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Dear Anna

We are writing in response to your working paper on the potential impact of Covid-19 on the default tariff cap in period 7. This submission is non-confidential and may be published on your website. We structure it around the three substantive chapters in the working paper.

Chapter 2: Is there a need for an additional adjustment for cap period 7?

We think this chapter provides an excellent summary of relevant forecasts and indicators that may influence how the economy rebounds from the pandemic. We agree that the major bullish feature of these forecasts is the likely boom in economic activity as we exit lockdown and the major bearish feature is the background increase in unemployment and risk that it may deteriorate further when the furlough scheme ends. We also agree that the economy-wide view may hide the very different experiences of those in secure and insecure employment, and that many are not benefiting from the aggregate increase in household savings.

At the time of writing, the government has just implemented the second step of its roadmap out of lockdown. If it remains on track, and clinical data allows it to do so, the fourth and final step should see the removal of all limits on social contact from 21 June. Around 32 million people have had their first vaccination jab, with a plan to offer the first jab to the remainder of the population by the end of July. There are reasons to be cautiously optimistic that this may be the last lockdown and that life may return to something approximating normality by the summer.

The impact of the furlough scheme ending in September are hard to assess. While the economy is expected to be in sharp growth by then, many businesses will have been severely damaged by the pandemic and may find the loss of this support difficult, faltering even as the wider economy recovers. However, the timing of the ending of the scheme is generous, given the prospects of the economy being ~fully reopened from late June. While the ending of furlough will cost some jobs, these may be counter-weighted by growth elsewhere.

We agree with your intention that you *'will only propose an adjustment for cap period seven if there is significant and clear evidence that suppliers are likely to incur material additional costs due to COVID-19'* but think it is very unlikely, given the uncertainty about the shape of the economic rebound from the pandemic, that 'clear evidence' will be available. Any adjustment would be inherently speculative and could be materially inaccurate. We think it would be safer not to make an upfront adjustment - a guess - but to wait and see what happens and, if necessary, make an ex post adjustment.

We also note that increasing the allowance for bad debt would, in itself, create consumer detriment by raising prices. We think you would need to have a high degree of confidence that such a step was necessary before taking it, and it is hard to see how you can have that confidence in the face of such uncertainty.

Chapter 3: Options for calculating the adjustment

Our comments above indicate that we are unpersuaded of the need for a period 7 adjustment. However, if you decide that such an adjustment is necessary, we think that you should apply Option 2, applying additional filters to the estimates of costs received from suppliers.

This is because of the concerns we have previously expressed on the use of supplier forecasts:

'Whilst you are correct that [suppliers] 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 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).'[1]

Anecdotally, several suppliers have told us that the levels of bad debt they are seeing are not as bad as they feared when the pandemic started. Furlough in particular, is perceived to have dampened the escalation of bad debt.

We therefore think it is appropriate that Ofgem has leeway to discard outlier forecasts or those that appear to lack robustness. We also think that it should assess suppliers' track record of forecasting bad debts to date during the pandemic when assessing their credibility for use in its model, giving more weight to those with closer matches between forecasts and outturn.

We raised, and retain, concerns that the last adjustment to the bad debt allowance for previous price control periods lacked transparency and robustness. We expect

[1] Citizens Advice response to Ofgem's second consultation on the impact of COVID-19 on the default tariff cap, 18 December 2020.

that, if you determine that an amendment to the bad debt allowance for period 7 is justified, you will publish much more detailed information to allow stakeholders to understand how you have reached that determination. In particular, it is important that the dataset from suppliers is comprehensive and not self-selected, and that range data is published.

Chapter 4: Prepayment meter ('PPM') customers

We agree with your proposal that you will not adjust the bad debt allowance in the PPM cap if there is no significant and clear evidence of material additional costs.

We note that when you previously considered this matter in February 2021, *'that the evidence at that time of publication indicated that the effects of COVID-19 on the costs of supplying PPM customers were limited.'*

We agree with your view that since PPM customers pay for their energy in advance rather than in arrears that it is much harder for them to incur a debt in comparison to credit customers. We also agree that this means it would not be fair for PPM customers to pay for the additional debt incurred by credit customers

Yours sincerely

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