Citizens Advice response to Ofgem's energy price cap review of historical debt related costs

Citizens Advice is pleased to respond to this consultation on debt-related cost allowances within the price cap. We believe that the evidence shows the float was set at a level which was too high and led to material over-recovery. As such, a further downward adjustment is required to return money to customers. Our view is that:

- Total debt-related costs and revenues should be calculated across all tariff types,
- Benchmark cost methodologies establish a plausible range to reflect inefficiencies within debt-related costs, and the weighted average approach should not be solely relied upon.

<u>Total debt-related costs should be calculated across all tariff types</u>

We support the proposal to calculate total debt-related costs and revenues across all tariff types (SVTs and FTCs) for all cost categories. As noted by Ofgem, debt costs are socialised across the entire customer base of paying customers. Allocating the costs separately to SVT and FTC customers would shift responsibility for bearing these shared costs from FTC customers to SVT customers. This would not be a fair or appropriate outcome. SVT customers are more likely to be disengaged or vulnerable and the price cap is explicitly designed to protect these customers. Placing greater cost burdens on paying SVT customers to recover non-payment would undermine the core protections of the cap, and could inadvertently worsen debt susceptibility among those already struggling. There is a clear policy rationale for this methodology change for calculating net debt-related costs.

<u>Benchmark cost methodologies reflect a plausible range</u>

However, we do not agree with using a weighted average benchmark. While the proposal aligns with the benchmark metric adopted for the DRC allowance, there is no clear correct benchmark methodology. Shifting to the weighted average methodology gives suppliers greater leniency on inefficient debt recovery costs relative to the lower quartile and hybrid approaches. Whilst it may be difficult to quantify, it is reasonable to expect that some of the variation in debt-related costs across suppliers reflects efficiency differences. It is not reasonable to expect consumers to fund inefficiencies relating to debt-costs.

Given the uncertainties over the magnitude of these inefficiencies, the net debt-related costs calculated using the weighted average benchmark can, at best, be seen as the lower bound of a plausible range, with the upper bound defined by the lower quartile approach. This reveals a range of over-recovery from £1.22 per customer to £23.80 per customer.

Setting, as proposed, allowances based on the lower bound of this range implies that none of the differences between supplier costs are due to efficiency and so is clearly not credible. We believe Ofgem now needs to instead select a point from within the range outlined above. The midpoint of this range is around £12.50 which we note is very similar to the true-up[1] applied by Ofgem, in the favour of energy suppliers, when reconciling Covid-19 costs.

Further, an over-recovery of £1.22 may appear immaterial on its own, but taken together with other potentially 'immaterial' over-recovery in any other element of the price cap can become material. For example, Ofgem's benchmark consumption review recognises that using median as opposed to mean benchmark consumption leads to over-recovery of fixed costs by suppliers. Ofgem should consider all instances of over-recovery in the round to determine materiality.

[1] £12.02 True-up process for Covid-19 costs