Clear Business Water Ltd response to "Covid-19 and the business retail market: Proposals to address liquidity challenges and increases in bad debt"

Dear Sirs,

Please see below Clear Business Water Ltd's response to each of the numbered questions for the above consultation.

1. Do you agree with these objectives as set out, which will guide our decisions about what are the preferred options?

In response to each of the numbered objectives:

1. We agree.

2. We agree, providing that there is equivalent support to retailers to offset the financial impact of not having the normal debt collection tools available and recognition that it will take time after credit control tools are enabled again for retailers to return to a normal credit control position.

3. We agree. However, we believe that retailers should only be required to pay wholesalers the proportion of customer invoices that directly relates to the wholesale charges. Retailers should be able to retain the proportion of charges that relate to the cost to serve allowance and allowable margins.

4. We agree but consider that Ofwat should be aware that the Government support may not be sufficient to allow retailers to pay wholesale charges. For example, the coronavirus business interruption loan scheme has only recently become available to businesses of our size and as yet we are not able to say if we will be able to secure funding through this scheme. As such, we do not know if we would be able to use the scheme to account for wholesale charges.

   Due to the removal of credit control tools and that retailers are expected to assist customers through this period, retailers need support in the forms of deferral. Retailers cannot fund the cost of interest unless this is allowed to be passed on to customers regardless of the source of funding.

5. We disagree. In normal market circumstances, retailers should be robust enough to withstand any changes in the business cycle. However, these are not normal circumstances and no business, retail or wholesale, should be expected to have accounted for the effects of a global pandemic in their business planning. Both retailers and wholesalers have been affected by these unprecedented times and we do not feel it is fair for wholesalers only to be shielded from the impact of coronavirus.

6. We do not agree that existing market arrangements should apply. The market arrangements are appropriate for dealing with normal and expected changes to the market. We are not dealing with normal or expected changes.

7. We agree that customers should not have to bear all of the additional risks of the expected increase in bad debt but it is not clear how retailers are expected to recover additional costs from non-household customers. Any additional risks should be shared

proportionately between non-household customers, retailers and wholesalers. Retailers should not be expected to cover anything above the bad debt provided for as an element within the cost to serve allowance.

2. **Excluding customers with temporary vacancy flags, what percentage of remaining wholesale charges are you currently able to recover from customers each month? Please explain why these customers, who are still open for business, are late paying (or not paying in full). Please also provide evidence to support your response.**

We are not currently in a position to be able to confirm or predict the percentage of wholesale charges we can collect from our customers. We operate on a monthly Direct Debit cycle which most recently collected at the end of March. As such, we will not have an accurate picture of our collections until after our next collection cycle at the end of April.

3. **Please explain how you expect your response to question 2 to change over the next month or two.**

We expect to be able to provide a clearer picture of our ability to recover payment from our customers in the next month or two.

4. **Which option for dealing with the remaining liquidity gap facing business retailers do you think would be in the best interests of customers, the market and best reflects the objectives we are trying to achieve? Please explain your view and provide supporting evidence.**

We believe that option ii 'pay when paid' best reflects the objectives. Retailers that can pay only the proportion of charges that they have been paid are better able to pass on the benefits of this flexibility to their customers.

5. **How should we determine the financing costs associated with any liquidity provided by wholesalers? Please explain your view and provide supporting evidence.**

We do not believe that retailers should be responsible for the financing costs of any liquidity provided by wholesalers. Any costs should be borne proportionately across the entire market and not just by retailers. We believe there are more appropriate ways to recover the financing costs such as additional allowances in pricing determinations. In any case the suggestions made by Ofwat, such as interest charges on deferred payments, would only increase the already significant financial pressure on retailers as the extra costs would likely exceed the margin that will already be reduced by the additional burden of bad debt.

6. **Do you agree that the financing costs associated with any liquidity provided by wholesalers should be borne by retailers? Please explain your view and provide supporting evidence.**

No, for the reasons set out in our answer to question 5. In addition, retailers are not being made to bear interest costs of deferring other payments such as VAT, nor are key suppliers in other sectors in which we operate seeking to levy interest as part of commercial discussions to extend payment terms, so we do not see the justification for doing so here. Furthermore, retailers in the English water market are specifically prohibited from charging interest or levying other penalties on late customer payments, so this inconsistent treatment of retailers would add a further burden to licensees which they are prevented from recovering.

7. **Do you agree that retailers should receive liquidity support at least to the end of July 2020? And that all additional liquidity provided by wholesalers should be repaid by the end of December 2020?**

It is not clear why July 2020 has been proposed as an end date for receiving liquidity support when the state of the economy more generally and the timing of easing COVID-19 restrictions remains unknown. Many businesses will require a period of trading after reopening before they will have the finances to pay any debts that they have accrued, which will have a knock-on effect on retailers' need for additional liquidity. Continuing social distancing requirements may prevent some businesses from resuming trade at pre-lockdown levels. As it is not yet known when businesses will be able to start trading we cannot comment on whether July 2020 is a reasonable date. The same applies to the repayment date of December 2020 as this links to the end date for receiving additional liquidity. We believe that the water market should not act in isolation from the rest of the economy or other regulators. We appreciate that the market wants certainty, but we should take the lead of the government and economists, who have not yet offered any timelines for the recovery of the economy.

8. **Should retailers incur all bad debt costs from non-household customers defaulting or should some of these costs be recoverable beyond a pre-determined threshold? Please explain your response and provide supporting evidence.**

Prior to market opening it was agreed that the bad debt costs retailers would be liable for would only amount to those accounted for in the cost to serve allowance. Retailers were assured that this allowance would be robust enough and as such we believe that the record of bad debt used before market opening should be the limit of retailers' liability. Ofwat should retain supporting evidence from the cost to serve allowance to demonstrate the amount of this liability. Any costs above and beyond this should be shared proportionately across all participants in the market.

9. **If bad debt costs from non-household customers defaulting should be recoverable beyond a pre-determined threshold, then do you agree that retailers should expect to manage all bad debt costs up to 2% of their turnover, or the level of bad debt from their most recently audited level +1%, whichever is the greater?**

We agree that there should be a sensible limit beyond a pre-determined threshold. However, we cannot comment on the specific levels of the limits until we have more information on the recovery of the economy and the recovery of non-household customers.

10. **Where bad debt costs from non-household customers defaulting exceed a predetermined threshold, should these costs be shared between retailers and non-household customers, and in what proportion, or should they be born wholly by customers? What relevant precedents are there (including in other sectors)? Please explain your response and provide supporting evidence.**

We believe that the bad debt costs should be shared proportionately between non-household customers, retailers and wholesalers. It is not clear why wholesalers should be exempt from bearing some of the costs of the coronavirus pandemic when they are active participants in, and beneficiaries of, the market. In any case, were the costs to be shared between retailers and non-household customers, it is not clear how these costs would be recouped from non-household customers. Until this is clarified, we are unable to comment on this proposal. We would note though that in the water industry in Scotland, wholesale pre-payment charges for licensed providers have been suspended for 2 months meaning licensed providers can be more flexible with their own customers if they are experiencing difficulties in making payment.

11. **Do you agree there is a case for protecting wholesalers from the bad debt exposure associated with the liquidity measures? To what extent do you think the wholesale price control mechanism provide sufficient protection to wholesalers for Covid-19 related bad debt? Do you think we should amend the totex sharing factors or introduce a cap for example, a proportion of wholesaler business market turnover?**

We agree that wholesalers should receive protection from their exposure to bad debt. This protection should be equivalent to any protections that are given to retailers. The existing market arrangements were not designed to account for the exposure caused by coronavirus and should not be used to do so. Any measures should be specific to the expected exposure from coronavirus and, given that the exposure has not been caused by the inefficiencies of retailers or wholesalers, should protect all parts of the market equally.