should consider for how to calculate the debt-related costs over or under-allowance in 2022/23?

We have no comment on this question.

Q11. Do you agree that we should consider each debt-related cost (bad debt, debt- administrative costs, and working capital costs) in scope of this review?

Whilst noting that the debt related costs exhibit different trends and have different drivers, there does appear to be sufficient relationship to consider them all as part of the review rather than exclude any given component.

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

We have no comment on the preferred approach to benchmarking.

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

As noted in our response to an earlier Ofgem consultation on allocating the cost of supplier failure[1], the allocation of policy driven costs to standing charges compounds the regressive effect of those charges. Whilst we recognise that cost-recovery through unit rates can also have a disproportionate impact upon certain consumer categories such as those with energy intensive medical equipment, there are alternative sources of financial support for such consumers which Ofgem may not be taking into full account when considering the distributive effect of its policy decisions.

We would welcome a wider review of standing changes and believe that in the meantime additional cost allowance should only be recoverable through such charges if they are clearly and demonstrably the most equitable option.

Q14. Do you agree with us allocating other debt-related costs (debt-related administrative and working capital costs) uniformly across payment method?

Given the absence of data referenced in paragraphs 8.25 - 8.26 of the consultation document, we agree that it is appropriate to allocate debt related administrative costs uniformly. It is not clear to us why the working capital costs would differ between payment methods, as compared to factors such as the age-profile of the debt, so uniform allocation again seems an appropriate starting point.

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

As set out in response to Q13, we are concerned that any additional recovery of cost through the standing charge would compound the already regressive nature of that charge, impacting low consumption households disproportionately and giving them no opportunity to avoid the additional cost through more efficient energy usage, etc.

We also note that some suppliers offer a unit-rate only tariff with zero standing charge. Allocating any additional debt-related costs to the unit rate only would seem to have least impact on competition, whereas recovery through the standing charge or a combination of standing charge and unit rate could have a distortive effect, particularly if consumers refer primarily to the unit rate when choosing a supplier.

Q16. How should we apportion any debt-related costs allowance between fuel and meter types?

As noted, the consumption patterns for gas and electricity are different and this should appropriately be taken into account, including the extent to which the quarterly revision to the default tariff cap may be inhibiting suppliers' ability to apportion costs (or any allowance for cost) over a longer period. Notwithstanding our views on the regressive nature of the standing charge, we agree that gas consumers' consumption is heavily weighted towards the winter months. A

[1] https://www.retailenergycode.co.uk/fs/wp-content/uploads/2023/01/RECCo-Response-to-Ofgem-Open-Letter-SoLR-Standing-Charges.pdf

volume-based apportionment of additional bad-debt costs may therefore compound the problem of affordability for gas consumers, even with the smearing effect available to those paying by direct debit. It may therefore be appropriate to provide a greater weighting of bad debt allowance during the Mar-Jun and Jul-Sep quarters. It appears that there is less of a seasonality issue in electricity.

Unless there is any evidence that there is a greater propensity for consumers with a particular meter type to accrue debt, applying a single unit rate uplift appears to be the most equitable means of apportionment in electricity.