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Dear Anna

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

In our response to your first consultation we provided qualified support for your proposal to amend the price cap to allow for recovering higher debt costs during the pandemic. That qualification being that while the arguments you put forward for a correction appeared reasonable in principle, there was a lack of quantified evidence or data to substantiate the case.

Having considered the second consultation, we retain these concerns. There is some quantified data, but it is limited, lacks transparency, and may not be robust.

You sought information on bad debt costs through a voluntary RFI, with only seven suppliers providing information in relation to cap period 4, and only five in relation to cap periods five and six. You note in several places that the quality of some of the data you received was poor.[1] The results to the RFI have not been published, and we do not know who responded. It is therefore very difficult to gauge whether the responses are genuinely representative of wider costs in the industry. There is a risk of self selection among respondents that could skew the results (eg that there would be stronger incentives on those suppliers incurring or expecting higher bad debts to respond than on those incurring or expecting lower ones). You also have not provided ranges for any figures, which impedes understanding of how clustered or dispersed they are, or of the implications of setting targets at the lower quartile rather than at another point.

You are using supplier forecasts to reach your figures. Whilst you are correct that they will have their own experience of the factors that affect bad debt and a specific understanding of the impacts on their own portfolios, none of them have experienced a pandemic before and it appears likely that a number in your sample will not have experienced the nearest analogous situation, the 2008 global financial crisis. The diversity in their forecasting approaches may reduce the risk of systematic error but this is not guaranteed, and there may be natural incentives on

[1] For example, 3.82, 3.83

them to be conservative in their accounting (eg to err on the side of caution and over-estimate the potential debts they may need to cover).

Given the materiality of the amendment that you are proposing, which exceeds £200m, we think the use of a limited, opaque and potentially unreliable dataset is undesirable. We recognise that you are 'setting a float, so the numbers are not definitive and will be subject to a true-up process'[2] but note that there may still be adverse short term implications for consumers if too high a figure is set, even if it is subsequently corrected in a later true-up process.

Setting aside our concerns on data disclosure and robustness, we are broadly supportive of the approach you are proposing to adjust for bad debt recovery. We think a float and true-up approach is the best way to do this - an ex ante approach would be too much at risk of substantive uncorrectable errors, while an ex post one may have negative implications for supplier solvency and for their ability and/or willingness to assist consumers in difficulty through the pandemic. You note in Annex 1 that 'as part of the true-up process, we will consider whether or not a disclosure process is required.' We think that it is, as, for the reasons noted above, the information published to date has not been adequate to give confidence in the materiality of the adjustment. We expect that when you reach that true-up process that you will seek data from all relevant suppliers, and not rely on a voluntary approach that allows for self-selection.

We agree that benchmarking costs based on a lower quartile would be appropriate when setting the float, noting that in principle this will somewhat protect consumers against short-term costs. We note that the materiality of setting the float at the lower quartile rather than the average cannot be deduced from the data published in the consultation, which is unhelpful.

We agree that it is reasonable to recover the costs of cap periods four, five and six when setting the float adjustment. As a general principle, we would expect Ofgem to try and smooth out the impact of any increase in costs on consumers - this may involve recovering costs over an extended period if necessary.

We 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. We agree that allocating costs between the unit rate and the standing charge in line with the historical split between them in the cap is appropriate.

[2] Appendix 1, 6.

We would welcome more information on the timeline and process for truing-up the float. We note that you will separately consult on this. We recognise the uncertainty on how long and deep the economic damage caused by the pandemic will be. It could mean it takes several years before full data is available, but given the materiality of the adjustment being made we suggest that you should provide an update on your thinking in no more than six months time in order to help stakeholders understand the possible next steps.

Yours sincerely

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