Georgina Mills
Director, Business Retail Market
Ofwat
21 Bloomsbury Street,
London WC1B 3HF

16th July 2020

Dear Georgina,

COVID19 and the Business Retail Market: Consultation on Next Steps

Thank you for the opportunity to respond to the proposals set out in the above consultation paper. Business Stream's responses to each of the questions posed in the paper are set out in the schedule attached.

I would be happy to provide more information or discuss anything contained in our response, so please don't hesitate to contact me if I can be of further assistance.

Yours sincerely

[redacted]

Jim McDowall
Finance Director

COVID19 and the Business Retail Market: Consultation on Next Steps

Responses to Consultation Questions – Business Stream

Introduction

As we emerge from this unprecedented period of lockdown, we want to do what is right for our customers. For many of them, times remain very uncertain: not knowing how their own customers will react to the lifting of restrictions and whether, how quickly, or how far consumer patterns will resume. Retailers are in a similar position. At this stage we do not know how many of our customers will reopen and to what extent. We know some big High Street brands have already gone into administration ([redacted]) and others are making significant cost cuts (e.g. [redacted]). We are being warned that it may not be viable for the smallest businesses to reopen under current health and safety restrictions and we continue to see new local restrictions being put in place. At this stage we have no idea what the economic impact will be once the employee furlough scheme comes to an end.

Given this level of uncertainty, we believe that it is too early to withdraw key customer support measures. Over the last months the industry has successfully developed a water market 'tool kit' that has allowed us to target relief at customers who need it most, and which shares the responsibility for doing so between Wholesalers and Retailers. It is clear that there are customers who continue to need such relief, and numbers may increase again as circumstances change (local lockdown, a second wave of the virus etc.). However, the withdrawal of the temporary vacancy flag and the liquidity support mechanisms would effectively remove all support by Wholesalers for the NHH market, leaving Retailers as the only source of customer support, through the provision of payment deferral and repayment schemes. This is not a sustainable position. As the customers in the vacancy mechanism reopen and move back into the market, Retailers could be faced with 240k customers seeking (or simply taking) payment deferral, at the same time as wholesale charges step up, wholesale charge deferral ceases and deferred wholesale charges require to be repaid. As Ofwat is aware from monthly returns, Retailers are already experiencing financial difficulties as a result of COVID19 and this combination runs the risk of causing Retailer default.

We also believe that as an industry we need to maintain our options to give us the greatest flexibility to respond effectively to whatever may come next. There has been a discussion this week about the potential for a second wave of the virus in the autumn/winter, for which we need to be prepared. We do not believe we are yet in a position to deal with the next phase of the crisis as 'business as usual' (BAU).

Responses to the individual consultation questions are set out below, but are subject to the concerns expressed above.

Liquidity Support

Consultation question 1: Of the three options identified in relation to extending liquidity support, which option do you support and why? Please explain your answer and provide supporting evidence wherever appropriate. Which option is most compatible with furthering customers interests and why?

Our general view is that at this stage of the COVID19 pandemic, there remains considerable uncertainty about the impact it will have on our customers and we should retain as much flexibility as possible so that the industry is able to respond to circumstances as they develop.

Of the liquidity options outlined in the paper, based on Ofwat's assessment it appears that Option 3, an extension of the maximum wholesale charge deferral, is not currently needed. Our concern would be that if there is a significant change in circumstances (a Retailer default or a second wave of the virus for example) it may yet be required.

In the meantime, we agree that Option 2 provides Retailers with some flexibility to support customers as they come out of lockdown, and would leave Wholesalers no worse off than under Option 1. Even as businesses reopen, we are experiencing considerable demand for repayment plans and expect that customers who are unable to open, and those subject to local/regional restrictions, will continue to need greater support. Extending the period over which wholesale liquidity support is available would give Retailers more time to assess and respond to the next phase.

Consultation question 2: If we were to implement option 2, should we retain the existing capped amount of liquidity support (i.e. 40% of primary charges from March to July), or should this be reduced to a lower level (e.g. 30%, or 25%)? Please explain your answer and provide supporting evidence wherever appropriate.

There does not seem to be any compelling case to reduce the cap below 40%. Whilst the maximum proportion utilised to date is around 30%, as we have said above, there remains considerable uncertainty about what will happen over the coming months. It seems almost inevitable that Retailers will face an increased working capital requirement as customers move off the temporary vacancy mechanism (driving an immediate increase in wholesale charges) into COVID19 Repayment Schemes (delaying the collection of the corresponding customer payments).

Retaining the cap at 40% gives Retailers a little more headroom whilst under the current interest payment arrangements, Retailers will be incentivised to minimise any draw.

Consultation question 3: If we were to implement option 2, should we continue to allow Retailers to opt into the scheme at any time up until October 2020? We also welcome stakeholder views on the most appropriate way a cap could be implemented into the current mechanism. Please explain your answer and provide supporting evidence wherever appropriate.

Clearly a number of Retailers have not yet opted into the deferral scheme, whether this is because their customer base continues to trade and make payment, or because they have secured funding from alternative sources. However, as we have said above, considerable uncertainty remains over how business customers will fare over the coming months, so it would seem sensible to retain the flexibility for Retailers to opt into the scheme if required.

The simplest approach to implement the cap would be to continue using the same methodology as now to assess the maximum deferral available, but its availability would be subject to the accrued headroom. In the interests of allowing Retailers greatest flexibility, we suggest avoiding any mechanism which dictates how and when Retailers use their remaining headroom.

Unwinding Liquidity Support

A combined response to Qs 4 and 5 on the repayment of deferred wholesale charges is outlined below.

Consultation question 4: Of the three options identified in relation to unwinding liquidity support, which option do you support and why? Please explain your answer and provide supporting evidence wherever appropriate. Which option is most compatible with furthering customers' interests and why?

Consultation question 5: Under option 3 do you agree that 33% of deferred wholesale charges should be repaid by end November 2020 and that 66% should be repaid by end January 2021? Please explain your answer and provide supporting evidence wherever appropriate.

Ideally the timescales for the repayment of wholesale charges would be aligned with the recovery of deferred customer payments. In this way, Retailers and Wholesalers would share the responsibility of providing business customers with support.

At this stage we do not yet have a definitive picture of the full extent of payment deferral that will be required by businesses affected by COVID19, but as an indication, [redacted] We will have [redacted] customers moving off the temporary vacancy flag, many of whom will inevitably opt into the repayment scheme, and an obligation under the CPCoP to continue to offer customers deferral plans until the end of March. It is safe to assume that Retailers will be recovering deferred customer payments well beyond the end of March 2021. Consequently, a hard deadline of March 2021 for the repayment of deferred wholesale charges means that Retailers will be left with the full cost of providing COVID19 support to business customers beyond this date. Whilst we believe it is right to support affected customers, it is highly inequitable if Wholesalers do not share this responsibility. In a competitive market, it is unlikely that upstream suppliers would avoid the impact of economic difficulties experienced by their customers.

In terms of the way in which the wholesale payment deferrals are unwound, we would hope that Retailers and Wholesalers are able to agree repayment schedules that reflect their specific circumstances, so the option to agree bilateral arrangements would provide greatest flexibility. However, we agree that a backstop position would be sensible to protect both parties and we would be content with the backstop proportions proposed, adjusted for any agreed Alternative Payment Arrangements.

Temporary Vacancy Flag

Consultation question 6: Do you agree that the option for Retailers to use the temporary vacancy flag should be allowed to expire on 31 July 2020? Please explain your answer and provide supporting evidence wherever appropriate.

The temporary vacancy flag has been a very effective mechanism for giving customers the relief from water and waste fixed charges that they needed during enforced closure. The feedback from our customers has been very positive and they have welcomed the support of the water industry in a way that has not been forthcoming from other utilities. We recognise that it has not been perfect, but it would never have been possible to apply a mechanism in this way with 100% accuracy.

Whilst many businesses are re-opening as restrictions are lifted, we know there are significant numbers of customers who still cannot operate viably under current health and safety requirements (e.g. small retail units, small restaurants). These businesses remain severely affected by COVID19 but, if the temporary vacancy flag scheme expired at the end of July, these customers would have to start paying fixed charges, despite no change in their trading status. The same would be true in local or regional lockdowns, or under a second wave of the pandemic.

We are concerned that it is too early to withdraw this relief from those customers whose businesses remain closed. If customers remain unable to pay, it will simply drive up customer bad debt.

Consultation question 7: Do you agree that in the event of (1): reduced consumption, and/or (2) any local lockdowns, Retailers should seek to obtain meter reads to reflect actual consumption in the market (or in the event a meter read cannot be obtained engage with customers to obtain an accurate estimate of consumption (YVE))? Please explain your answer and provide supporting evidence wherever appropriate. If you do not agree, please set out an alternative proposal.

Obtaining meter reads and improving the accuracy of consumption data is of course the right thing to do wherever practical, and we are working closely with our meter reading providers, and where possible our customers, to do so. However, our experience, and that of our meter readers, is that where premises remain closed it is very difficult to gain access to obtain reads, and we have a much lower success rate engaging with customers whose businesses are not trading. From a practical perspective, it will remain difficult to obtain new consumption data for those customers who are most affected and continue to need support (local lockdown or unable/not viable to reopen).

For these customers, we believe that the continued use of the temporary vacancy flag would continue to offer greatest support i.e. relief from fixed charges, until we are confident it is no longer needed. There is little risk that Retailers will leave customers marked as temporarily vacant if they are in fact operating: Retailers have every commercial incentive to remove the flag if the customer is trading so as to allow the recovery of revenue.

Maintaining the temporary vacancy mechanism also gives us flexibility to deal with a second wave of the virus, which has been discussed this week as a real possibility, especially during the autumn and winter months.

Consultation question 8: Do you agree that following the expiration of the temporary vacancy flag Retailers will have until the end of September to remove these flags from CMOS? Please explain your answer and provide supporting evidence wherever appropriate.

As explained above, we believe it would be sensible to continue the use of the temporary vacancy flag for the meantime. However, as businesses start to reopen, there are many thousands of customers whose status needs to be updated, consumption data obtained etc., as we transition back towards 'business as usual' (BAU). We agree that there is merit in providing Retailers a reasonable period to administer this transition.

However, it is important to recognise that we will not achieve BAU in two months. Almost 240k premises have been closed during lockdown. Whilst it was relatively straightforward to identify categories of businesses that had been forced to close, as we come out of lockdown there will be many more permutations in customer circumstances. It will take many months to accurately establish each customer's circumstances and ensure that they have been, and are now being, charged correctly. For example, [redacted] so our access to data remains constrained. We are taking customer reads where possible, [redacted] Challenges from Wholesalers and customers about their status and consumption also slows the process.

In practice, in order to meet a two-month deadline, it is likely we will have to make some bulk systems changes. Consequently, it will be important that we are able correct customers' temporary vacancy status retrospectively up until the final settlement run (RF).

Consultation question 9: Do you agree that a new MPS should be introduced from 1 October that focusses on the timely removal of all temporary vacancy flags? If so, what are your views about how this standard should be designed? Please explain your answer and provide supporting evidence wherever appropriate.

If a customer has commenced trading, Retailers are already incentivised to remove the temporary vacancy flag in order to collect revenues. We do not believe there will be any need for a penalty threat when the commercial incentive is so strong.

As above, we believe there will be groups of customers for whom the continued use of the temporary vacancy flag would provide ongoing support, in which case, a new MPS on temporary vacancy would be inappropriate.

Data Accuracy and Yearly Volume Estimates (YVEs)

Consultation question 10: Do you agree that an additional MPS (or alternatively an API) should be introduced to monitor the use of YVEs in the market and incentivise the submission of more accurate consumption data? Please explain your answer and provide supporting evidence wherever appropriate

We agree that it should be a priority to obtain accurate consumption data wherever possible and we are working with our customers and meter reading partners to obtain reads. However, we are highly dependent for reads on third parties and, as indicated above, they are still facing some practical constraints:

- as indicated above, where premises are closed and businesses not yet trading, (where consumption is likely to be zero or minimal), it is not yet possible to obtain meter reads and more difficult to engage with customers;
- meter read providers are not yet back to full capacity. We are trying to get back to normal read cycles and schedules, [redacted] Meter readers are still unable to get access to islands (e.g. the Ise of Wight) and none of them are doing two-man lifts; and
- the availability of data is different in each region, depending on the provider and the metering stock. In Yorkshire region for example, where there is widespread penetration of automated meters, [redacted] The average success rate across the rest of our English estate is [redacted] This will also be affected by local and regional lockdowns, as well as the ongoing good health of the meter readers.

Consequently, we do not believe that an additional incentive is appropriate at this stage. In addition to these practical constraints, Retailers already have an incentive to bill customers accurately. It is not in our commercial interests to under-estimate customers' consumption or to collect less revenue than we are due, especially at the moment. We would also be concerned about the potential for additional charges when Retailers are already in financial difficulties as a result of COVID19.

Consultation question 11: If we were to introduce a financial incentive on YVEs, how could arbitrarily low YVEs entered into CMOS be identified in a proportionate way (for example via one or more simple rules)? If we were to introduce a reputational incentive on the use of YVEs, how could such a reputational incentive be strengthened?

As indicated above, we do not believe that a YVE incentive is required, but it would also be very difficult to define. It is not clear how any 'simple rule' could distinguish between genuinely low and 'arbitrarily' low YVEs. We conducted an extensive piece of work on YVEs 18 months ago, and we know that many customers genuinely have low YVEs. The numbers of customers with low consumption is likely to have increased as a result of COVID19, especially where businesses remain closed. Consequently, to suggest that Retailers be penalised for 'arbitrarily low' YVEs could also undermine our ability to support customers who remain in need.

If there is concern about any particular Retailer or Self-Supplier misusing the YVE data field or 'normal' vacancy flag (or indeed any other) this should be tackled directly, not by placing a constraint on all Retailers and potentially penalising their customers.

Consultation question 12: What are your views on how we can better (financially or reputationally) incentivise Wholesalers to work constructively with Retailers during the unwinding of the temporary vacancy flag and to improve the accuracy of data in CMOS?

Inevitably all Wholesalers' operations have been disrupted by the lockdown and so backlogs of issues have accumulated over the last four months. Our priority is that Wholesalers produce concrete plans to work through these backlogs, so that we can keep customers informed and monitor progress against the plans.

In some regions we are aware that Wholesalers may have access to additional meter reads, collected for their own purposes. It would also be useful if this data was made available to Retailers.

Although the window for doing so is now limited as businesses reopen, if Wholesaler field staff are able to obtain accurate information about the trading status of premises during lockdown, this may also be useful. However, experience to date has been very mixed and the quality of data provided often insufficient to validate the status of a property (e.g. pictures of lights on in an office building, cars in a carpark etc). It could be useful to develop an industry standard, which should have to include physical evidence rather than 'virtual' information (e.g. we have found that websites have often not been updated to reflect trading status). We would be happy to be involved in developing a standard template.

Consultation question 13: Do you agree with the expectations set out above, which will guide trading parties through the unwinding of the temporary vacancy flag?

The expectations that Retailers will maintain appropriate records and keep customers up to date and informed about the unwinding of the vacancy support mechanism are entirely reasonable.

We also fully support Ofwat's expectation that in marginal cases and in unforeseen circumstances where consumption has occurred despite a business premises being closed, that Retailers and Wholesalers will make decisions in favour of the affected customer. Our observation of behaviours in the market in recent weeks is that Wholesalers tend to argue in favour of removing the vacancy flag where there has been incidental consumption, so this clarification is particularly welcome.

Market Performance Framework

Consultation question 14: Should Market Performance charges come back into effect from end September 2020 or end October 2020? Please explain your answer and provide supporting evidence wherever appropriate.

Reintroducing charges before we reach a steady state would simply be to introduce an additional cost to Retailers at a time when we are already in financial difficulty as a result of COVID19. The question is then whether we are likely to be back to normal by the end of October.

At the moment it feels as though we still have a long way to go. As we have outlined in response to a number of the questions above, we do not yet have a clear picture about how many customers will remain closed (and hence unable to read meters) for example. None of our meter reading providers are operating at full capacity, and we are highly dependent on them to meet our performance standards. We fully anticipate that the situation will continue to improve, but timescales remain unclear. We also have dependencies on Wholesalers (e.g. to fix broken or faulty meters), but we haven't yet seen backlog rectification plans. There would also be a question about how local lockdowns would be accounted for.

Given that considerable uncertainties remain about how the recovery process will progress, and the level of dependencies on third parties, we could set end of October as a provisional start date but review progress at regular intervals between now and then.

How the MPS charges will be restarted is equally as important as when. It will be important that trading parties are not penalised for underperformance as a result of COVID19 and that charges are not effectively backdated.

Given the difficult financial circumstances of Retailers as a result of COVID19, we would also propose a 'soft landing', using a phased ramping up of the level of fines over the remainder of the financial year, and/or retaining the 2019/20 cap levels, rather than imposing the step-up originally planned for April 2020.

Consultation question 15: Should OPS charges be introduced before MPS charges? Please explain your answer and provide supporting evidence wherever appropriate.
&
Consultation question 16: Should non-meter reading MPF charges come into effect before meter reading MPF charges? Please explain your answer and provide supporting evidence wherever appropriate.

If it would help incentivise Wholesalers to prepare and adhere to plans to address the operational backlogs that have developed during lockdown, we would agree that OPS and non-meter reading MPF charges could be turned on ahead of meter reading MPS charges. In a proportion of cases, Retailers' MPS performance will have dependencies on Wholesalers' performance – for fixing faulty meters, identifying leaks, replacing assets etc. – although we do not have an estimate of the precise proportion at this stage

Consultation question 17: Note – responses to this question will be shared with MOSL. Of the 3 options identified in relation to credit security requirements, which option do you support and why? Please explain your answer and provide supporting evidence wherever appropriate. Which option is most compatible with furthering customers interests and why?

The requirement for credit support should be proportionate to the Wholesaler's exposure to the risk of Retailer default. It is unlikely that consumption levels will return to March 2020 levels for some time, so we agree that it would not be reasonable to expect Retailers to maintain credit support at pre-COVID19 levels (Option 3) indefinitely.

We recognise that it would be prudent to wait until we have established a new 'norm' before adjusting credit support requirements, so suggest we reassess in say September, when more information is available.

Consultation question 18: Do you agree that the CPCoP does not require amendment in light of the proposals set out in this document? Please explain your answer and provide supporting evidence wherever appropriate

We believe that continuing to provide support to customers affected by COVID19 is the right thing to do, and we will continue to offer those customers repayment plans. It is disappointing, as noted in our Introduction above, that the corresponding liquidity support from Wholesalers will not be aligned to customer payment deferrals.

On the other hand, it is also essential that Retailers are able to employ normal collection and recovery procedures where customers continue to trade and are able to pay their bills.

We understand that the current wording of the Code allows both, so we are content that no amendments are required at this stage.