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Ofwat
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By email: covidbusinessretailmarket@ofwat.gov.uk

22nd January 2021

Call for inputs: Covid-19 and the business retail market – customer bad debt costs

Dear Ofwat

We write in response to your call for inputs, published on 30th November.

In response to the questions posed in the CFI we make the following observations:

Question 1 – Our initial view is that we consider it is relevant to measure customer bad debt costs that may arise for Retailers solely in terms of amounts due from customers that are appropriately provided for or written off. To what extent do you agree with our initial view here?

We agree – but recognise that due to differing write-off policies it may be several years until all debts relevant to the Covid period are written off, and so therefore any mechanism may need to be applicable over an extended timeframe.

Question 2 - To what extent do you consider that bad debt costs may have differed by geographic region and/or by customer type?

We would expect significant differences by customer type, particularly given that since the initial lockdown, restrictions have varied on which sectors of the economy have been allowed to remain open. Use of the tier system through August-October in particular will have compounded this in some regions, and is also have caused some differences between regions in the level of bad debt experienced.

Question 3 - What is your view on the best approach to measure bad debt costs arising, in ways that are objective, consistent and verifiable?

Policies on outstanding debt will vary – e.g. is it applied to the oldest outstanding debt that is not written off, or allocated to current charges?

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We agree it makes sense to base this on an accounting year.

Question 4 – Do you agree that Ofwat should allow Retailers to determine the basis on which they report bad debt costs (provided that it complies with relevant accounting standards)? Alternatively, should Ofwat set out a more prescriptive and defined basis for the determination and reporting of bad debt costs? Please set out the basis for your view or conclusions.

Using statutory accounts carries the disadvantage that Covid was a known factor for 2019/20 and therefore bad debt provisions may have already been made for 2019/20. And 2018/19 is too early to the start of the market.

The provision/recovery mechanism itself could affect the provision judgements made for statutory accounts – so a non-statutory accounts basis therefore may work better (e.g. no payments for six months and no project plan).

Question 5 – (a) What is your view on the period over which we should be measuring bad debt costs arising, (b) What in your view is the appropriate time interval following this for the measurement of bad debt costs?

We believe it will be clearest to start the period at 1st April 2020, which was only a few days after the initial lockdown was imposed. We expect bad debt related to Covid to persist through 2020/21 and 2021/22.

Question 6 – What is your view on the change in and/or scale of bad debt costs likely to arise since March 2020? Please provide evidence to support your views, for example concerning metrics on changes in the number of customers with payment difficulties or payments in arrears.

In this context we think this question is best answered by retailers, as whilst we have experienced some increase in bad debt in the household sector, these have been limited thus far particularly due to income protection measures and furlough.

Question 7 - Do you agree that these are the right objectives for considering whether and how to amend regulatory protections in relation to bad debt costs?

In general yes, we certainly agree on protection of customers, providing clarity and minimise implementation costs. Whilst we would also agree promoting efficiency should be a normal

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objective in regulation of debt management, we think it should be recognised that the circumstances and consequences of the pandemic were far beyond what would be envisaged in normal operations. Many factors make the level of debt beyond the control of retailers (or wholesalers) and we would caution against attempts to impose unrealistic expectations of the efficiencies that can be obtained in these circumstances.

Question 8 - Do you have views about the merits of enabling the recoupment of (some portion of) excess bad debt costs via amendment to the REC? Do you have any comments or views about the practical implementation of such an approach?

We think this is the most appropriate approach, as recovery through charge caps will be less disruptive an option to market switching than recovery through wholesale charges. The question about how it applies to debt for those customers not on default tariffs arises.

The challenge is applying to individual retailers – it is easier if spread over customers as a whole as a standard bad debt recovery that applies to all customers, but you can't impose this unless wholesalers are advised before setting charges how much to assume.

Question 9 - Do you have views about the merits of enabling the recoupment of (some portion of) excess bad debt costs through wholesale charges? Question 10 – Concerning the option of recoupment of (some portion of) excess bad debt costs through wholesale charges, do you have comments or views about the costs for trading parties of implementing such an approach? Do you have comments or views about the practical implementation of such an approach? Do you have any comments about a possible application process and the data and audit requirements to accompany this?

Our response covers both questions.

We think this approach would be more complex, as wholesale price controls make no allowance for increased Covid bad debt as Covid was not a known factor when the PR19 determination was set. There can be no burden borne by wholesalers, and this includes cash flow timing of any recovery mechanism. We therefore believe it is highly unlikely that we will be able to support such an approach, given the approach Ofwat took on wholesalers taking a share of liquidity and on retailer failure, including the use of PR19 totex sharing rates.

This process would therefore require a central fund to be established amongst wholesalers, and a licence amendment would be required to support its operation.

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It would be necessary to amend wholesale charging guidance to allow for specific recovery of these costs in non-household charges, to protect household customers from this additional burden.

Recovery option (2) through wholesale charges – would need to be outside of a revenue control. A discount to wholesale charges would need to be advised to wholesalers to set a central fund, and this would need to be before the start of a charging year. There would also need to be licence changes to codify this.

The rebate rules would get complicated – so a central clearance approach by retailer / by wholesaler would be required. Customer types would be a further complication. Eventual true up will also be complicated. The timing would need to reflect the wholesale charges timetable.

Question 11 – Aside from amending the REC or recovery through the wholesale charges, do you have any views on whether other mechanisms or approaches to amending regulatory protections may be appropriate? If yes please describe your preferred approach and your view of why it may be warranted.

No, as above we think the REC is the most appropriate means of recouping excess bad debt costs.

Question 12 – What is your view of the appropriate timing for the measurement and recovery of (a portion of) any excess bad debt costs?

This may depend on how different write-off policies are between retailers. Three years would seem a reasonable cut-off for resolution of this issue.

Question 13 - Do you agree that it makes sense to 'pool' recovery of (some portion of) excess bad debt costs across customer groups and/or regions?

We would not agree with pooling by customer groups, as this runs counter to normal charging principles of non-discrimination. We would be more supportive a pooling approach within regions, and this would better reflect the set-up of the market.

Question 14 - Where excess bad debt costs exceed 2% of turnover on an industry wide basis in your view, how should such excess bad debt costs be shared between Retailers and customers?

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This is a primarily matter for retailers and customer representatives, but we would suggest a 50:50 sharing of excess bad debt costs would be appropriate and in line with other regulatory risk-sharing mechanisms.

We hope these comments are useful, as ever please let us know if we can be of any further assistance.

Yours sincerely

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