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Dear Sir or Madam

**COVID-19 AND THE BUSINESS RETAIL MARKET – CUSTOMER BAD DEBT COSTS**

Thank you for the opportunity to provide comments on the potential recovery of customer bad debt costs in the retail market.

In Appendix 1 we set out our responses to the specific consultation questions.

We hope that you find our comments helpful. Please contact us if you would like further detail.

Yours faithfully

**Sally Mills**  
**Regulatory Director**

D: [REDACTED]

E: [REDACTED]

**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?**

SWW agrees with this approach. Debt provision and write off is a standard business process, that is subject to external review and assurance during the annual audit process and disclosure in the statutory accounts. Using this basis will enable transparency across the market and assurance of the validity of amounts being recovered through new regulatory protections.

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

SWW's review of CV19 impacts in this region indicates that customer type is a key factor in COVID-19 impacts. As a region heavily reliant on leisure and tourism we have seen significant demand drops from these industries, whilst other industries have seen more stable consumption in line with prior years. Regional impacts will be dependent on the mix of customers within them, making the customer type the primary driver.

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

To measure the overall debt in the market, SWW would prefer the use of the statutory basis for bad debt recognition and measurement, as this is clearly identifiable from each Retailer's financial statements. Whilst there may be some variation in application across Retailers, this variation will have existed in determining the historic market bad debt level of 1% so should not distort any future analysis of the market.

**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.**

Retailers should be able to report their debts as they wish, subject to accounting standards, in their financial statements as it is a decision specific to their business and subject to external audit.

To evaluate the level of debt applicable for regulatory assistance, a more prescriptive method that is uniform across all companies may be more appropriate. Consideration should be given to ringfencing the customer debt eligible for regulatory support (i.e. related to use of the vacant flag), this would help demonstrate to the end customers that relief is targeted and being kept at a level that meets the 3 objectives of assistance (reviewed in question 7).

Ringfencing the debt in question also prevents an inefficient retailer or whereby insufficient resource is given to debt collection gaining a benefit from this mechanism.

**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?**

Since the consultation was first issued the country has entered 2 further lockdowns. It is therefore unlikely that bad debts will be restricted to the financial year 2020/21.

As we do not yet know when the intermittent lockdowns will end, there are suggestions that they may be required throughout 2021, it would seem appropriate to review the situation on an annual basis, with the assistance period closed 12 months after the final lockdown.

**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**

SWW is a Wholesaler and has no visibility of commercial debt payments and therefore cannot provide comment.

**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?**

SWW agrees with the objectives, especially the objective of clarity. As it is proposed to permit some cost recovery from customers through additional charges, it is vital that customers are clear as to how much they are being asked to pay, to whom, why and for how long. There should also be clear transparency about when any additional charges cease.

**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?**

Amending the REC, as proposed, has the advantage of allowing Retailers to collect their own costs. It would also be cost effective to organise and implement.

The concern would be that Retailers can only collect from their own customers, so customers may be adversely impacted based on the customer base and efficiency of their Retailer. If a Retailer has specialised in a specific type of customer or is predominantly based in a particularly hard hit area, then customers could face sharply varying charges around the market.

Given the impacts of COVID-19 across the entire country and economy, and a wish to avoid inadvertently increasing the hardship in already hard hit areas, SWW would favour an approach which shared the burden evenly across the market and made it clear to each customer exactly how much they were paying as a result of the additional support being provided to the market.

**Question 9 - Do you have views about the merits of enabling the recoupment of (some portion of) excess bad debt costs through wholesale charges?**

SWW does not support recovery of these costs through the wholesale charges. Wholesalers have supported the market during the COVID-19 pandemic through use of the vacant flag and by allowing deferred payments. Wholesalers including SWW continue to look at improving available credit terms which would be highly unusual in any other sector in the middle of an economic crisis. Therefore further support in the form of administration and recovery of retailer bad debt charges appears unduly asymmetric with regard to balancing the risk between wholesalers and retailers.

As the debt is retail related and the charges collected would be entirely due to Retailers, it seems burdensome and unnecessary to involve Wholesalers to administer and run the recovery system.

As identified in the proposal it would require the involvement of multiple parties, the set up of bespoke mechanisms and additional external reviews and audits to run and administer it. This is not in line with the stated objectives of providing clarity and minimising implementation costs.

Adding additional cost onto the wholesale charge would also then increase the revenue recovered through the REC as the Retailer added on its margins – leading to higher than required increases in charges to end customers.

How the RFI mechanism works would also need to be considered so that wholesalers were not penalised where recovery of monies from non-household customers increases revenue which drives an RFI reduction in revenue to all customers in future years. The overall allowed revenue for a Wholesaler would also need review to prevent price decreases for HH customers that then reverse in future years once the recovery period ends.

**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?**

The consultation notes a likely need to build a process involving Ofwat and external providers to manage the processes and complexities. It notes that Retailers would be asked to cover these costs.

Whilst SWW is not in favour of amending wholesale charges to recover Retail costs, we would comment as follows assuming this approach were to be used:

- The total amount to be recovered by each Wholesaler should be determined by a third party across the market (a process administrator). This administrator should be responsible for reviewing and auditing Retailer claims to ensure only appropriate debt costs are claimed.
- The administrator should be responsible for notifying each Wholesaler how much revenue to recover through the wholesale charges.
- The administrator should collect the funds recovered and distribute to retailers and oversee the true up recoveries / reimbursement to customers as necessary.
- As wholesale charges are subject to the allowed revenue controls, it should be clear how wholesalers are to recover these charges and, as these revenues are all to be paid across to the administrator, that they are outside the scope of the RFI.
- The additional Retail margin recovered on these wholesale costs needs to be accounted for somewhere in the recovery calculation.

For the practical implementation

- The earliest initial review quoted in the consultation is October 2021. As indicative wholesale charges must be published in October it would not be possible to give either the market or end customers a view of potential charges at that point.
- As final wholesale charges must be published in early January 2022, it is a very short window for Ofwat / the administrator to review market debt, determine whether additional regulatory support is required, audit Retailer claims, convert this into amounts to be recovered by each Wholesaler and still give sufficient time to wholesalers to adapt their tariff processes to incorporate this element.

One of the options for recovery through the wholesale charges is for Wholesalers to repay amounts directly to Retailers via rebates offset against future charges. This approach, if used, would need to be clearly regulated as to when rebates were to be paid (monthly, quarterly etc), to avoid Wholesalers facing undue pressure to accelerate the process to aid Retailer cashflow. It would also need to be clear that Retailers must pay the wholesale charges in full, not make deductions for estimated rebates due to be trued up later.

**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.**

The REC approach is to amend the Retail charges, whilst part of the Wholesale charge proposal is to set up a central fund to administer the refunds due to Retailers.

An alternative option may be to combine these two approaches. By adding a simple flat charge per customer or customer banding to all Retailer bills regardless of region and paying this collected money across to the central fund, would ensure that all customers in the market contributed to supporting the market. Retailers could then claim from the fund as per the wholesale charge proposal, providing auditable evidence to support their claim. Spreading the recovery evenly across the whole market should also help to minimise the per customer charges.

This approach would enable the recovery to be kept separate from normal charges, without requirement to amend the REC or involve Wholesalers in the process. It would also enable customers to see what they are contributing and for how long as this separate charge would disappear once market support ended.

In asking customers to contribute to debt costs in the market, transparency of charges for the end customer may be key in obtaining their support. A central fund would also then be able to ensure any excess funds are returned to customers through the same process (a credit instead of a charge).

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

SWW agrees with the timing proposed. It is reasonable to treat the recovery with a timeline and methodology similar to that of the RFI where recovery or true up happens in the next available year after the audit is completed.

**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?**

The principle of recovering costs from within the same size band of business is reasonable and would, as stated, protect smaller businesses from bearing the cost of big business failure.

Further analysis of market impacts is required as it may be that recovering costs by business size may still place a disproportionate burden on the small and micro businesses who are least able to support the burden.

It may be worth considering recovering the costs over the whole market perhaps with some weighting to reflect customer bandings.

**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?**

The current proposal is based on total bad debt costs incurred by the market firstly and then by Retailer. However, under the CPCoP customers have been distinguished between those that used the vacant flag and those that did not. Those that used the flag are acknowledged to be COVID-19 impacted and provided with additional protections. Those that did not use the vacant flag are subject to the same rules and protections as before the pandemic. This flag should be used to identify the additional market debt related purely to COVID-19.

If analysis shows that non COVID-19 debt collection has been as efficient and effective as historically then it would be reasonable to ask all Retailers to take 1% extra cost on top of their historic run rate and recover the rest from customers. This would then ensure Retailers all bore a proportionate burden – under the current proposal any Retailer whose historic bad debt rate is less than 1% would bear an additional burden

compared to other Retailers, as they would need to absorb more than an extra 1% before regulatory assistance was provided.