NWL response to Covid-19 and the business retail market: Proposals to address liquidity challenges and increases in bad debt – a consultation

Summary

NWL are supportive of the generic wholesaler response co-ordinated and submitted via Water UK. We have engaged in the formulation of that response and support the approach adopted.

We reiterate the stance that throughout this period when the non-household retail market has faced, and continues to face, significant challenges due to impacts of COVID-19, wholesalers have endeavoured to take a holistic approach to solutions for the market as a whole – guided by what is in the best interests of customers, both in the short-term in these exceptional circumstances, and in the longer term. NWL and the broader wholesaler community have engaged constructively with Ofwat and other stakeholders on this basis and will continue to do so. Whilst we no longer have the primary customer relationship with NHH Customers we are still proud to support and serve these customers who receive our essential services.

In the remainder of this document, we provide responses to the specific questions in the consultation only where we would like to add some specific emphasis on a particular point. We have no significant differences in opinion or approach but would like strengthen one or two points where we have a strong corporate view or feel we are impacted in a notably different way.

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

No additional comments to the Water UK response.

Consultation question 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.

Consultation question 3: Please explain how you expect your response to question 2 to change over the next month or two. [NB these questions are aimed at retailers but we would welcome views and evidence from other stakeholders].

In addition to the Water UK response we would like to add in the following general comments on the use of the temporary vacancy flag and highlight the slightly disproportionate way in which it can impact NHH Customers and wholesalers.

This element of our response doesn't align as a specific response to any one of the clarification questions but does impact a number of them in that it impacts the potential for NHH bad debt, the liquidity gap and wholesaler exposure.

The temporary use of the vacancy flag within CMOS and the waiving of charges associated with this period is undoubtedly welcomed by NHH Customers and retailers alike. It produces a number of immediate benefits but also inadvertently highlights a degree of imbalance in both NHH Customer benefit and wholesaler impact. Across the market there exists a range of charging policies and structures that means NHH Customers, retailers and wholesalers will be impacted differently by the use of the vacancy flag. This situation existed before the covid-19 event but has been markedly increased by the allowable use of the vacancy flag. It is important that the implications of this change are fully understood and that appropriate adjustments are made to the RFI (formerly WRFIM) mechanism to allow for any materially adverse impact resulting from this change. To provide a scale of this impact we have seen over 29,000 premises (out of a total premise count of 118,000) made vacant since the introduction of CPW091. Therefore we would re-iterate the request in this regard under the Water UK response to question 11, "*Given the unprecedented nature of these circumstances, it would be inappropriate to apply any revenue forecasting penalty under the Wholesale Revenue Forecasting Incentive Mechanism/Revenue Forecasting Incentive (WRFIM/RFI).*"

As a Company that has followed best practice guidance and moved to an area based approach for Surface Water Drainage and Highway Drainage charges we are more significantly impacted by the waiving of the non-volumetric charges whilst the vacancy flag is used. We anticipate managing this impact via the RFI mechanism but are concerned by the potential materiality of the impact.

Arguably though the greatest concern on imbalance is the potential difference experienced at individual customer level. We foresee many issues with differences in the application of the vacancy flag, with both wholesaler policies and retailer interpretation. We have already observed significant differences in approach within the market. We remain concerned over customer understanding of the use of the vacancy flag and its implication for their charges. There is insufficient clarity over the treatment of consumption during these vacancy periods and we are concerned that this will lead to significant customer confusion and or complaints on the resumption of charging. We appreciate that these are primarily matters for retailers to address but given the scale of the use of the vacancy flag observed to date we are concerned that unless resolved the unwinding of the vacancy flag use could present the market with a significant risk in this area; such that it could impact the effective unwinding and return to normal operation of the market.

Our final point on the use of the vacancy flag is that it currently has no affordability component to its application. Whilst the current approach is simple and expedient to apply it does potentially result in some NHH Customers that could and would pay, now not being required to do so. So whilst the current broad based approach affords a significant spread of support it perhaps lacks optimisation of support to those most in need. The cost of providing this support will in effect be borne by the broader NHH Customer base under the RFI so we feel that there should be an obligation to try and more effectively target this support.

Therefore as part of these next actions in the market we would like to see the application of the vacancy flag and the associated guidance reviewed and any and all appropriate adjustments made.

Consultation question 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.

No additional comments to the Water UK response.

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

Consultation question 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.

In addition to the comments in the Water UK response we would highlight a clear desire to not be seen to be making a profit or margin on the provision of this liquidity support. This presents an obvious dilemma, in that the provision of this support on an actual cost only basis is likely to act contrary to the aspiration for wholesaler provided liquidity support to be seen as the "liquidity of last resort". On a simple financial basis it could potentially be a more attractive option for a retailer. To prevent this we support the principle that a rate above the cost of provision must be applied but we are not wedded to any particular rate; just one that covers the cost of provision whilst still acting as an incentive to retailers to seek and obtain alternate liquidity. We support the use of the WACC in this regard but remain open minded to alternate options that maintain the same retailer incentives.

Consultation question 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?

No additional comments to the Water UK response which recognises that this timeline is a balance between a desire to return to a business as usual position as soon as possible, whilst recognising there remains uncertainty over the start and duration of the recovery phase.

Consultation question 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.

Consultation question 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?

Consultation question 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.

In addition to the Water UK response we would like to affirm our support for the use of the REC to recover bad debt costs from NHH Customers.

In a competitive market, temporary cost shocks are often recovered after the event by suppliers adding a cost recovery premium to future sales. For example, an event that caused losses in the insurance market will typically be followed by increases in premiums across the whole customer class, as insurers recover their losses and rebuild their balance sheets.

We would expect the same to apply in the NHH retail market. Once the cost shock is complete, retailers would expect to rebuild their resilience through increased retail charges. As such, we believe Ofwat should consider extending the retail price controls (REC). We appreciate that a threshold approach may have the same effect, but we note that this could create a perverse incentive for a retailer not to chase bad debt once the threshold has been reached. It may be better to increase the REC controls by an average industry amount, creating an incentive for retailers to chase bad debt whether or not they are above or below this level.

Consultation question 11: Do you 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?

No additional comments to the Water UK response.

Northumbrian Water Limited
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