July 2020

Covid-19 and the business retail market – consultation on next steps

Ofwat

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Foreword

Back in March, as the potential implications of Covid-19 were only starting to materialise, Ofwat worked with the market operator, MOSL, and other industry stakeholders to initiate a series of interventions aimed at protecting business customers.

It seemed possible that the measures taken to combat the virus – in particular the closure of businesses and social distancing measures – could lead to material reductions in consumption of water and waste water services, and business customers struggling to pay their bills on time, both of which could have negative implications for liquidity for Retailers. The situation was very fast developing, meaning Retailers didn't have the time they would normally have to consider their options in terms of securing further funding where that was needed, including from Government support schemes which were only just emerging. We were concerned that this could have led to systematic Retailer failure in the sector, which would not have been in the best interests of business customers.

Working closely with the industry, we implemented two urgent code changes in March aimed at addressing these issues. CPW091 (temporary change to vacancy) allowed Retailers to mark certain properties as temporarily vacant and aimed to ensure that in the absence of meter reads, charges more accurately reflect (reduced) levels of consumption. CPW093 (interim deferral of wholesale charges) allowed Retailers to temporarily defer payment of up to 50% of wholesale charges, reflecting the potential cash flow issues faced by Retailers as a result of business customers struggling to pay their bills on time. Parallel changes made to the Customer Protection Code of Practice (**'CPCoP'**) protected all business customers by prohibiting disconnection, interest charges and late payment fees in the event of late / non-payment of bills. And code changes CPM023 and CPW090 suspended market performance charges for both Wholesalers and Retailers.

Having provided business customers and the business retail market with some immediate and temporary relief, we continued to work closely with the sector to implement some medium-term measures. On 30 April, we published our decision that Retailers should receive a time limited period of liquidity support, which allowed them to defer up to 40% of wholesale charges due between March and July 2020. This decision provided Retailers with time to establish what other support – including Government support – they could gain access to and how quickly, which we were clear should be the principle vehicle for managing the financial pressures resulting from Covid-19. We also published decisions in relation to how bad debt arising from both (1) Retailers exiting the market, and (2) business customers permanently closing, should be treated. Following this, we made further changes to the CPCoP to target the strongest protections at those business customers who need them most and to require Retailers to offer Covid-19 Repayment Schemes to customers affected by Covid-19. These changes also enabled Retailers to pursue debts as normal for customers unaffected by Covid-19.

We are now starting to see a gradual easing of the restrictions imposed to combat Covid-19, with many businesses starting to reopen. For example, the Office for National Statistics (**'ONS'**) Business Impact of Coronavirus (COVID-19) Survey (**'BICS'**) most recent report shows that of the 5,926 UK businesses that responded (out of a sample size of 24,473), 86% of businesses reported continuing to trade as their current trading status, which compares to 72% in May. However, some businesses may be adapting to a 'new normal' given social distancing measures and we may also see local lockdowns emerge like the one in Leicester. This consultation document focuses on next steps in the business retail market against this wider context.

We have been clear that liquidity support provided to the market was temporary and was intended to give Retailers the opportunity to explore and put in place other forms of support, including Government support where relevant. In this consultation we explore and seek views on whether the existing liquidity support scheme should end in July 2020 or whether there should be a short extension (of time but not in relation to the amount of total liquidity provided). We also explore options for how this support should be unwound so that all deferred wholesale charges are repaid by end March 2021.

The temporary vacant flag was introduced as a measure to reflect that an unexpectedly large number of businesses were closed and could therefore experience significant reductions in consumption. In the absence of this measure charges based on historic use would have not been accurate. This measure is no longer appropriate given businesses are re-opening and this consultation explores and seeks views on how use of the temporary vacant flag should be unwound, reflecting that some business customers may continue not to consume at levels experienced prior to Covid-19. We also consider options in relation to reintroducing market performance charges and credit support requirements.

All of the policy interventions we have made have been with the intention of protecting business customers. In order to protect customers, we want to avoid systemic Retailer failure and ensure our interventions do not come at the expense of the financial viability of the wholesalers. To be clear, protecting customers does not equate to preventing individual Retailers from exiting the market, as supplier exit is a feature of any functioning market. Nor does it mean absolving business customers of their requirement to pay for services they have knowingly and legitimately consumed in the operation of their business. But it does mean providing business customers with appropriate and targeted relief, for example by providing customers with additional time to pay their bills and making sure they are not charged for services they have not consumed and are not liable for. We ask all stakeholders responding to this consultation to consider their submissions in light of how we can continue to protect business customers in response to effects of Covid-19.

We are grateful for the continued support and engagement of all stakeholders in the sector who have worked tirelessly to implement and adapt to changes, many of which have been made at pace.

Executive summary

The impacts of Covid-19 have been felt across the whole of the UK economy. Government and Regulators have been acting together to support businesses though this period, with Government providing substantial financial support to business, economy wide.

Working closely with the market operator, MOSL, we have taken a number of steps to further protect the interests of business customers in the water sector. We committed to review and consult on next steps early in the summer, which is the focus of this consultation. This document identifies and seeks views on a number of options and below we summarise the proposals we are currently minded to implement.

Liquidity support

In April we decided that Retailers should receive a time limited period of liquidity support, which allowed them to defer up to 40% of wholesale charges due between March and July 2020. This decision provided Retailers with time to establish what other support they could gain access to and how quickly, which we were clear should be the principle vehicle for managing the financial pressures resulting from Covid-19.

We are minded to implement one of the following options in relation to future liquidity support and will use this consultation to seek further evidence to inform our decision:

- There is no extension of liquidity support available after July 2020. From August, Retailers will no longer have the option to defer any wholesale charges; OR
- We cap the maximum amount of total wholesale charges that can be deferred at no higher (or alternatively less) than the amounts set out in our April decision (i.e. 40% (or alternatively 30%) of wholesale charges due between March and July 2020)). So long as they don't exceed this cap, Retailers can continue to defer up to 40% of wholesale charges due in August, September and October 2020. Under this second option we propose refined reporting requirements on Retailers who choose to opt into the scheme as this will be contingent on each Retailer demonstrating that they are actively exploring other forms of support (including Government support), recognising that the ability to defer wholesale charges will end in October 2020.

Deferred wholesale charges need to be repaid in full by end March 2021. Our preferred option for consultation is that Retailers and Wholesalers be given the opportunity to agree their own repayment profiles, which will need to be published. In the absence of trading parties reaching their own agreements, we propose that:

- 33% of the total deferred amount of wholesale charges must be repaid to Wholesalers by end November 2020; and
- 66% of the total deferred amount of wholesale charges must be repaid to Wholesalers by end January 2021.

Temporary vacancy flag

In March we introduced a code change (CPW091) that allowed Retailers to mark a premises as temporarily vacant (making it exempt from fixed and in some cases volumetric charges), if a premises was completely shut or activities at the premises had fallen by at least 95%. The intention of this code change was to ensure that customer bills more accurately reflect reduced levels of consumption where businesses were temporarily closed due to Covid-19, by providing Retailers with a workable proxy to identify reductions in consumption of 95% or more when there were significant challenges to obtaining accurate meter reads. We confirmed in June that Retailers could continue to use this temporary vacant flag until end July 2020.

Given the nationwide easing of restrictions, we propose to allow the option to apply the temporary vacancy flag to expire at the end of July 2020. Our preferred option for consultation is that all temporary vacancy flags must be removed from the Central Market Operating System (**‘CMOS’**) by end September 2020.

As restrictions are eased and businesses start to reopen, we expect Retailers to be actively engaging with their customers to understand their circumstances and likely level of consumption. There needs to be a concerted effort to improve the quality of data in CMOS so the market can get back on track with the data improvement activities that were being pursued prior to the Covid-19 pandemic. Where vacant flags are removed and premises are reverted back to occupied in CMOS, Retailers should in the first instance seek to obtain meter reads. Only where this is not possible should Retailers engage with customers to obtain estimates based on the best available evidence.

To further encourage the removal of temporary vacant flags, we are considering whether a new Market Performance Standard (**‘MPS’**) should be introduced that would incentivise Retailers by applying a charge for every Supply Point Identifier **(‘SPID’)** that remains flagged as temporary vacant beyond the end of September 2020. We are also seeking stakeholders’ views on whether we should introduce an additional MPS (or an Alternative Performance Indicator (**‘API’**)) that incentivises

Retailers to replace arbitrarily low Yearly Volume Estimates (**'YVE'**) with meter reads or at the very least more accurate estimates based on the best available evidence.

We are also seeking views on how we can better incentivise Wholesalers to work constructively with Retailers during the unwinding of the temporary vacancy flag and to improve the accuracy of data in CMOS.

We propose some expectations to guide Trading Parties through the unwinding of the temporary vacancy flag, which emphasises the importance of Wholesalers and Retailers working collaboratively, which includes Wholesalers sharing evidence that can support Retailers in maintaining accurate occupancy status for their customers.

Market Performance Charges

We temporarily suspended the invoicing and payment of market performance charges in the non-household sector to reflect that many charges – including in relation to meter reading – could be materially affected by business closures and social distancing measures implemented to combat Covid-19. This temporary suspension of Market Performance Charges is in place until the end of July.

We are minded to implement one of the following options in relation to the reintroduction of Market Performance Charges:

- Market Performance Charges come into effect from end September 2020; OR
- Market Performance Charges come into effect from end October 2020.

We are also seeking views on whether Operational Performance Standards (**'OPS'**) charges be introduced before MPS charges and whether non meter reading MPS charges should come into effect before meter reading MPS charges.

Credit support requirements

Retailers who choose to pay their primary charges in arrears are required to provide a form of credit support to Wholesalers to mitigate the impact of a Retailer exiting the market. Following implementation of code change CPW096, credit support requirements are temporarily pegged to pre-Covid (March 2020) levels. This sought to avoid a sharp and temporary reduction in the level of credit support required through Retailers applying the temporary vacancy flag. This would have increased risks to Wholesalers from a Retailer exiting the market. And it also would have resulted in Retailers encountering a cliff-face in the provision of credit support when temporary vacancy flags are switched off and consumption begins to rise.

Our preferred option for consultation is to maintain the credit support requirement – for all Retailers who are making use of the temporary vacancy flag – at March 2020 levels until all temporary vacancy flags are switched off. Beyond this date, we propose that credit support requirements would then be calculated based on primary charges that are due.

The industry Codes Panel is currently considering a code change proposal (CPW100), which seeks to reduce the credit support requirements for Retailers who have not deferred any of their wholesale charges. Given interdependencies and to avoid multiple consultations, we are including in this consultation questions that will allow the Codes Panel to reach a recommendation on that proposed change (see Appendix 1).

Customer Protection Code of Practice

We consulted and made changes to the CPCoP on 8 April (CP0006) and then again on 1 June (CP0007) to ensure that business customers affected by Covid-19 are provided with relief and additional support where appropriate. This consultation does not include any further proposals in relation to changes to the CPCoP as we consider the changes introduced via CP0007 remain appropriate to ensure business customers receive appropriate protections and support going forward.

Retailer bad debt

In April we committed to monitoring the level of additional Covid-19 related bad debt emerging in the business retail market and if it looks like bad debt across the market is likely to exceed the 2% threshold, we will provide regulatory protections for a portion of this exposure. We also noted that retailers should be prepared to absorb bad debt costs up to a level of 2% of their annual turnover or +1% of their baseline bad debt level, whichever is higher. This consultation sets out a timetable for taking further decisions on Retailer bad debt in line with our stated commitment but does not include any policy proposals.

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1. About this document

Covid-19 and the associated restrictions on the movement of people and the operation of businesses has affected the whole of the UK economy, with some areas of the economy more impacted than others. The lockdown announced towards the end of March created immediate challenges to the ongoing operation of the business retail market – for example, it created a sudden reduction in demand amongst many business customers and meant customers could face difficulties in paying their bills on time, creating consequential cash flow issues for Retailers.

To protect and provide continuity for non-household customers at a time of uncertainty, we worked closely with MOSL to implement a number of urgent and temporary changes to the industry codes. These changes focussed on protecting end customers and avoiding systemic Retailer failure (which would not be in customers' interests at this time) and are set out below.

- **Temporary change to vacancy (CPW091):** We allowed Retailers to temporarily apply the 'vacant' flag in CMOS to ensure charges more accurately reflect (reduced) levels of consumption where businesses had temporarily closed. If this change had not been made, consumption (and consequential charges) would have been based on historic usage or estimates, which in many cases would have materially exceeded actual levels of consumption. When CPW091 was introduced in March, Retailers could use it until end June 2020. In June, we notified trading parties that use of the temporary vacancy flag had been extended to end July 2020.

- **Interim deferral of wholesale charges (CPW093):** We allowed for a deferral of up to 50% of the charges due from Retailers to Wholesalers. This change covered amounts that were invoiced and due in March and April. This modification was an interim measure to reduce the burden on Retailers in the immediate term directly following lockdown, and was reviewed in April 2020 (see further below).

- **Customer Protection Code of Practice (CP0006):** We made temporary changes to the CPCOP in order to afford all non-household customers added protections immediately following lockdown. These changes i) prohibited Retailers from requesting the disconnection of non-household customers for non-payment due to the outbreak of Covid-19; ii) ensured that Retailers could not seek to recover any default interest for non-payment of invoices during a specified period which covered the outbreak of Covid-19; and iii) prohibited

Retailers from seeking to enforce the non-payment of invoices against non-household customers until Ofwat permits this.

- **Temporary suspension of Market Performance Standards Charges:** We temporarily suspended the invoicing and payment of Market Performance Charges to reflect the impact that measures to combat the spread of the Covid-19 pandemic (in particular business closures and social distancing) had on Trading Parties who were less able, for reasons outside their control, to meet the requirements of the market performance framework. For example, many 'Business As Usual' activities, such as meter reading, were likely to be affected and our changes ensured that Trading Parties were not unfairly penalised for failing to meet market performance standards due to factors outside of their direct control. This temporary suspension of Market Performance Charges is in place until the end of July.

Collectively, code changes CPW091 and CPW093 assisted Retailers in addressing the immediate liquidity challenges that arose as a result of Covid-19[1]. Following implementation of the temporary changes set out above, and as the impact of the lockdown became clearer, we worked with MOSL and the sector to develop a set of medium-term arrangements aimed at protecting business customers, including from systemic retailer failure. We consulted on a set of proposals in relation to liquidity and bad debt on 16 April 2020, and published our final decision on 30 April 2020. The key decisions we made are set out below.

- **Liquidity (CPW096):** We decided that Retailers should receive a time limited period of liquidity support, which allowed them to defer up to 40% of wholesale charges due between March and July 2020. This decision provided Retailers with time to establish what other financial support they could gain access to and how quickly, which we were clear should be the principle vehicle for managing the financial pressures resulting from Covid-19. Retailers who chose to opt-in to these arrangements have been required to pay the higher of either:

    - 60% of primary charges due to the Wholesalers; or
    - 94% of the cash they have collected from their customers.

  We decided that deferred amounts should be paid back by the end of March 2021, and we also decided that Wholesalers could charge interest on deferred

[1] An urgent code change, CPW095, was approved on 15 April 2020. This change corrected an unintended consequence of CPW091 by maintaining credit support levels at pre-Covid levels, and was superseded by implementation of CPW096. This issue is discussed further in section 3.3

payments to incentivise Retailers to use other sources of liquidity (including Government finance) where they can. We set a maximum interest rate of 5.98% nominal, which is equal to the PR19 nominal wholesale allowed return on capital plus 1%. This interest rate was set as a ceiling, so individual Wholesalers have been able to provide liquidity at lower rates than this if they chose to do so.

- **Customer Protection Code of Practice (CP0007):** In response to the liquidity and bad debt consultation, a number of Retailers expressed concern that the provisions introduced into the CPCoP to protect customers during the current crisis (via CP0006) would affect their ability to effectively recover and manage debt from customers who could pay. In addition, some Retailers highlighted an inconsistency in the application of interest. We therefore revisited the CPCoP to ensure customers seriously affected by Covid-19 continue to be protected.

  Following a consultation, we published our decision on changes to the protections in place for customers affected by Covid-19. We decided that customers defined[2] in the CPCoP as "Covid-19 Affected Customers" would continue to be protected from the prospect of disconnection, enforcement of debt and interest and late payment charges. For all other Non-Household Customers, Retailers are required to take necessary steps to differentiate between Non-Household Customers who genuinely need support and those who should be expected to pay. For those customers who do not fall into the category of a "Covid-19 Affected Customer" but need support as they have been affected by Covid-19, Retailers are required to offer them a Covid-19 Repayment Scheme which is tailored to reflect how seriously the customer has been affected by Covid-19. We also strengthened the requirements on Retailers to include clear and accessible information on their websites, including means of contact.

When we published our decisions on liquidity and bad debt on 30 April, we committed to review and consult on next steps early in the summer, which is the focus of this consultation. This document is structured as follows:

- Section 2 focuses on liquidity support. It identifies options and explains our proposals on:
    - whether to extend provision of liquidity to the business retail market; and

[2] Non-Household Customers where all of their premises have been designated vacant in accordance with section 3.1.6 of CSD 0104 of the Wholesale-Retail Code

    - how to unwind liquidity support.
- Section 3 identifies options and explains our proposals on:
    - future use and unwinding of the temporary vacancy flag, including use of YVE's;
    - Market Performance Charges; and
    - Credit Support Requirements.
- Section 4 sets out next steps;
- Appendix 1 includes questions and a pro forma relating to code change CPW100; and
- Appendix 2 summarises the consultation questions.

Responding to this consultation

We welcome stakeholder views on the questions detailed in Appendix 1 and 2 of this document **by 5pm on Thursday 16 July 2020.**

Please note that the questions in Appendix 1 are being asked on behalf of the Industry Codes Panel. We will share the responses to those questions – as well as consultation question 17 – with MOSL. If marked as 'Confidential' the material will be shared with the Panel only. If not marked as 'Confidential' it will be shared with Panel and published on MOSL's website, along with all the other non-confidential responses.

Please submit email responses to covidbusinessretailmarket@ofwat.gov.uk, with the subject 'Covid-19 and the business retail market – consultation on next steps'.

Responses to this consultation (excluding Appendix 1) will be published in full, on our website at www.ofwat.gov.uk. If you wish to redact information, please submit a both a redacted and an unredacted version of your response to the consultation by **5pm on 16 July 2020.**

Due to the closure of the Ofwat offices we are currently unable to accept responses by post.

Information provided in response to this consultation, including personal information, may be published or disclosed in accordance with access to information legislation – primarily the Freedom of Information Act 2000 (FoIA), the General Data Protection Regulation 2016, the Data Protection Act 2018, and the Environmental Information Regulations 2004. For further information on how we process personal data please see our Privacy Policy.

If you would like the information that you provide to be treated as confidential, please be aware that, under the FoIA, there is a statutory ‘Code of Practice’ which deals, among other things, with obligations of confidence. In view of this, it would be helpful if you could explain to us why you regard the information you have provided as confidential. If we receive a request for disclosure of the information, we will take full account of your explanation, but we cannot give an assurance that we can maintain confidentiality in all circumstances. An automatic confidentiality disclaimer generated by your IT system will not, of itself, be regarded as binding on Ofwat.

In developing these consultation proposals we have used information and evidence collected so far, including from requests for information from trading parties and from discussions we have had with the UK Water Retail Council, Water UK and the Consumer Council for Water. We have welcomed the constructive discussions thus far and this consultation is an opportunity for stakeholders to provide further evidence to support their positions and views. It’s important that stakeholders explain their views clearly and provide supporting evidence wherever possible. We will continue to work closely with MOSL in making final decisions and implementing the solutions.

Terminology

Within this document, Wholesalers are the companies responsible for owning and maintaining the physical assets associated with supplying water and wastewater services to customers. Retailers are those responsible for billing non-household customers for their consumption, and for providing other customer-related services. Non-household customers are businesses (e.g. corner shops, hotels, laundrettes etc.), charities and public sector organisations that are using and paying for water and wastewater services and who are eligible under industry rules to choose their Retailer. The term Trading Parties is used to refer to Wholesalers and Retailers collectively in this document.

2. Liquidity support

2.1 Whether to extend temporary liquidity support

The liquidity support arrangements introduced by Ofwat in March 2020, and amended in May 2020, were intended to provide temporary relief if Retailers found themselves facing cash flow challenges as a result of Covid-19. The measures were intended to provide temporary support whilst Retailers establish what other forms of financial support they can gain access to and how quickly. The arrangements were time-limited and not designed to be the principal vehicle for managing the financial pressures resulting from Covid-19.

In considering whether to extend the current temporary (sector specific) liquidity support arrangements beyond July 2020, we have analysed take up and operation of the current liquidity support scheme and have also considered the wider economic context.

2.1.1 Wider economic conditions

The UK Government announced significant restrictions on the UK economy in response to the Covid-19 pandemic. These restrictions, which took effect on 23 March 2020, ordered all non-essential businesses in England to close their physical premises. A similar set of restrictions were put in place by the Welsh Government. Some of these restrictions are now being lifted, albeit with the possibility of their reintroduction at a local level if infections increase, as has been seen in Leicester and surrounding areas.

The ONS has been assessing the impact on businesses of the Covid-19 pandemic through the BICS. The most recent report published on 2 July shows that of the 5,926 UK businesses that responded (out of a sample size of 24,473), 86% of businesses reported continuing to trade as their current trading status. 14% reported they had temporarily closed or paused trading.

In the previous report covering Wave 6, (18 May to 31 May 2020), the ONS reported that, of the 3,521 businesses who had responded to all waves from 2 to 5, 72% reported continuing to trade between 23 March and 17 May 2020, and 28% reported they had temporarily closed or paused trading at some point in this period.

There are limitations to the conclusions we can draw for the economy as a whole given the response rate to the survey, however the findings from the BICS does give us some indication of how the situation in the wider economy is changing. Given the increase in businesses continuing to trade from 72% in May to 86% in June the economic situation is likely to have improved since the peak of the pandemic in April 2020, and the recent lifting of business restrictions in early July are likely to continue to improve the economic conditions.

2.1.2 How have Retailers used the current liquidity scheme?

The current arrangements allow Retailers to defer up to 40% of primary wholesale charges due between March and July 2020. We are continuing to analyse the operation and effectiveness of this scheme. Below we provide some (aggregated and anonymised) analysis of the scheme to date. Retailers have also been able to use the temporary vacancy flag, which has the effect of suppressing fixed (and in some cases volumetric) charges for premises marked as vacant. Section 3 analyses Retailers' use of this flag to date and discusses future use and unwinding of the temporary flag.

At the end of June, eight Retailers in total – four Associated Retailers and four independent Retailers – had opted to defer payment of a portion of their wholesale charges. Retailers are required to make a minimum payment of the higher of: 60% of primary charges due to the Wholesalers; or 94% of the cash they have collected from their customers. The majority of the Retailers were required to make a minimum payment of 94% of their cash collected from customers.

The table below sets out the outstanding amounts of the eight Retailers that opted into the deferral scheme. In the period April to June, the maximum amount deferred by any one Retailer was c.30% of the cumulative primary charges incurred. In addition, six out of the eight Retailers that opted-in to the deferral scheme have paid voluntary payments in addition to the minimum payment required. Two Retailers have indicated that they will have no outstanding balance at the end of June and will repay all deferred wholesale charges. The majority of Retailers have repaid any deferment of March primary charges and only c£2m remains in the March pool.

Type of opted in retailer	Percentage of cumulative wholesale charges outstanding at end June 2020
Associated	0.0%
Associated	0.0%
Associated	8.8%
Independent	11.5%
Associated	15.0%
Independent	16.4%
Independent	25.1%

Independent	29.8%

Retailers who opted to defer payment of wholesale charges are required to submit information regarding their access to government finance and other borrowing facilities. Large business loans offered by the UK Government (CBILS loans) appear to be the most suitable form of Government support for larger Retailers, who report that this takes time to secure and put in place and requires the Retailer to have significant engagement with their principal lender(s). No Retailer that has opted into the deferral scheme has to date accessed Government support, although a number have indicated that they are either actively considering it, or will consider it in the future. Some Retailers are exploring and others have already arranged access to other forms of liquidity support, with six out of the eight Retailers that opted-in to the deferral scheme having paid voluntary payments in addition to the minimum payment.

2.1.3 Options for the future of Temporary Liquidity Support

We have identified three options regarding the future of temporary liquidity support arrangements as described below.

Option 1: No extension of liquidity support post July 2020

This option would prevent Retailers deferring any amount of primary charges due from August 2020 onwards and the current scheme would terminate at the end of July.

Option 2: Extend the period over which Retailers can defer charges, but do not increase the total amount of wholesale charges that can be deferred

This option would allow Retailers to continue to defer a maximum of 40% of primary charges for August, September and October, subject to a cap on the total level of deferred wholesale charges. The cap would be calculated as a percentage of cumulative primary charges due from March to July 2020. We are proposing a maximum cap equal to 40% of wholesale charges due between March and July 2020 equivalent to the maximum amount of charges that Retailers could have deferred under the current deferral scheme.

Given the level of deferment we have seen from Retailers to date we are also considering whether a lower cap equal to 30% or 25% of primary charges due between March and July 2020 may be appropriate.

Option 3: Extend the time period and the permitted maximum amount of deferred charges

This option is an extension of the current wholesale charge deferral scheme and would allow Retailers to defer up to a maximum of 40% of wholesale charges for August, September and October. This option does not include a cap on the total deferred amount.

Options 2 and 3 would require retention of other aspects of the deferral scheme – for example in relation to the interest payable by Retailers who defer payment of wholesale charges. We are minded to allow Retailers to opt into the scheme at any time, but are interested in stakeholder views on this.

Under options 2 and 3 we propose to refine reporting requirements on Retailers who choose to opt into the scheme as this will be contingent on each Retailer demonstrating that they are actively exploring other forms of support (including Government support), recognising that the ability to defer wholesale charges will end in October 2020.

2.1.4 Options Appraisal

Is there evidence that a further amount of liquidity support is needed in the market?

The sector-specific liquidity support arrangements introduced in March and amended from May were intended to be time limited measures that would allow Retailers a period to explore and access other forms of financial support. Only eight Retailers in the market have opted to defer payments of wholesale charges and all have deferred amounts significantly below the maximum 40% that could have been deferred. In addition, half of the deferring Retailers are Associated Retailers whose main creditors are the associated Wholesalers with whom they share a common owner.

We note that Retailers have access to additional forms of liquidity support outside the deferral scheme implemented by Ofwat. We are beginning to see some Retailers take up other forms of financing from various sources, with several Retailers considering whether to access Government support. Retailers have also opted to make additional voluntary payments on top of the minimum payment due, indicating that there is financial support available to Retailers in the market.

For these reasons we are of the view that no further increase in the total amount of liquidity is needed in the market beyond July 2020. We are therefore minded to rule out option 3.

Is there evidence that flexibility is needed post July 2020 in relation to the current level of liquidity support?

Extending the period - but not the amount - of liquidity support could provide Retailers with more time to secure additional liquidity support from other sources, reflecting that some Retailers are still exploring options in relation to financing and Government support. It could also provide Retailers with some extra flexibility to manage cash flows reflecting that some business customers may need additional support and will take some time to pay their bills in full even after reopening.

We are however aware that extending the time period over which previously agreed levels of liquidity support could be used may increase uncertainty in the market. By extending the period, the Wholesaler bad debt cap will remain in place which will mean there is no increase to the financial risk that Wholesalers are subject to compared with the current liquidity support arrangements.

The relative advantages and disadvantages of options 1 (ending the liquidity scheme in July) versus option 2 (retaining the existing scheme in the period August to October but not increasing the total amount of primary charges that can be deferred) are not yet clear from our view of the current evidence. **We are therefore using this consultation to seek further evidence that will inform our decision whether to implement option 1 or option 2.**

Consultation Questions

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?

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.

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.

2.2 Unwinding the liquidity arrangements

We previously set out in our April decision document that any wholesale charges deferred by Retailers under CPW093 and CPW096 would need to be paid back to Wholesalers, in full, by end March 2021 at the latest. We continue to think this date is appropriate and we retain the requirement that any amounts of deferred wholesale charges should be repaid by end March 2021.

This section sets out three options relating to how the liquidity arrangements should be unwound to ensure all deferred wholesale charges are repaid by end March 2021. The three options detailed below apply whether we allow an extension of the liquidity measures or prevent any further deferment of charges.

2.2.1 Options identification

We have identified the following three options in relation to repayment of deferred wholesale charges in full by March 2021:

Option 1: Ofwat does not set any specific repayment profile

Retailers and Wholesalers agree on a bilateral basis the repayment profile of any deferred amounts. This option puts responsibility on Trading Parties to agree a repayment profile that ensures all deferred charges are repaid in full by end March 2021.

Option 2: Ofwat specifies the repayment profile for the industry

Under this option the repayment profile would be specified in the Code, so as to ensure full repayment by the end of March 2021. Failure to adhere to the specified repayment profile would result in a Retailer being classified as a Defaulting Trading Party, as defined under the current Code.

For example, a repayment profile could be set by increasing the minimum percentage of primary charges due (‘the Y factor’) each month in a linear fashion until it reaches 100% in March 2021. We welcome stakeholders’ views on how a repayment profile could be implemented.

Option 3: Ofwat specifies a backstop repayment profile

Our third option is a hybrid of options 1 and 2. Under this option, Retailers and Wholesalers can agree bilateral agreements regarding the repayment of the deferred wholesale charges, but the Code would also provide a backstop repayment profile that would apply in the absence of agreement. The backstop will comprise of two ‘check-in’ points prior to March 2021 that will be set at a percentage of total deferred wholesale charges. In the absence of a negotiated agreement, Retailers would be required to meet the repayments – failure to do so would result in the Retailer being classified as a Default Trading Party. Our initial thoughts on the check-in points included in the backstop is as follows:

- End November 2020: 33% of the total deferred amount of wholesale charges must be repaid to Wholesalers
- End January 2021: 66% of the total deferred amount of wholesale charges must be repaid to Wholesalers

Where Wholesalers and Retailers agree a bespoke repayment profile, we will require the agreement to be published, potentially on MOSL’s website. In addition, where a Wholesaler agrees a different repayment profile between Retailers, the Wholesaler will be required to objectively justify why this is the case.

2.2.2 Options appraisal

The business retail market is a competitive market and when considering the repayment of deferred wholesale charges we want to encourage engagement between Wholesalers and Retailers to agree bilaterally the best route forward in order to pay off the deferred balance by March 2021. A commercially agreed repayment profile is more likely to be tailored to the specific circumstances of the Wholesaler and Retailer, reducing the risk of negative unintended consequences which can be associated with regulatory intervention in a market.

The primary policy aim of the temporary liquidity support provided to Retailers in the form of the allowed deferral of wholesale charges was that it provides relief whilst Retailers arrange access to other forms of support. Consistent with this policy aim, we expect Retailers to act prudently and repay any deferred wholesale charges over time. Option 1 carries a risk to both customers and Wholesalers that a Retailer may exit the market in March 2021 having not repaid any of the outstanding balance of wholesale charges it deferred. Ensuring that some repayments are made earlier can uncover issues where a Retailer may not be in a financial position to repay the deferred amount by March 2021. Option 1 could also detrimentally impact the ability of Wholesalers to prepare their own financial forecasts. Phasing the repayments limits this risk by allowing Wholesalers sufficient time to incorporate the deferred repayments into their forecasts, and recognising the liability on the Wholesalers’ books reducing over the period.

The regulatory risk of unforeseen circumstances is likely to increase with the level of intervention Ofwat proposes to impose on the industry. Option 2 requires significant intervention from Ofwat in order to set an industry level month-on-month repayment profile of deferred wholesale charges. If the repayment profile set by Ofwat is too stringent, we could inadvertently force a Retailer into default where it may be able to pay its balance off under a different repayment profile.

Option 3 sets out a hybrid of options 1 and 2. Under this option, we would continue to encourage negotiation between Trading Parties to agree commercial terms that reflect the interests and circumstances of individual Retailer-Wholesaler pairings. In the case that an agreement cannot be reached, our backstop would provide a repayment profile by specifying two check points in November 2020 and January 2021 whereby 33% and 66% of the total deferred wholesale charges would need to be repaid. For clarity, any agreement made bilaterally between Trading Parties would supersede the backstop repayment profile.

Option 3 could avoid some of the risks associated with option 1 and provides greater certainty in the market about the rate of repayment of any deferred amount. It also reflects a lighter touch approach than option 2, which will help to mitigate the risk that our regulatory intervention leads to unintended consequences in the market. **Given the above points, we consider option 3 provides the best balance between allowing Trading Parties to agree terms while providing a level of regulatory certainty. As a result we are minded to implement option 3.**

Consultation Questions

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?

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.

3. Temporary vacancy flag and the use of YVEs, Market Performance Charges and Credit Support Requirements

3.1 Temporary vacancy flag

The ability for Retailers to apply a temporary vacant flag was introduced at the end of March 2020 through CPW091. Retailers can apply the flag where a premises was completely closed or activities at the premises had reduced by at least 95%.The intention of this Code change was to ensure that customer bills more accurately reflect reduced levels of consumption where businesses were temporarily closed due to Covid-19, by providing Retailers with a workable proxy to identify reductions in consumption of 95% or more when there were significant challenges to obtaining accurate meter reads.

The ability for Retailers to use the temporary vacancy flag originally covered the months of April, May and June. Following an informal consultation with Trading Parties, on 15 June we extended the period to 31 July 2020. In that notification we also advised Trading Parties that:

- We would use our consultation on next steps to consider the extent to which further use of the temporary vacant flag was necessary and appropriate as well as the timescale and process for unwinding use of the flag;
- We might consider if all Covid-19 temporary vacancy flags should be switched off by the end of August 2020; and
- As more businesses were starting to reopen and premises were becoming reoccupied, Retailers should use the extension to proactively review their customer portfolios and update the status of any business premises where the requirements for a temporary vacant flag no longer apply.

3.1.1 Analysis of the temporary vacancy flag

As of 30 June 2020, 262,729 premises have been marked as vacant since March 2020. 238,502 of these premises were labelled as Covid-19 temporary vacants[3].

Table 1 - Market wide statistics

[3] Data (including Tables 1, 2 and 3 overleaf) taken from CMOS and provided by MOSL, 30 June 2020 data cut

Total premises	Vacant premises		Marked vacant since 16 March		COVID labelled vacants		Change in vacancy since 1 June	
	#	%	#	%	#	%	#	%
1,516,549	517,777	34.1	262,729	17.3	238,502	90.8	-10,476	-0.7

- June has seen a reduction in the total vacancy rate, with a net reduction of 10,476 premises
- Of these, 7,666 have been premises that have turned vacant since 16th March, with the rest having been originally turned vacant to a date pre-dating Covid-19 monitoring
- Almost all Retailers have seen a reduction in vacancy, with the primary exception being Water Plus who have seen a 3% increase in vacancy figures. The largest reduction has been Pennon Water Services, who have seen a 21.3% reduction in the number of vacant premises, accounting for 6.3% of all of their premises turning occupied

We have seen a variance in the application of the temporary vacancy flag by Retailers. Combining business as usual and Covid-19 temporary vacant premises, this ranges from 13.2% (Water2Business) to 64.5% (Yu Water) of all premises marked as vacant since 16 March 2020. The table below compares how different Retailers have made use of the vacant flag.

Table 2 – Covid vacancy by retailer (excluding Self-suppliers)

RetailerID	Total Premises	Total Vacant Premises		Total Premises Vacant since 16th March		Total Premises Marked Vacant as due to COVID-19		Change since 1st June	
		#	%	#	%	#	%	#	%
YUWATER-R	166	107	64.5%	58	34.9%	59	101.7%	-9	-7.8%
SUTTON-R	26,680	17,157	64.3%	7,382	27.7%	6,872	93.1%	-8	0.0%
EVERFLOW-R	35,222	10,023	28.5%	8,777	24.9%	8,657	98.6%	440	4.6%
FIRSTBW-R	2,643	708	26.8%	648	24.5%	611	94.3%	-662	-48.3%
CLEARBUS-R	9,429	2,679	28.4%	2,288	24.3%	2,201	96.2%	-2,990	-52.7%
BUSSTREAM-R	83,827	26,730	31.9%	19,651	23.4%	18,079	92.0%	-26	-0.1%
SMARTA-R	661	157	23.8%	144	21.8%	142	98.6%	-2	-1.3%
CASTLE-R	322,572	119,844	37.2%	66,648	20.7%	56,987	85.5%	-839	-0.7%
WAVE-R	242,326	87,692	36.2%	47,877	19.8%	43,576	91.0%	-6,700	-7.1%
YORKSHIRE-R	126,562	40,568	32.1%	20,503	16.2%	19,396	94.6%	665	1.7%
SEVERN-R	220,203	73,493	33.4%	33,019	15.0%	30,380	92.0%	2,526	3.6%
SOUTHWEST-R	113,679	25,921	22.8%	16,404	14.4%	16,102	98.2%	-7,035	-21.3%
UNITED-R	238,670	97,226	40.7%	28,501	11.9%	26,339	92.4%	2,391	2.5%
WATER2BUS-R	82,926	10,974	13.2%	6,423	7.7%	4,697	73.1%	1,916	21.2%

This variance is also reflected when comparing data across different wholesale regions where the range of all premises marked as vacant (business as usual and

Covid-19 temporary vacant) varies from 11.6% (Bristol Water) to 47.1% (Northumbrian Water).

Table 3 – Covid vacancy by wholesale region

WholesalerID	Total Premises	Total Vacant Premises		Total Premises Vacant since 16th March		Total Premises Marked Vacant as due to COVID-19		Change since 1st June	
		#	%	#	%	#	%	#	%
SUTTON-W	14,002	5,990	42.8%	4,333	30.9%	4,296	99.1%	-67	-1.1%
NORTHUM-W	116,538	54,837	47.1%	31,520	27.0%	29,768	94.4%	-2,927	-5.1%
THAMES-W	225,141	90,891	40.4%	53,247	23.7%	44,742	84.0%	-2,562	-2.7%
SOUTHERN-W	58,639	19,930	34.0%	13,378	22.8%	12,191	91.1%	-118	-0.6%
SOUTHEAST-W	51,925	17,507	33.7%	11,017	21.2%	9,643	87.5%	-258	-1.5%
PORTSMOUTH-W	15,700	5,073	32.3%	3,292	21.0%	3,182	96.7%	-95	-1.8%
YORKSHIRE-W	142,841	45,273	31.7%	24,874	17.4%	23,642	95.0%	58	0.1%
SOUTHWEST-W	79,824	20,415	25.6%	13,757	17.2%	13,432	97.6%	-5,319	-20.7%
AFFINITY-W	73,542	23,010	31.3%	12,092	16.4%	11,641	96.3%	-619	-2.6%
SEVERN-W	222,250	74,790	33.7%	33,293	15.0%	30,776	92.4%	1,777	2.4%
UNITED-W	259,834	105,023	40.4%	34,496	13.3%	32,351	93.8%	1,358	1.3%
ANGLIAN-W	130,795	35,675	27.3%	17,033	13.0%	14,272	83.8%	-1,461	-3.9%
SOUTHSTAFF-W	42,361	9,399	22.2%	5,304	12.5%	5,180	97.7%	-1,571	-14.3%
BRISTOL-W	33,330	3,872	11.6%	2,135	6.4%	1,413	66.2%	532	15.9%
WESSEX-W	48,848	6,031	12.3%	2,930	6.0%	1,947	66.5%	790	15.1%

When we consider this data alongside that collected by the ONS[4], there is a possibility that some Retailers may have been either overusing or underusing the temporary vacancy flag in the market.

A consequence of overuse of the flag may be that some customers who have continued to consume water and sewerage services throughout the period of restrictions may have been undercharged. If it is established that a customer was consuming services during this period, it could result in billing shocks further down the line, especially in cases where they subsequently become exposed to wholesale fixed (non-volumetric) charges. Fixed charges can vary significantly from region to region. For example, in one region we are aware that fixed charges comprise over one third of the non-household bill. Conversely, underuse of the flag may mean that customer premises that should have been classified as temporary vacant throughout

[4] Report covering Wave 6, (18 May to 31 May 2020), the ONS reported that, of the 3,521 businesses who had responded to all waves from 2 to 5, 72% reported continuing to trade between 23 March and 17 May 2020, and 28% reported they had temporarily closed or paused trading at some point in this period. This increased to 86% reporting that they continued to trade and 14% reporting they had temporarily closed or paused trading in June.

this period will not have received any relief from Wholesaler fixed charges[5] where they are eligible and should have therefore benefitted from such relief.

Under the current temporary vacancy arrangements, the guidance for the use of the flag notes that where a customer has been impacted but has not closed due to Covid-19, the Retailer should engage with these customers to estimate the expected reduction in consumption. Retailers are then directed to calculate their best estimate of the annual volume as the YVE and enter one third of that figure into CMOS[6]. Where a YVE adjustment is applied, and a premise is flagged as occupied, customers remain liable for fixed charges. Some of the data we have seen from MOSL suggests that there may have been instances in the market during the past three months where arbitrarily low YVEs have been applied across a range of customer premises. We are concerned that this approach suggests that some Retailers might not be correctly following the terms of the guidance.

MOSL has instructed the market auditor to commence a targeted Covid-19 vacancy audit across a number of Retailers that have been noted as outliers in terms of applying the temporary vacancy flag or in making YVE adjustments. The results of the audit are scheduled for mid-July. We will continue to engage with MOSL on this review and in relation to its ongoing market monitoring, the outcomes of which may identify areas where intervention from Ofwat is necessary.

3.1.2 Should the temporary vacancy flag be allowed to expire?

The intention of introducing the Covid-19 temporary vacant flag was to ensure that customer bills more accurately reflected reduced levels of consumption where businesses were temporarily closed due to Covid-19, by providing Retailers with a workable proxy to identify reductions in consumption of 95% or more when there were significant challenges to obtaining accurate meter reads. **Given the nationwide easing of restrictions, we propose to allow the option to apply the temporary vacancy flag to expire at the end of July 2020.**

In response to our May consultation on our proposal to extend the use of the temporary vacancy flag until the end of July, some respondents suggested that retaining the use of this flag may allow the market to take a flexible approach and

[5] Some (but not all) Wholesalers do not levy volumetric charges where premises are marked as vacant.

[6] This guidance was issued to ensure CMOS settlement reacted to the sudden drop in consumption for some customers (where they were not vacant) and that retailer settlement charges were representative of current consumption. When there are not two actual reads within the last 12 months, CMOS uses older reads but caps these off at three times the YVE.

react to regional differences in the way restrictions are imposed, now and in the future. For example, it was noted that Wales was taking a different approach to easing restrictions than England. Wholesalers, however, were generally concerned at the prospect of the flag being extended any further, noting the detrimental impact that it was having on the accuracy of data in CMOS and their ability to recover fixed charges from customers who have been consuming water and sewerage services while restrictions have been in place.

We propose that following the expiration of the flag where a business premises cannot meet the original code requirements for vacancy (section 3.1.4. of CSD 0104) it should be returned to the status of occupied in CMOS and meter reads should be obtained to ensure charges accurately reflect consumption. We acknowledge that while activity in the market is now increasing, in some cases consumption of water and sewerage services is unlikely to be back to levels recorded prior to the national lockdown. Therefore it is important that Retailers make a concerted effort to obtain meter reads in the first instance to ensure customers' bills accurately reflect their levels of consumption.

If for any reason a meter reading operative is unable to access a premises to take a read we expect Retailers to engage with their customers to see if they are willing and safely able to self-submit a meter read. Only where a meter read is still not possible, Retailers should then engage with their customers to understand current levels of consumption and make appropriate adjustments to the YVE. As per the process for applying temporary vacant flags, from now on we ask that Retailers to retain evidence to support its use of YVEs, including a log of engagement with their customers. We anticipate that consumption and billing for such sites should balance out once meter reads are submitted again in CMOS. We are aware that many Wholesalers are in a position to assist Retailers with obtaining actual meter reads and would encourage them to share this data with Retailers where possible (e.g. via Wholesaler owned Automatic Meter Reads).

If the ability for Retailers to use the temporary vacancy flag expires at end of July, this means the effect of the temporary vacancy flag (to suppress fixed and in some cases volumetric wholesale charges) will expire at the end of July. A premises that is genuinely temporarily vacant from 1 August (e.g. a gym) will need to be marked as occupied with a meter read or accurate YVE estimate.

While this flag cannot then be applied to premises from 1 August 2020 onwards, Retailers will be able to make retrospective adjustments to the flag beyond the end of July, but those retrospective changes can only apply to a period (or subset of the period) 16 March 2020 - 31 July 2020. It is worth noting that any retrospective changes will need to be made before the final settlement (RF) run.

This ability to apply retrospective changes will allow Retailers to consider where temporary vacant flags were incorrectly applied and update the status of premises accordingly. Importantly, it will also allow Retailers to retrospectively apply the temporary vacant flag for premises that were incorrectly flagged as occupied during this period. Where evidence suggests the temporary vacant flag has been applied incorrectly, Retailers should attempt to establish when a customer was likely to have been consuming water and sewerage services at a premise when backdating the flag.

Consultation Questions

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.

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.

3.1.3 When should all temporary vacant flags be removed from the market?

Following the expiration of the temporary vacancy flag, the Codes stipulate that Retailers have two months to revert premises back to a status of occupied, unless they meet the original criteria for being classified as vacant.

In response to our May consultation on extending the use of the temporary vacant flag, several Retailers indicated that they would require a substantial amount of work to contact customers to determine whether their properties should revert to business as usual vacant or be classified as occupied. It was argued that sufficient time was required to enable Retailers to properly engage with customers as part of this process when unwinding the use of the flag.

As noted above, in our 15 June decision to extend the use of the flag until the end of July, we indicated that we could require all Covid-19 temporary vacancy flags to be removed from the market by the end of August 2020 and encouraged Retailers to review and update the status of any business premises where the requirements for a temporary vacant flag no longer applied.

In light of the above, we have considered two potential options. We have already signalled to the market that with the easing of restrictions and reopening of businesses, we expect Retailers to be reviewing, and where appropriate updating, the status of their customer premises. In line with the increase of meter reading activity in the market an end of August deadline for removing all flags from CMOS could provide a strong driver for correcting the status of premises at the earliest opportunity.

However, we also acknowledge that there may be practical challenges that Retailers will face in engaging with some of their customers over the next couple of months. **On balance, we are therefore minded that all temporary vacant flags should be removed from CMOS by the end of September**. We consider that this longer deadline should provide sufficient time for more actual meter reads to be submitted and enable Retailers to properly engage with their customers. Even if we determine that the end of September deadline is appropriate, we still expect Retailers to already be reviewing their portfolios to establish where the status of customers' premises now need to be updated.

We consider that there is a clear need for all temporary vacancy flags to be removed from the market by the end of September 2020. In removing these flags, there needs to be a concerted effort to improve data in CMOS so the market can get back on track with the data improvement activities that were being pursued prior to the Covid-19 pandemic. Where vacant flags are removed and premises are switched back to occupied in CMOS, Retailers should in the first instance seek to obtain meter reads. Only where this is not possible should Retailers engage with customers to obtain YVEs based on the best available evidence.

To further encourage the removal of temporary vacant flags, we are considering whether **a new MPS should be introduced that would incentivise Retailers by applying a charge for every SPID that remains flagged as temporary vacant beyond the end of September 2020.** For retailers, there are 4 charge levels that could be applied to each SPID: level 0 (£0); level 1 (£5); level 2 (£10) or level 3 (£20).

Table 4 - Illustrative MPS measure: Removal of the temporary vacant flag

Time parameter 1	0BD (measure introduced 1 October 2020)	(Level 1) £5 charge would applied to every SPID still flagged as temporary vacant
Time Parameter 2	10 BD and	(Level 2) £10 charge would be applied for every SPID still marked as temporary vacant

	And reoccurring on 1st of the month thereafter	

We want to incentivise the submission of good quality consumption data into CMOS and want to avoid the risk that a new MPS, which is aimed at incentivising removal of temporary vacancy flags, inadvertently incentivises the submission of inaccurate estimates (e.g. in the form of arbitrarily low YVEs). **We are seeking stakeholders' views on whether we should introduce an additional MPS (or alternatively an API) that incentivises Retailers to replace arbitrarily low YVEs with meter reads or at the very least more accurate estimates based on the best available evidence**.

In relation to the introduction of a financial MPS incentive on YVEs, we are interested in stakeholders' views about how arbitrarily low YVEs entered into CMOS could be identified in a proportionate way – for example via one or more simple rules.

In relation to the introduction of a reputational API incentive on YVEs, we are interested in stakeholders' views on how a reputational incentive could be strengthened – for example through the use of performance rectification plans or the application of interest charges at later settlement runs.

Where temporary vacancy flags are removed and a premises is marked as vacant, Retailers will need to assure themselves that the premises meets the original criteria for being classified as vacant (section 3.1.4. of CSD 0104). We plan to work closely with MOSL to **publish league tables to compare the proportion of temporary vacant premises that are switched to vacant properties for each Retailer**. Where there appear to be high proportions of temporarily vacant premises being switched to vacant premises, we may engage with specific Trading Parties and take action – for example we could ask the Codes Panel if it would be appropriate for the market auditor to target those Retailers for greater scrutiny of their processes.

As noted earlier, Wholesalers also have a role to play in assisting Retailers in establishing the correct status of customer premises. With this in mind we are **interested in stakeholders' views on what more can be done to incentivise Wholesalers to constructively contribute towards the unwinding of the temporary vacancy flag and getting more accurate meter reads in CMOS**.

Consultation Questions

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.
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.
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.
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?
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?

3.1.4 How should all temporary vacant flags be removed from the market?

We think it would be beneficial for Ofwat to set out some expectations to guide Trading Parties through the unwinding of the temporary vacancy flag.

It is worth noting that Guidance on the use of the temporary vacant flag exists and provides practical guidance intended to ensure efficient and consistent application of CSD0104. We are aware that there have been cases where Retailers have been applying the flag on the basis of a reduction or cessation of trade at a premises. CPW091 only permits the application of a temporary vacant flag either where the premises in question are closed to workers as well as visitors and the public or the usual activities that take place at the premises have reduced by 95%. This is because the purpose of the provision was to provide Retailers with a workable proxy for identifying premises where consumption had fallen by a similar amount in circumstances where there were significant challenges to obtaining an accurate meter read so that charges more closely reflected actual consumption. This point has been reiterated in the recent guidance update developed with the Market Performance Committee (**'MPC'**). The guidance has also been updated to clarify how Retailers should approach amending a property status where it turns out the flag has not been applied correctly.

- **Expectations of Retailers**

  We expect that all Retailers should retain an audit trail for customer sites that have used the temporary vacant flag.

  As per the process for applying temporary vacant flags, from now on we ask that Retailers retain evidence to support their use of YVEs, including a log of engagement with their customers.

  Retailers should ensure that their customers understand the changes that are being implemented during the unwinding phase and the impact this may have on bills. We expect that Retailers ensure that this information is easily accessible to customers and published on their websites.

  Where customers are exposed to backdated charges that they weren't previously aware of, and have been financially impacted by Covid-19, they must be accounted for under each Retailers' Covid-19 Reasonable Repayment Plans.

  We recognise that there may be unforeseen circumstances where a business site was closed and not accessed while trading restrictions were in place yet consumption was recorded (e.g. due to a leak at the site or a tap left running). In such scenarios we would encourage Retailers to engage with Wholesalers before applying an occupied flag to discuss whether applicable non-volumetric charges should be pursued.

  We recognise there may be marginal cases where it transpires that the temporary vacant flag has potentially been applied incorrectly, but the original decision to apply the flag was made in good faith using the best available evidence on likely consumption at the time. In such circumstances, where it is still not evidently clear that the customer was continuing to use more than 5% of their normal water and sewerage service, we encourage both Wholesalers and Retailers to make decisions that favour the impacted customer.

- **Trading Parties should constructively work together**

  In the light of the operational challenges driven by Covid-19, Wholesalers should at the earliest opportunity share evidence that can support Retailers in maintaining accurate occupancy status for their customers. We also expect Trading Parties to work together to identify supply points flagged as temporarily vacant but which are actually consuming.

Where disputes regarding property status arise, we expect Trading Parties to mediate with each other, sharing any data that supports their conclusions, before instigating a formal dispute under the Codes.

Incumbent companies[7] provide meter reading services for many of the Retailers across England. They therefore play a key role in ensuring that CMOS reflects accurate consumption data as Covid-19 restrictions continue to be lifted. We expect incumbents that provide meter reading services to work constructively with Retailers to develop a strategy to ensure that, where possible, meter reads can be prioritised and fast-tracked into CMOS over the next couple of months.

- **The roles of MOSL and Ofwat**

  MOSL will continue to track the levels of changes being made to vacancy flags, alongside changes made to YVEs during the unwinding period. Where there appear to be issues that warrant further investigation, MOSL will engage with relevant Trading Parties in the first instance.

  MOSL will continue to share data with Ofwat on a regular basis and this may highlight issues that warrant further investigation or action from Ofwat.

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?

3.2 Market Performance Charges

We temporarily suspended the invoicing and payment of Market Performance Charges to reflect the impact that measures to combat the spread of the Covid-19 pandemic (in particular business closures and social distancing) had on Trading Parties who were less able, for reasons outside their control, to meet the requirements of the Market Performance Framework (**'MPF'**). For example, many business as usual activities, such as meter reading, were likely to be affected. To ensure that Trading Parties were not penalised for failing to meet MPF standards due to factors outside of their direct control, MPS Charges and OPS Charges were

[7] Regional monopoly companies who provide water and sewerage services across England and Wales. All of which will have wholesale teams that engage with Retailers

suspended (through code changes CPM023 and CPW090). This temporary suspension of charges is in place until the end of July.

3.2.1 Reintroducing MPF charges

Data from the market and feedback from trading parties suggests that meter reading activity has increased in recent weeks.

Whilst it is acknowledged that meter reading operatives may continue to face challenges, we also believe that MPF charges provide incentives to both Retailers and Wholesalers to read meters and complete other tasks in a timely way (e.g. completions and notifications of new connections; declarations of temporary disconnections or reconnections, etc.). Insofar as these charges incentivise Trading Parties to act differently, switching them back on could benefit customers.

We want to provide a clear signal to Trading Parties that MPF charges will be reintroduced in the near future, and have identified two options for consultation:

- MPF charges are reintroduced from end September 2020; or
- MPF charges are reintroduced from end October 2020.

It could be argued that an earlier date for reintroducing MPF charges provides a greater incentive for Trading Parties to complete tasks (including meter reads) in a timely way, which could benefit customers. On the other hand, recognising that some MPF charges are submission based, a later date could make it more likely that relevant data (e.g. meter reads) are entered into CMOS, which will improve the quality of market data and ultimately lead to benefits for customers. A later date may also reflect that there remain factors outside of the control of Trading Parties that could impact Trading Parties in meeting MPF Standards. We are aware that many Wholesalers provide meter reading services directly to Retailers so would be interested to hear both Wholesalers’ and Retailers’ views on the likelihood of meter reading capacity returning to normal levels in the coming months.

We also consider that there may be a case for phasing in charges for different elements of the MPF ahead of others.

For example, there may be a case for the charges associated with OPS to be turned on before those associated with MPS. OPS apply only to Wholesalers, but contain a number of operational activities that interact with Retailers’ MPS tasks. There may be some logic, therefore, in strengthening incentives to deliver OPS for an initial period to ensure that the market environment is right for the timely completion and reintroduction of charges for MPS tasks. We would welcome stakeholder's views on this possible approach.

Noting that the delivery of certain MPF standards may not be entirely in the control of Retailers we would welcome views from stakeholders if there is merit in turning on underperformance charges for non-meter reading focussed MPF standards first.

Consultation Questions

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.

15. Should OPS charges be introduced before MPS charges? Please explain your answer and provide supporting evidence wherever appropriate.

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.

3.3 Credit support requirements

Retailers who choose to pay their primary charges in arrears ('post-pay') are required to provide a form of credit support[8] to Wholesalers. The requirement to provide credit is a common feature across regulated markets and seeks to mitigate the impact on Wholesalers should a Retailer default and exit the market with monies being owed to Wholesalers. The value of credit support required by each Retailer is normally based on the value of each settlement report between the Retailer and the Wholesaler(s) it has contracts with. Settlement reports are calculated based on the consumption of a Retailer's customers in each given region.

Code change CPW091 enabled Retailers to mark premises as temporarily vacant within CMOS. At the same time, CPW093 enabled Retailers to defer payment of a proportion of wholesale charges. The combined effect of these changes increased the bad debt risk to Wholesalers as the credit support requirements were based on settlement reports which would have been substantially lower due to increased

[8] The various forms of credit support are set out in Schedules 2 and 3 of the Business Terms of the Wholesale-Retail Code.

vacant premises, while at the same time Retailers that chose to defer a proportion of their wholesale charges would owe Wholesalers more money.

To address an unintended consequence of code change CPW091, through code change CPW096, credit support requirements were maintained at pre-Covid (that is, March 2020) levels for all Retailers[9]. The rationale for this was to mitigate the increased risk to Wholesalers arising from a potential reduction in the level of credit support required through Retailers' applying the vacant flag, and, for prudential reasons, to protect Retailers from encountering a cliff-face in the provision of credit support when vacant flags are switched off and consumption begins to rise.

3.3.1 Options

We have identified three options in relation to credit support requirements:

1. Allow credit support requirements to be calculated on the basis of primary charges owed in any given month;
2. Maintain credit support requirements at March 2020 levels until all the temporary vacancy flags are switched off; or
3. Maintain credit support requirements at March 2020 levels until further notice (essentially, the 'do nothing' approach).

We recognise that economic recovery could take time. This could lead to capital being tied up in the market unnecessarily if credit support levels remain at pre-Covid levels. For these reasons, we have discounted option 3.

That said, we think it is prudent to ensure that the level of credit support is maintained at the March 2020 level in the short-term to avoid Retailers encountering cliff-faces where they will be required to find additional credit support at incredibly short notice to reflect increased consumption as temporary vacant flags are switched off. Therefore we also discount option 1.

We are therefore minded to implement option 2. This option should also provide additional incentives for Retailers to remove the temporary vacancy flag and get

[9] Code change CPW095 was approved which maintained credit support requirements at March 2020 levels, but this only applied to Retailers who did not defer payment of wholesale charges. CPW096 superseded this code change.

meter readings into the market so that their credit support requirement is more closely aligned to actual consumption levels going forward.

3.3.2 A different approach for Retailers who have not deferred wholesale charges – Code change CPW100

The industry Codes Panel is currently considering a code change (CPW100) proposed by a trading party[10], which seeks to reduce the credit support requirements for Retailers who have not deferred any of their wholesale charges. Given interdependencies and to avoid multiple consultations, we are including in this consultation questions that will allow the Codes Panel to reach a recommendation on that proposed change. Should respondents to this consultation also wish to provide views on CPW100, then they are able to do so by responding directly to the questions on CPW100. These questions, and the pro-forma, are included in Appendix 1. Please note that the questions in Appendix 1 are being asked on behalf of the Industry Codes Panel. We will share the responses to those questions – as well as consultation question 17 (below) – with MOSL.

If marked as 'Confidential' the material will be shared with the Panel only. If not marked as 'Confidential' it will be shared with Panel and published on MOSL's website, along with all the other non-confidential responses.

Consultation Question

17. 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?

3.4 Customer Protection Code of Practice

We do not consider that any further changes are required to the CPCoP in light of the proposals set out in this document.

Following implementation of CP0007, the category of Covid-19 Affected Customer was established so that customers that are seriously affected by Covid-19 can be identified and afforded additional protections. Covid-19 Affected Customers are

[10] CPW100 was raised by Castle Water on an urgent basis.

categorised by reference to use of the temporary vacant flag[11]. At present, application of the Covid-19 temporary vacant flag is set to end on 31 July 2020 which aligns with the easing of restrictions and the reopening of non-essential shops in June 2020 and intended opening of most venues and businesses in early July (with some exceptions, both in terms of the timing of businesses reopening and differences in approach adopted across the UK's devolved Governments). In this consultation, we propose that all temporary vacant flags should be removed from CMOS by the end of September 2020.

Once temporary vacant flags are removed from CMOS, the relevant customers will no longer be defined as 'Covid-19 Affected Customers' for the purposes of the CPCoP. However, following removal of the temporary vacancy flag, customers will automatically become eligible for a Covid-19 Repayment Scheme. This means that Retailers will be required to assess their individual circumstances and agree repayments of any outstanding amounts to be made over an agreed timeframe. All customers that are affected by Covid-19 will be eligible for a Covid-19 Repayment Scheme up until 31 March 2021, or such other date that Ofwat notifies in writing to Retailers. For clarity, this is not the date that all repayments must be made by, but instead is the date by which customers may be placed onto a Covid-19 Repayment Scheme.

As this additional protection obliges Retailers to take into account the customer's individual circumstances and agree repayments of any outstanding amounts over an agreed period of time, customers are protected from being asked to pay these sums in full straight away. **Therefore, we do not consider that further changes to the CPCoP are required.**

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.

[11] Covid-19 Affected Customer "means a Non-Household Customer for whom all of its premises have been designated as Vacant Premises by the Retailer in accordance with section 3.1.6 of CSD 0104 of the Wholesale Retail Code, unless the exception applies. The exception is where a Retailer can provide robust evidence that the Non-Household Customers' ability to pay is unaffected by Covid-19. Where a Non-Household Customer has multiple premises but only some of which have been designated Vacant Premises, this definition does not apply;"

4. Next steps

We will publish consultation responses as soon as we are able to and we plan to publish our final decision on 30 July 2020.

Where implementation of our decisions require amendment to the market Codes by end July (e.g. so they can be reflected in the settlement runs that take place in early August), we intend to recommend a Code change to the Industry Panel at its meeting on 28 July.

Where implementation of our decisions require amendment to the market Codes at a later date then we will work closely with MOSL to develop recommendations for future Industry Panel meetings. For example, if we decide to introduce a new MPS, we will recommend a Code change to the Industry Panel at its September meeting and make a final decision on this by the end of September to allow for implementation from 1 October 2020.

This consultation does not include any proposals in relation to Retailer bad debt. Below we set out expected next steps in relation to this.

4.1 Retailer Bad Debt

We have previously set out and acknowledged that, as a result of Covid-19, and despite a number of support measures introduced by government, many business customers may struggle to pay sums owed. As a result, levels of bad debt faced by Retailers may increase.

Our April 2020 Decision document set out that we recognised that there is a case for Retailers to recoup a proportion of bad debt costs that may arise over and above those levels that might reasonably be expected, i.e. concerning incremental bad debt costs that are seen to arise as a result of the effects of the Covid-19 pandemic. We also noted our desire to avoid committing customers to bearing an undue share of bad debt costs above a certain threshold, when it is as yet unknown to what degree these costs will exceed the threshold, and how and on whom bad debt costs may crystallise.

We said that we will monitor the level of additional Covid-19 related bad debt emerging in the business retail market and if it looks like bad debt across the market is likely to exceed the 2% threshold, that we would provide regulatory protections for a portion of this exposure. We also decided that retailers should be prepared to absorb bad debt costs up to a level of 2% of their annual turnover or +1% of their baseline bad debt level, whichever is higher. Our Decision document did not however specify the approach we would take to assessing the need for, nor the form of, any revised regulatory protections.

It remains the case that the degree to which bad debt cost might exceed the threshold, and the distribution of these in terms of which customer groups and Retailers may be most affected, is not yet well known. We think the possible approaches to assessing and implementing any amendments to regulatory protections will be sensitive to the possible scale and form of bad debt emerging. Furthermore, there are a number of choices to be made regarding the form and implementation of any regulatory protections, for example concerning how any central 'pot' of redistributed monies reimbursing Retailers might work. Consideration of options will require the input and views of interested stakeholders.

For these reasons we have decided to proceed as follows:

Date	Milestone
July/August 2020	Seek information and data from Retailers concerning indicators of the likely scale of outturn bad debt that may crystallise following the introduction of measures to combat the Covid-19 pandemic
Autumn 2020	Call for Inputs published – seeking views on the range of possible approaches to amending any regulatory protections and mechanisms for refunding appropriate bad debt costs to Retailers
January/February 2021	Consultation published – setting out and consulting on Ofwat's preferred option for any amendment regulatory protections
April 2021	Proposals for any amendment to regulatory protections published
2021/22	Where relevant, any amended regulatory protections become operational

Appendix 1: Questions asked on behalf of the Panel, as input into Code change CPW100

As explained in section 3.3.2 above, the industry Codes Panel is currently considering a change proposal (ref CPW100), which seeks to reduce the credit support requirements for Retailers who have not deferred any of their wholesale charges. Given interdependencies and to avoid multiple consultations, we are including in this consultation questions that will help inform the Panel's analysis of this issue and allow it to reach a recommendation on this proposed change. Answers to these questions should be supported by evidence, where appropriate.

Please note that the questions in Appendix 1 are being asked on behalf of the Industry Codes Panel. We will share the responses to those questions – as well as consultation question 17 – with MOSL. If marked as 'Confidential' the material will be shared with the Panel only. If not marked as 'Confidential' it will be shared with Panel and published on MOSL's website, along with all the other non-confidential responses.

A1. What are the benefits and risks associated with implementing different credit support requirements for Retailers who have and have not deferred wholesale charges?

A2. What assumptions are you making about the level and speed of return of NHH water consumption?

A3. Please explain the makeup of your credit support and levels of Unsecured Credit Allowances in the pro-forma on the following page.

A4. Please tell us how regularly you reduce or increase credit lodged to match falls and rises in the P1 Settlement Report and explain what the associated costs are. Please also clearly state the monthly cost or saving you would expect to incur across your portfolio as a result of maintaining credit equivalent to July P1 vs credit equivalent to March P1 and provide supporting evidence where necessary.

Appendix 1: Pro-formaCredit Support Type and Discounts (Question 3)

Retailer:

Wholesaler area*	Credit Support Type (%)					Discount	Explanatory Comments
	Cash	Guarantee	Letter of Credit (LoC)	Surety Bond	Alternative Credit Arrangement (ACA)	Unsecured Credit Allowance (UCA) (%)	

* Information may alternatively be provided at a more aggregated level (given the tight timescales).

Appendix 2: Full list of consultation questions

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?

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.

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.

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.

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.

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.

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.

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.

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

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?

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?

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?

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.

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.

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?

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.

Ofwat (The Water Services Regulation Authority)
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