SES BUSINESS WATER

BUSINESS RETAIL LIQUIDITY AND BAD DEBT CONSULTATION RESPONSE

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

We would make the following comments relating to the objectives:

- Objective 2; We understand the desire to support customers in the difficult circumstances they find themselves in. However, this regulated change to industry dynamics must be managed holistically and the corresponding impact upon retailers recognised and financially supported. For example, it is clearly inappropriate for customers to benefit from not being exposed to interest charges whilst retailers are required to pay interest to wholesalers.
- Objective 3; Clarity is required that the obligation to pass on payments received from customers to wholesalers applies to the wholesale element of payments received only and not retail gross margin aspects.
- Objective 4; Like many otherwise solvent companies across the UK it is highly unlikely that retailers will be able to access alternative liquidity support given their credit status and bank requirements. This of course would change should the government position change and loans be 100% backed by them.
- Objectives 5 and 6; The current circumstances are far from a normal business cycle. If it were then the market would not be undertaking this consultation, so by definition the objective does not stand any reasonable test of 'normality'. Consequently, we do not believe that addressing market issues through a 'historic lens' is appropriate. Like much of the rest of the economy, this is about market survival and needs to be managed based upon capacity and capability of participants rather than historic roles. If this were part of a normal economic cycle we are unlikely to have seen such extraordinary government intervention.
- Objective 7; Retailers in this market are constrained from managing the impact of the changing risk profile of the industry by the very nature of imposed price controls. In a non-price capped market the increasing risk profile would be priced through to customers in the near term as the risk emerged. The nature of price controls imposed prevents what would be normal commercial practice in other markets and as such retailers are disadvantaged and should not incur financial exposure as a result.

  Furthermore, the regulatory intervention that has prevented retailers from utilising late payment interest and disconnection have inevitably made the potential bad debt situation worse both in terms of collecting pre-COVID debt and that arising over the last couple of months.

- As stated customers in other markets would ultimately bear the risk. We contend that water should be no different. In terms of being managed over time, thought needs to be given to how the liquidity required is provided and the interest cost thereof recovered by retailers.

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.

- We billed xxxx in Feb 20 and xxxx in Mar 20 to our non-flagged customers. Of the Feb 20 billings as at end of Mar 20, xx% of this was still outstanding. Of the Mar 20 billings, xx% is still outstanding.

  There is an element of fear concerning when the economic situation will get better and how it will affect their cashflow and many businesses are clearly choosing to preserve their cash. This we believe is exacerbated by customer's knowledge that we are restricted in our ability to take recovery action, which means we can often be towards the bottom of the list of suppliers to pay.

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

- This is impossible to predict at this stage. What is clear is that the longer the current circumstances prevail the greater the bad debt will become.

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.

- The best method overall for the market and customers is method 2 'pay when paid'. This is the ONLY WAY to align the actions already taken such as no interest charges for customer non-payment and no disconnection risk with the impact of such regulatory intervention upon retailers.
- It is not in anyone's interest for retailers to exit the market in an uncontrolled manner and method 2 is clearly the most likely to avoid such circumstances. Such exit by several retailers would disrupt services to customers and expose any with credit balances to losses themselves. It would reduce customer choice and undermine confidence in the market potentially leading to a significant reduction in customer engagement in the market. Whilst this would inevitably affect wholesaler cashflow they are the parties with the stronger asset backed credit worthiness best able to access liquidity options, whether they be government backed schemes or direct from financial markets.
- Notwithstanding our stated view and in recognition of the 70% proposal outlined within the consultation document, we would request clarity over how the 70% proposal is to align with the current temporary 50% measures put in place in terms of cashflow. Without further clarity it is impossible to accurately assess the liquidity implications on our business.

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.

- Should it be decided that financing costs are to be recovered by wholesalers then it should be based on the cost of short term debt as that is likely to be where they source their liquidity.

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.

- Whilst accepting that there is a real cost to wholesalers associated with providing liquidity, it is clearly inequitable that wholesalers are able to impose financing costs upon retailers but retailers are prevented from recovery of financing costs from customers who caused the liquidity issue in the first place.
- Retailers are being expected to provide liquidity to customers with no credit support from said customers or obvious mechanism to recover such sums. We appear to be in a grey world where we have the obligations of an appointed business but few of the protections.
- We would propose that financing costs incurred by wholesalers be recovered through an adjustment to wholesale costs in the following financial year.

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?

- The impact of COVID-19 is unprecedented in modern times. The impact is not going to disappear over a few months with the economic world back to where it was before the outbreak, as would appear to be assumed within the consultation paper.
- The world is facing a COVID induced recession possibly greater than the great depression of the 1930's. The drivers of the liquidity position we have now are likely to continue well into the future and certainly significantly past the point of lockdown measures being eased. Therefore additional market liquidity will be required beyond the removal of the lockdown period.
- Business customers that survive the immediate circumstances are going to be cash constrained and the likelihood of retailers being able to recover sufficient funds to pay wholesalers for the liquidity provided within such a short period as proposed is highly unlikely in our view. A significantly longer period of circa 18 months is probably required.

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.

- Retailers should certainly not incur all bad debt costs. Retailers operate in a commercially constrained environment due to the regulated price caps imposed that they must operate within. Within which the allowances for bad debt have not accounted for the scale and impact of the current circumstances.
- In a non-price capped 'commercially open' market retailers would be free to price risk and to amend risk provision within their prices as the risk profile of the industry changed. Customers would therefore be exposed to the financial impact of changing industry risk profiles and ultimately bear the risk. Water retailers are prevented by regulatory imposed rules from this normal commercial practice. The consequence of this regulatory imposed constraint is that it should not be retailers who incur bad debt costs above the provisions allowed for but customers. Effectively, business retailers are providing customers liquidity as a group, and once the economy returns to the normal, those customers, as a group, should return the costs of doing that to retailers.
- We would also like to make one additional point in relation to retailers recovery of bad debt. The consultation document refers to an 'option' to re-open the REC in order to recover costs

from customers. However, this applies to default paying customers only. If the principle of recovery is agreed then we would suggest the best methodology would be to adjust wholesale costs so that all customers are treated equitably.

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?

- We do not agree with this approach. Retailer bad debt should be capped at historic levels. It cannot be equitable for the regulator to intervene in the market and by its actions (remove the right to charge interest or disconnect customers for non-payment) significantly distort the normal operational working practices of the industry, dramatically increasing the risk of bad debt arising, and then expect retailers to accept an arbitrary additional level of bad debt.

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.

- Bad debt under these circumstances should be borne by customers. The precedent here is one of normal economic commercial behaviour you would expect from a prudently managed company. As stated elsewhere in our response, in a non-price capped market environment risk would be priced through to customers as the risk profile of the industry changed. Retailers have been prevented from this behaviour by regulatory control of market dynamics. The quid-pro-quo of retailers effectively providing liquidity to customers should surely be that bad debts and working capital costs are returned to retailers.

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 this is an industry problem not just a retailer problem. Wholesalers already enjoy considerably greater protection given the balance of risk in the market is significantly in their favour.