

Tackling energy debt

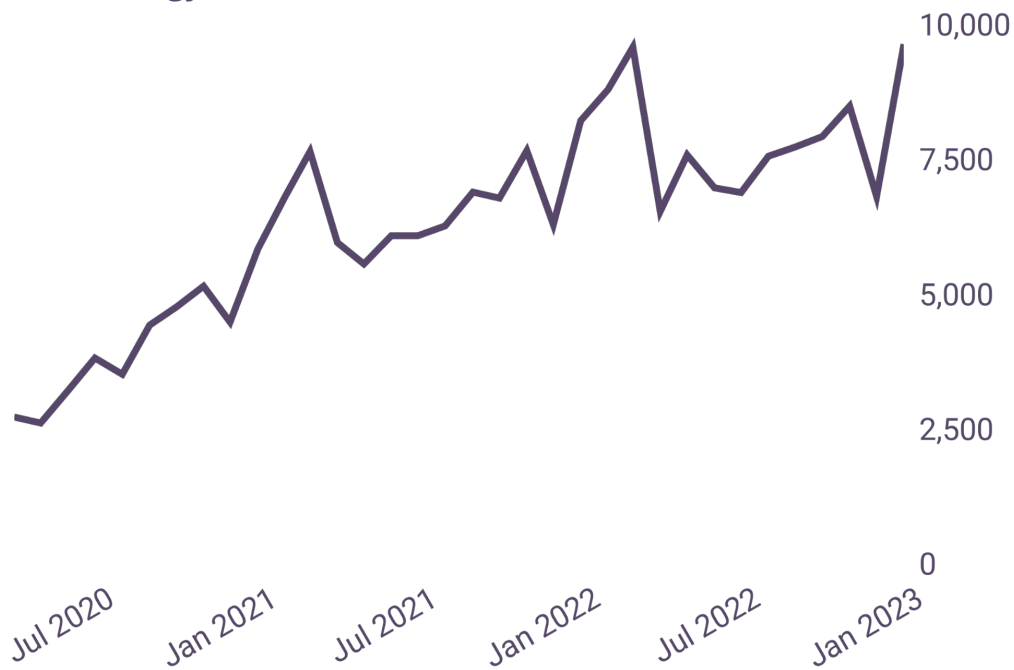
Assessing options to address the growing energy debt crisis



The scale of the problem

Britain is experiencing the worst cost of living crisis in decades. With prices increasing, more and more people are unable to afford their energy bills, as well as other essentials. For some people their incomes are not enough to cover these price increases, meaning more people are falling into debt. Research commissioned by Citizens Advice shows that 11% of people are currently behind on their energy bills.²

The number of people Citizens Advice are helping with energy debt each month



With more people struggling, we've already seen an increase in the number of people coming to Citizens Advice for help with energy debt. We saw over 93,000 clients with energy debt issues in 2022, a 19% increase on 2021.³ Ofgem data similarly shows an increase in the number of consumers repaying energy debt to their supplier since the start of 2021.⁴

Due to increasing energy bills, not only has the number of people in debt increased, but the value of the energy debt consumers owe has also grown considerably. Ofgem recently estimated the total energy debt owed by consumers to be £2.5 billion.⁵ This trend is reflected in Citizens Advice data - which shows the average amount of energy debt owed by our clients is now around £1500, up from £1200 two years ago.⁶

We expect levels of energy debt to continue increasing in the coming months and years. With the Energy Bills Support Scheme coming to an end and the Energy Price Guarantee increasing to £3000, more people will struggle to afford their energy bills. Consumers who came into this crisis with limited savings may fall into debt as those savings are eaten up by higher costs, even if bills do not further increase. There is evidence of widespread bad practice in the forced installation of prepayment meters and remote switching of smart meters from credit to prepay mode. This bad practice has led to a temporary halt in forced prepayment meter installs, which may also lead to an increase in energy debt.

Possible solutions

Based on our preliminary analysis and discussions with stakeholders, we have identified a range of options that could reduce the burden of consumer debt. We make no pretence that any of these options are perfect; there are significant downsides to each. We would particularly welcome feedback on alternative solutions, given those difficulties.

The seven options considered by this paper are⁷:

- Expanding debt allowances in the price cap to give customers breathing space
- Using the fiscal headroom created by recent falls in the wholesale price to fund debt forgiveness
- Transferring indebted customers to a government backed white label supplier
- Spreading the costs of debt recovery over a longer period
- Coupling more extensive use of smart prepay with spreading the costs of debt recovery over a longer period
- Allowing for individualised recovery of actual debt costs through regulatory levies
- Do nothing

We acknowledge that the presentation of these options is highly simplistic - they are intended to be simple “pen portraits” that can form a basis for discussion and for teasing out issues and possible alternatives, they are not fully formed models.

Upfront, it should be acknowledged that all of the change options involve some degree of cost socialisation and that this is by definition problematic. It is widely acknowledged that recovering costs through taxation rather than through bills may result in more progressive cost recovery, but that is not the only dimension of fairness. Many households are struggling at the moment, and it may not be reasonable to expect the just-about-managing to cover the costs of those who are not.

There are some ideas to reduce consumers' bills in the long term that we have not explored in this paper because they are being explored elsewhere or are not likely to be big enough to make a difference. We recently completed a project with the Social Market Foundation and Public First, which found that the current system for supporting families with high energy prices is inadequate, and should be replaced by a form of special tariff arrangement.

Separately, there is a widely held view across industry and consumer groups, predating the current crisis, that some or all bill levies associated with social and environmental policies should be paid for through taxes rather than bills, to make cost recovery more progressive. In our view, this would help but is unlikely to make a large enough dent in debt levels to be considered a stand-alone option.

This paper largely focuses on how funding could be raised to pay for debt forgiveness, or repayment on more affordable terms. It does not go into detail on how that funding would be used: who would qualify; on what terms, etc. Those questions are very difficult in their own right and will also need to be answered.

Expanding debt allowances in the price cap to give customers breathing space

How this would work

A price cap is in place for consumers on default tariffs (those they have not actively chosen). Most consumers are covered by the cap. It includes an allowance for bad debt. During the pandemic, Ofgem took a decision to add a temporary additional allowance to take into account the perceived additional costs of bad debt that were likely to accrue as a result of the economic disruption it caused. This was set in advance, and subject to a later “true-up” process to correct the costs allocated as actual figures became available.

While the causes of the current energy crisis are very different to those underlying the pandemic, there are similarities in both causing acute, and unpredictable economic shocks with a likely flow-through to consumer bad debt. One response to the current debt crisis could be to repeat this approach of adding a temporarily increased debt allowance to the price cap. This could include introducing a debt allowance for those on prepayment meters.

Potential advantages to this approach

- + It could reduce pressure on suppliers to aggressively chase bad debt and to install prepayment meters.
- + Where debt repayment plans are being agreed with consumers, it may allow for the terms of these to be stretched over longer periods, reducing the affordability challenge and consumer distress.
- + It may reduce the risk of supplier failures, and the socialisation of Supplier of Last Resort (SoLR) costs.
- + There is a precedent for this approach (from the pandemic), and the price cap methodology has been subject to frequent alteration to reflect changing underlying costs. The approach to deliver this option may therefore be comparatively straightforward.

Potential disadvantages to this approach

- × The costs would be socialised over all consumers on the price cap. The recipients of help would see the benefits reduced by also funding the costs. Many of those paying for the policy but not receiving the benefits will also be struggling, and would see their own financial position deteriorate.
- × Overall bills would increase, with a knock-on effect of feeding inflation.
- × There is no guarantee that additional funding provided to suppliers would be spent on debt forgiveness, or on giving consumers in difficulty leeway.
- × The legislation enacting the price cap requires that the same methodology is applied to all suppliers, but they are likely to differ quite widely in their exposure to debt depending on their portfolio of consumers. This approach could result in windfall gains or losses.

Other considerations

Consideration should be given to how costs are allocated between different payment types, as the profile of debt may have evolved due to the current crisis.

Using the fiscal headroom created by recent falls in the wholesale price to fund debt forgiveness

How this would work

The government has put in place a significant package of universal support for consumers in the form of the Energy Price Guarantee (EPG), which holds average bills at a level of £2,500/year until the end of March 2023, and then £3,000/year until the end of March 2024.

The financial cost of doing so is very substantial, and was initially estimated by the government as £60bn for the first six months. However, wholesale prices have subsequently dropped significantly, reducing the cost to taxpayers. Despite this, bills are likely to remain unaffordable for many households.

The government could use some of the headroom created by falling wholesale prices to fund measures to help households with significant energy debts. This could take the form of debt forgiveness, of grants to struggling households, of allowing for more affordable repayment plans, or some combination of several or all of those things.

Potential advantages to this approach

- + Does not require the government to find new funding; it was already expecting to spend this money.
- + Does not force bills and inflation to rise in the way that bill-funded approaches would.
- + The repurposing of spend would be consistent with the government's original intention: to try and help hard-pressed families afford their energy bills.
- + Easier to find the scale of funding needed to make a meaningful dent in the problem through this route than doing so via bills (eg the price cap route), given bills are already unaffordable.

Potential disadvantages to this approach

- × With taxation at a 70 year high, the national debt at 102% of GDP, and funding crises in services like the NHS, the government may view competing demands for this cash - tax cuts, paying down debt, investment in public services - as higher priorities.
- × With limited exceptions, Treasury has been extremely reluctant to pay for energy policy through taxation; there is a clear cultural preference for bill levies.

Other considerations

A number of organisations, including Citizens Advice, have called for the repurposing of headroom to keep the EPG at £2,500. Our modelling suggests that there would be no headroom left for use in debt forgiveness if that policy was adopted.

Transferring indebted customers to a government backed white label supplier

How this would work

This approach was suggested by a large supplier in their response to the consultation on the interim report of our energy bill support project.

It would involve a government-led energy supply scheme with the government acting in the capacity of a white label supplier to all customers on means tested benefits. This would effectively be a taxpayer-subsidised energy tariff available for all whilst in receipt of means-tested benefits from the DWP. Government could either procure the energy directly from the market or take advantage of market forces by auctioning off the delivery of the supply contracts (including all administrative functions) to interested energy suppliers for a share of the 6 million households on means tested benefits.

It is argued that suppliers would theoretically be prepared to offer very attractive bids for these contracts for multiple reasons including removal of bad debt risk (as government would hold this risk) and automatic identification of those customers who would qualify for funded energy efficiency measures (eg ECO). The Treasury would determine an appropriate level of bill reduction and ensure affordability by setting the social tariff on an annual basis during each budget.

Eligibility to receive the social tariff could be tied to the consumer accepting energy efficiency interventions and smart metering (if needed), facilitating delivery of those schemes.

It's suggested that this approach would deliver support for the most financially vulnerable, progressively funded through taxation rather than bills, with data mapping onto receipt of benefits making auto-enrolment easier.

Potential advantages to this approach

- + The costs of helping the most vulnerable consumers would be picked up by taxpayers, not bill-payers, resulting in more progressive cost-recovery.
- + Government may be a more patient creditor than the private sector, resulting in less aggressive debt collection and more affordable repayment terms for those in debt.
- + Government has a lower cost of borrowing than the private sector, reducing the cost of managing debt and charges passed through to consumers.
- + Government may be able to leverage the attractiveness of the contracts to demand improvements in quality of service etc that have a positive knock-on effect on merchant supply.

Transferring indebted customers to a government backed white label supplier

Potential disadvantages to this approach

- × Moving consumers to a new supplier without their consent is problematic.
- × Although the government would be subcontracting the delivery role to one or more suppliers, it would nonetheless effectively be entering the energy supply market. Given there will always be some consumers in debt, later exit may be impossible. There may be limited appetite from government to become an enduring market participant.
- × “You break it, you own it” - by taking explicit ownership of energy supply to the most vulnerable consumers, government may find it hard to escape blame if the service goes wrong or is badly delivered. This may not be politically attractive.
- × While it may be assumed that government would be a sympathetic creditor, evidence from other sectors suggests that is not always the case.
- × Eligible consumers may become a captive market if served by a sole supplier; this may reduce incentives around quality of service and efficiency.
- × Tying receipt of a social tariff to agreement to take energy efficiency measures or a smart meter may be problematic where the recipient does not have agency to do this (eg they do not own their property). Some consumers who may have problems with debt may not wish to accept smart meters if they fear they may be remotely switched to prepay.

Other considerations

With ~6m households on means tested benefits, there may be value in breaking down the portfolio of eligible customers into smaller chunks for tendering. Having multiple providers should improve competitive tension. It may also reduce customer service risks (eg it is unlikely that any one supplier could take on that many customers simultaneously, and handing over to a new supplier at the end of contract could be equally problematic). Rapid expansion or dilution in portfolio size may also create scaling risks to suppliers (inability to serve well, or stranded investment) that ultimately flow through to higher consumer costs or worse quality of service. Chunking may reduce this range of risks.

The scale of the affordability crisis extends far beyond those on benefits. While the Energy Price Guarantee (EPG) will keep the average energy bill at £2,500 until June 2023, this is still historically high, and gas prices are expected to stay volatile until the medium to long-term future.

Spreading the costs of debt recovery over a longer period

How this would work

This approach has been proposed by [Energy UK](#) and others, initially before the Energy Price Guarantee was introduced.

Under this approach, the industry and financial institutions would work together to introduce a deficit tariff scheme to protect consumers from elevated wholesale prices. It would seek to lower and stabilise prices by using government-backed loans to smooth rising wholesale costs for consumers over a longer period of time, perhaps 10-15 years.

This may mean that consumer prices are higher in later years than they would be otherwise, as the loans are paid back - that the cost of reducing current high prices would be met by increasing future low prices. But by smoothing costs over a number of years, the acute distress being felt by consumers as a result of price spikes should be reduced. By improving ongoing affordability, consumer energy debt may reduce (or increase less sharply than it otherwise would).

Potential advantages to this approach

- + Previous active consideration may mean that it is capable of (a) being put in quickly and (b) enjoying industry support.
- + Reducing current peaks could materially reduce consumer financial distress, reducing consumer debt.
- + The cost of government backed borrowing is cheaper than that enjoyed by the private sector, reflecting its very low default risk.
- + As loans, the government would expect to be paid back. This may be more politically sale-able than expecting it to provide grants, given difficult public finances.

Potential disadvantages to this approach

- × Some forecasts suggest that high wholesale prices are not a short term blip, and may be with us for the rest of the decade. If this is the case, affordability may be no better at the time the loans become due - this approach may simply displace the debt crisis rather than solve it.
- × Government has previously rejected this approach in favour of the EPG. Because of the need to service the compounding interest, the total cost to consumers would be higher than doing nothing. The universal nature of bill smoothing means it is a very indirect way of tackling debt, and arguably rather unfocused.

Other considerations

An alternative to using long term loans to try and smooth all bills could be to use it simply to smooth and lower the cost of debt repayments (eg overall consumer bills would remain the same, but those with debt repayment plans would be given longer to pay, on better terms).

Coupling more extensive use of smart prepay with spreading costs of debt recovery over a longer period

How this would work

Consumers on smart prepayment plans can much more easily subsequently switch to other payment methods if their circumstances change than those with traditional, 'dumb' prepayment meters. This option would be actively encouraged for consumers in payment difficulties. It would be coupled with the provision of government backed financing to stretch the cost of debt recovery over a longer period to make it more affordable.

Potential advantages to this approach

- + See 'Spreading the costs of debt recovery over a longer period' for potential advantages of that aspect of this proposal.
- + Consistent with government policy aspirations for full roll-out of smart metering.

Potential disadvantages to this approach

- × See 'Spreading the costs of debt recovery over a longer period' for potential disadvantages of that aspect of this proposal.
- × The crisis is immediate. But only ~half of households have a fully functional smart meter installed⁷ and at the current pace it may take many years to reach the remaining households.

Other considerations

Is this an option in its own right? Smart meter rollout is happening anyway.

Allowing for individualised recovery of actual debt costs through regulatory levies

How this would work

Ofgem would seek evidence from suppliers of their individual debt costs, including likely levels of bad (i.e. unrecoverable) debt. These estimates would need to be scrutinised, and potentially subject to a later 'true up' process, to ensure their accuracy. The process would be similar to the existing supplier of last resort (SoLR) levy.

Ofgem would then seek to raise a levy on the networks to recover those assured costs. The networks would recover those costs through their own charges, passing them back on to suppliers for recovery across energy consumers as a whole.

The potential advantages and disadvantages of this approach are very similar to those associated with 'extending the debt allowances in the price cap to give customers more breathing space', although this approach is less tried and tested and may come into conflict with the intention of the price cap.

Potential advantages to this approach

- + It could reduce pressure on suppliers to aggressively chase bad debt and install PPMs.
- + Where debt repayment plans are being agreed with consumers, it may allow for the terms of these to be stretched over longer periods, reducing the affordability challenge and consumer distress.
- + Might reduce the risk of supplier failures, and the socialisation of Supplier of Last Resort (SoLR) costs.
- + It should reflect suppliers' individual debt exposure better than the necessarily 'one size fits all' price cap can.

Potential disadvantages to this approach

- × The costs would be socialised over all consumers. The recipients of help would see the benefits reduced by also funding the costs. Many of those paying for the policy but not receiving the benefits will be struggling, and would see their financial position deteriorate.
- × Overall bills would increase, with a knock-on effect of feeding inflation.
- × There is no guarantee that additional funding provided to suppliers would be spent on debt forgiveness, or on giving consumers in difficulty leeway, although perhaps a mechanism to ensure this could be developed.
- × Possible slippery slope towards setting supplier-specific recovery amounts for other costs ("if you've done it for debt, why not do it for..." etc). This could lead in the direction of individualised supplier price caps, which would be inconsistent with the requirements of the price cap legislation that a single cap is set for all suppliers.

Other considerations

It is not clear what the legal basis would be for this approach: it would need to be established whether Ofgem has the powers to do this under current legislation..

Do nothing

How this would work

No changes are made.

Potential advantages to this approach

- + Implemented by default, no development needed.
- + No socialisation of new costs over other consumers, whether through taxes or bills.

Potential disadvantages to this approach

- × Energy affordability is likely to deteriorate further from an already bad starting position.
- × Millions of consumers' experiencing one or more of the range of serious harms that can result from unaffordable energy debts: self-disconnection; unaffordable repayment plans; self-rationing; health damage from living in a cold home; unable to afford to run critical medical equipment etc.
- × Reduction in customer service quality for consumers in general, as suppliers struggle to keep up with increased demands for assistance.
- × Increased difficulties for suppliers in financing their activities with potential adverse knock-on consequences: reduced investment appetite; greater risk of supplier failures; unhealthy incentives for aggressive debt recovery etc.
- × Wider damage to the economy: reduced consumer spending; reduced growth.

Other considerations

Failure to act is a false economy. It is likely that the Government will come under intense and sustained pressure to intervene if consumer energy debt spirals. Putting the thought into what form that response will take now is likely to leave future policymakers in a better position to deliver a robust, credible policy response than a later response to a deepening crisis will.

Please get in touch

There are pros and cons to each of these options, and none stands out to us as the ideal solution. We would welcome feedback from stakeholders both on these ideas, and on any alternative approaches that could tackle the growing debt problem. If you have any feedback on these proposals please contact thomas.brookebullard@citizensadvice.org.uk.

References and bibliography

1. Survey data based on a representative poll of 6000 adults (18+) in the UK conducted by Walnut Unlimited for Citizens Advice, fieldwork conducted between 9th January and 8th February 2023.
2. Citizens Advice, January 2023, [Average amount of energy debt owed](#)
3. Survey data based on a representative poll of 6000 adults (18+) in the UK conducted by Walnut Unlimited for Citizens Advice, fieldwork conducted between 9th January and 8th February 2023.
4. Ofgem, December 2022, [Number of accounts with a consumer repaying an energy debt](#)
5. Citizens Advice, January 2023, [Average amount of energy debt owed](#)
6. We originally published this paper on 20 February 2023. Subsequent discussions with stakeholders have identified two further possible approaches to easing the consumer debt crisis.
7. According to official statistics, by Q3 2022 47% of household meters were smart and operating as such. A further 7% were smart meters operating in traditional ('dumb') mode.

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