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12 October 2020

Dear Anna

We are writing in response to your consultation on the impact of COVID-19 on the default tariff cap. This submission is non-confidential and may be published on your website.

The consultation provides a qualitative review of a range of factors arising from the pandemic that could have caused suppliers' costs to increase or decrease. That review appears to be relatively exhaustive in terms of cost categories, and the description of potential impacts is well reasoned and credible. It does not contain any quantitative analysis of the scale of costs however. This makes it difficult to understand the potential materiality in a range of areas. It also impedes stakeholder understanding of what precedent your decision may potentially be setting, eg at what point a deviation in actual costs from projected efficient costs becomes sufficiently large that it may merit a change in the price cap methodology, now or in the future.

The absence of quantification makes it difficult for us to provide anything more than a qualified view. Through our own interactions with suppliers we are aware of significant anecdotal evidence to suggest that their costs may have been materially impacted by the pandemic in a range of areas. Concerns around bad debt, either which has already crystallised, or that may come to crystallise if the economic downturn continues, or worsens, are prominent among these. While in many areas the impacts may have resulted in cost increases, there are also areas where decreases are likely. For example, use of the furlough scheme has been widespread within industry and may have reduced operational costs. We note that the underlying price cap methodology includes allowances for uncertainty and headroom, and would expect relatively limited changes in costs to be covered by those mechanisms rather than justifying re-openers.

Your proposal suggests that you only intend to correct the price cap methodology to account for debt costs, and not for any of the other impacted cost categories, as you consider debt costs to be more material than those other impacts. In principle, if the evidence supports this - and we reiterate the point that the cost implications have not been quantified for any category - we think that a time-limited additional allowance for debt costs could be justified.

Underlying this view is a recognition that the pandemic was unforeseeable and wholly outside the control of suppliers. A reasonable argument can be made that the efficient cost of managing bad debt in normal circumstances will not be reflective of costs in these circumstances. While any increase in consumer bills will be deeply unwelcome in the current economic climate, we are also mindful of the fragility of supplier finances and of the need for the sector to be able to fund its commitments to support consumers in financial difficulties through the pandemic.

Any adjustment should take into account the net change in indebtedness, including any old bad debt that has been paid off, and not simply any additional new bad debt, noting that in some other sectors (for example, in relation to credit card debt) there is some evidence that consumers have been paying off debt during the crisis.

We agree that any such adjustment should take the form of a one-off ‘add-on’ allowance rather than a revision to the underlying debt allowance methodology. While the long term impacts of the pandemic are yet to be known, it appears more reasonable to treat its impact as being time-limited, rather than a permanent change to the level of efficient costs.

We also agree that given the uncertainty on evolving costs, that it may be appropriate to initially include a conservative estimate and then true-up with outturn costs when they become available.

We further agree that it would be appropriate to base the additional allowance on the lowest quartile supplier. While we expect some suppliers may argue that something more akin to cost pass-through (i.e. average costs) may be more appropriate we think that it is important to maintain efficiency incentives to remain consistent with the intention of the Domestic Gas and Electricity (Tariff Cap) Act 2018. We also note that in other areas the proposals may be relatively favourable to suppliers, for example, you note that failing to account for furlough cost reductions is ‘a particularly conservative approach in suppliers’ favour’. Given that there are areas where suppliers’ costs may have been reduced but you are not proposing to adjust the cap, it appears appropriate to be challenging in any area where you do increase allowed costs.

We agree that any adjustment should only take into account bad debt costs associated with default tariff customers; other tariff prices are unregulated and there is no reason why the bad debt costs associated with non-default tariff customers should be paid for by default tariff customers.

We further agree with your proposals that costs should be shared between direct debit and standard credit customers, rather than wholly footed by the latter. We are not aware of evidence to suggest that direct debit customers are more sheltered from financial difficulty during this crisis.

Finally, we note that supplier financials are not simply affected by the revenues that they receive from regulated default tariff prices but also from the pricing decisions they make on acquisition tariffs. We are concerned that there are significant issues with unsustainable pricing in the market that predate the pandemic, and have led some suppliers into financial difficulty. Suppliers should be mindful that the case for providing them with financial support is weakened where they appear to be consciously selling some tariffs below cost. Costs associated with imprudent pricing decisions should not be recovered from default tariff customers.

Yours sincerely

Rich Hall

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