



Covid-19 and the business
retail market:
Proposals to address liquidity
challenges and increases in bad
debt.

Consultation response



Exec summary

Please find enclosed a short submission from Thames Water Utilities Ltd in response to this consultation.

We recognise the significant work and time that Ofwat have invested in both this consultation and the recent code changes and we wish to continue to support Ofwat and the market in the interests of our Retailers and the non-household users of our services.

Our submission in response to this consultation is short, on the basis that we fully support the response made by Water UK and have added only a few key practical and detailed clarifications that we believe Ofwat may find helpful.

We appreciate that there are many issues for Ofwat to consider. We believe that early agreement on the treatment of exceptional bad debt, that could arise from a retailer exiting the market while owing deferred charges, would be helpful. This will serve to reduce the sensitivity and urgency of other changes that may be necessary to protect customers and the market in the coming weeks and months.

Answers to questions

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

1.1 We support the Water UK response and consider that the objectives are appropriate.

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

1.2 We support the Water UK response.

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

1.3 We support the Water UK response.

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.

1.4 We support the Water UK response.

1.5 We also wish to further emphasise our support for Ofwat's ongoing efforts to monitor the cash flow and financial health of Retailers, including the possibility of Retailer insolvency, while the full extent and duration of the economic impact of COVID 19 remains unknown.

1.6 Retailers choosing the option to defer any proportion of their charges, should be subject to more detailed financial reporting requirements.

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.

1.7 We support the Water UK response.

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.

1.8 We support the Water UK response.

However, we note that use of the standard Wholesale WACC in nominal terms may not, in isolation, act as a sufficient incentive to encourage Retailers to seek other forms of funding. As you are aware, and within the rules set out in the market codes, some Retailers already choose to pay wholesale charges late on a monthly basis and are accepting of the commercial cost of this.

1.9 Whatever rate is determined by Ofwat to apply, it should be complemented with a range of other measures to ensure wholesale liquidity support is only used as a last resort.

We note for practical implementation purposes that the Business Terms (para 9.9.2) sets out the current rate to be applied to late payments. We suggest Ofwat update this rate as part of the code changes.

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?

1.10 We support the Water UK response.

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.

1.11 We support the Water UK response.



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?

1.12 We support the Water UK response. For the purposes of clarity this means we support Option 3 for the following reasons:

- This approach is consistent with the principles of good regulation, provided that the level of the cap is set at the level of wholesale exposure based on the rules that existed **before the 27 March code change.**^[2]

1.13 This option is therefore preferred. We do not believe the current price control mechanisms provide a mechanism for this to be enabled and we are happy to continue to work with Ofwat to develop the new mechanisms needed to implement this option.

1.14 We have concerns regarding Option 1 and Option 2 including the implications of these options on investor confidence, creditworthiness of the sector and alignment with Ofwat's objectives (to ensure that additional liquidity provided to the business retail market does not come at the expense of the financial viability of the wholesalers) and primary duties defined in the Water Industry Act.

^[2] Note that the capped level of exposure may change each month, based on the market rules for calculating collateral and settlement that existed before the 27 March code change. The incremental and exceptional risk we are seeking to be made whole for are only outstanding deferred payments.

