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PAYMENT TERMS BETWEEN WHOLESALERS AND RETAILERS CONSULTATION

Response from South West Water

We are pleased to have the opportunity to respond to Ofwat's formal consultation on payment terms between wholesalers and retailers.

We understand that this is a key element to consider in preparation for market opening and discussions on this matter are already taking place as part of the 'Open Water' project. The payment terms between the wholesaler and retailer can have a significant impact on the cash flows and working capital requirements of both businesses and it is essential that any standards set are not detrimental to both incumbents and potential new entrants.

We have considered each of the questions in the consultation and in addition have included an illustration of the areas which need to be considered.

Q1: Is our proposal to set standard terms, but to allow companies to agree to vary these terms appropriate? Q2: Are our proposals around publication of non-standard payment terms appropriate?

We support the proposal that there should be standard terms between wholesalers and retailers to establish a level playing field for new entrants in the open market and that this should be the default position.

Q3: Is a settlement period of one day appropriate?

Current billing for customers is based on a daily settlement period and therefore a settlement period which is consistent with this approach would seem appropriate.

Q4: Is it reasonable to apply the same payment terms to all products and services in the markets?

We have assumed that services supplied directly by the Wholesaler to the end user would not be subject to these standard payment terms and that separate arrangements would exist between the end user/customer as required.

For other products and services which are passed between the wholesaler and retailer (for example service level agreements) these would be consistent with the standard payment terms and bundled with the wholesale water and sewerage charges.

Q5 Are the details of the standard payment terms – billing period, payment period and collateral requirements - appropriate?

The PR14 methodology confirmed that *‘retailers should be required to pay wholesalers in arrears and there needs to be a consistent billing and settlement period across non-household market, which should be based on appointed companies’ current billing and settlement practices to **minimise any impacts on wholesale cash flow and credit risk**’.*

A monthly billing period as suggested would result in the wholesaler billing the retailer within a billing period to be settled at the end of the following month.

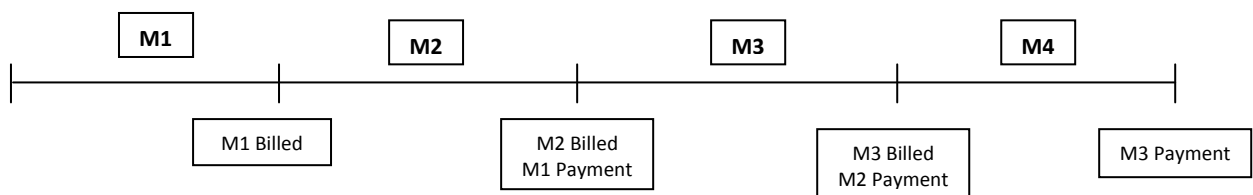
To test the proposed payment terms we have used South West Water’s billing data to ascertain the impact of proposals within a wholesale/retail situation.

From current billing records we have identified:

- 6% commercial customers are unmeasured and are billed for the full year in February, however many will have monthly payment plans
- 77% are quarterly billed
- 13% are 6 monthly billed and pay on a monthly Meter Budget Plan
- 5% are monthly billed.

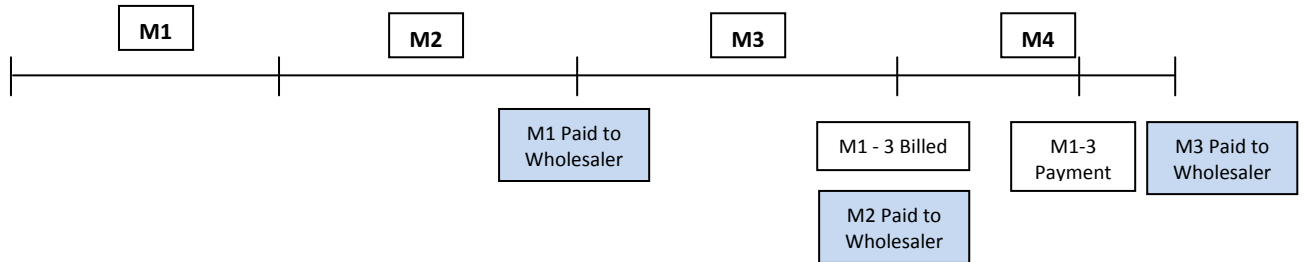
For a retailer’s customer who is billed quarterly, with a meter reading twice a year, there is potential that the wholesaler would have billed three months of usage to the retailer and been paid for two months before the invoice to the customer is raised.

Wholesaler Billing



The retailer however, would only bill the customer at the end of month three, with payment terms of on average 21 days.

Retailer Billing



Based on this example, by the end for month 4 the payment for months 1-3 would have been received by both the wholesaler and retailer. However, there is a difference in the profile between the cash flow of the retailer and the wholesaler.

For unmeasured customers and monthly billed customers (assuming 21 days payment terms) this would be the opposite position, where customer payments were received in advance of making payment the payment to the wholesaler.

The impact of this on a retailer’s cash flow would be dependent the number of customers within each billing cycle and the average payment days. In addition, this assumes that all customers pay invoices within 21 days, however in reality the timing and value of collections can vary.

Using South West Water’s integrated data we have considered the impact on the retailer cash flows and thus the potential impact for the wholesaler. Throughout the year both the working capital requirements of the wholesaler and retailer fluctuate depending on the timing of bills and payments. Through scenario testing this impact appears to minimised using 44 days payment terms.

Please do not hesitate to contact me if you have any queries regarding this response.

Yours sincerely

Louise Rowe
Corporate and Central Finance Manager