Consultation Response

Energy price cap operating cost and debt allowances

Office of Gas and Electricity Markets (Ofgem)

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dion.tickner@ageuk.org.uk

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Age UK
7th Floor, One America Square
17 Crosswall
London
EC3N 2LB
T 0800 169 87 87 **F** 020 3033 1000
E policy@ageuk.org.uk
www.ageuk.org.uk

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About this consultation

Ofgem is reviewing operating cost allowances for the first time since the energy price cap was introduced in 2019. Operating costs cover an energy supplier's costs for IT systems, providing customer service, and costs incurred for energy debt. The consultation explores how operating cost allowances are set, and the mechanisms for cost recovery.

This includes how costs are spread across different payment methods, whether the costs are recovered on a volumetric basis, or recovered through standing charges. Price cap allowances have traditionally been set according to a principle of cost-reflectivity, meaning that higher 'cost to serve' consumers, including those least able to afford their energy, tend to face higher energy prices.

Key points and recommendations

- Ofgem should resume its work to levelise debt-related costs between standard credit and direct debit consumers.
- This work should happen alongside the implementation of a Debt Relief Support Scheme, and the review of debt standards.

About Age UK

Age UK is a national charity that works with a network of partners, including Age Scotland, Age Cymru, Age NI and local Age UKs across England, to help everyone make the most of later life, whatever their circumstances. In the UK, the Charity helps more than seven million older people each year by providing advice and support. It also researches and campaigns on the issues that matter most to older people. Its work focuses on ensuring that older people: have enough money; enjoy life and feel well; receive high quality health and care; are comfortable, safe and secure at home; and feel valued and able to participate.

Response

Age UK disagrees with Ofgem's decision not to proceed with levelisation of debt allowances between standard credit and direct debit. There is a strong case for levelising debt allowance. This includes the fact that, according to Ofgem's own analysis, the redistribution of costs would produce a benefit of £223mn for low-income consumers.

Age UK understands the rationale for adopting a cost-reflective approach and note that the premium paid by standard credit consumers is smaller than the difference in average debt related costs that suppliers report across different payment methods.

Ofgem argues that maintaining the premium "will continue to incentivise both customers and suppliers to opt for lower cost-to-serve options, reducing overall costs". We recognise it is important that suppliers do not see standard credit customers as a liability and need to be able to recover their reasonable costs, however we believe the cost-reflective approach is sub-optimal and does not work in consumers' interests.

It is counter-productive to place additional costs onto consumers that are least likely to be able to pay. Standard Credit consumers, as a group, contain a significant proportion of fuel poor households (21.3% of fuel poor households pay by standard credit compared to 25.3% who pay by pre-payment meter and 10.8% who pay be direct debit)[1]. By maintaining a significant premium for standard credit consumers, Ofgem are compounding the affordability challenges faced by these consumers.

By levelising debt-related costs, there would still be a premium paid by standard credit users. The premium, which would be much lower, would still produce an incentive for engaged consumers to choose to pay by lower cost-to-serve payment methods like direct debit.

This is not just an economic issue; it is an issue of fairness. Consumers should not be penalised for using a payment method that meets their needs. Age UK agrees with Ofgem's view that where costs of non-paying customers are being socialised across paying customers, they should be socialised as broadly as possible rather than concentrated on the unlucky few. In principle, all consumers who are capable of generating debt should contribute equally to debt-related costs incurred by suppliers. This applies to direct debit and standard credit consumers.

Households move onto standard credit for a variety of reasons, including because their monthly direct debit is simply unachievable. A household may also be using standard credit because they do not feel comfortable giving control of their bank account to a third party through the direct debit system. According to Ofgem's research, 43% of households that pay by standard credit are unaware that there is a difference in cost compared to if they were to pay by direct debit.

[1] Department for Energy Security and Net Zero (2024), Annual fuel poverty statistics report: 2024, Available at: [Annual fuel poverty statistics report: 2024 - GOV.UK]

The current system penalises both those who knowingly accept a payment premium due to their distrust of the market, and those who are oblivious to the additional costs they are paying.

It is Age UK's view that there is little reason for this penalisation.

Finally, in the consultation, Ofgem refers to significant feasibility barriers for the levelisation of debt costs. Age UK is keen to see more detail on these.

If these concerns are regarding the practical delivery of levelisation, including a reconciliation mechanism to prevent a distortion of competition, it should be explained how these barriers are different to the barriers Ofgem overcame through levelising prepayment standing charges.

In conclusion, Age UK's preference is for Ofgem to proceed with levelisation of debt allowances in parallel to implementing the Debt Strategy, and Debt Relief Support Scheme.