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OFWAT
Centre City Tower
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22nd January 2021

By email: covidbusinessretailmarket@ofwat.gov.uk

Dear Sirs,

Response to the CFI on Covid-19 and the business retail market – customer bad debt costs

Many thanks for the opportunity to input into this CFI; we are responding on behalf of the Self Supply community. Whilst for many of the questions we are unable to provide supporting evidence and are not dealing with customer bad debt in this context; we have, like all businesses, been impacted by customer and supply chain issues due to Covid so can offer a perspective. We are keen to help inform decisions where we can add value; to that end we have responded, where appropriate below:

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 support this view; significant support has been provided through the swift action undertaken when the first lockdown came into force and this has been extended through later activities. With this, other opportunities and the time lapsed this should have enabled Retailers to address the other issues raised in the consultation document, namely working capital and debt collection activities.

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

Customer type is likely to have had the greatest impact given the government enforced restrictions, with many businesses ceasing to trade entirely (i.e., pubs and restaurants) and others increasing their activities (food manufacturing, etc). Geography will also have a significant impact based upon the demographic and of course the regionalised lockdowns. The extent of this is hard to measure given the variances we have seen; in the hospitality sector alone, there are those who have been able to retain their portfolios and staff and continue to pay their bills, others who are disposing of premises and seek payment deferrals and many who face severe financial hardship and are unable to pay. Each Trading Party will have a very individual experience based upon their customer portfolio.

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

Given the need for objectivity and consistency it feels more appropriate to take a non-statutory accounts-based approach. We are fully aware that Trading Parties operate very differently, and we have all witnessed the variety of interpretations made by Trading Parties. Application of a more explicitly defined measure will cover concerns of objectivity and consistency. We would propose that no remittances received within the 2 months prior that could indicate slower payments be included. All provisions should be specific and not general and could be subject to verification by an independent auditor.

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There should also be evidence of invoicing, whilst we appreciate this is a difficult metric to monitor there is evidence of debt being chased, when no customer invoice has ever been levied.

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.

As per our response to question 3, Non-Statutory basis allows for the introduction of a set of tighter parameters that will ensure a more consistent approach retailer to retailer and that are unique to these circumstances.

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?

Retailer will have had debt prior to April 2020 against which it would be reasonable to assume that payment was forthcoming but subsequently never arrived. As such there may be an argument to move the period start date by the retailer's average DSO achieved over the past two accounting periods.

The proposed time interval proposed feels appropriate.

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.

We are not privy to this information so cannot provide a response,

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?

Absolutely. Protecting the customers interests must be the primary focus and efficiency and clarity support the delivery of this. It is essential given the potential impact on customers, who will already be suffering from the impacts of Covid-19, that transparency is provided demonstrating the logic and accuracy of data utilised to determine any change implemented.

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?

This seems a logical approach and we do not have an alternative simple proposal. Whilst ideally, we would avoid any further burden on the customer this is being seen across all markets and will not be unexpected. Option 1 seems the most practical approach and will encourage focus on debt collection as well as having other positive unintended consequences i.e., debt due to poor billing practices (or indeed no billing at all), rather than Covid specific challenges, will need to be addressed and efficiencies introduced to remain competitive in pricing.

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

This approach seems burdensome and more complex to deliver, also perhaps introduces more cashflow issues with the uplift of Wholesale charges. There needs to be further clarity with regards to its application which we would anticipate seeing in the next consultation.

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?

We do not have access to data to provide a meaningful response but believe this to be an overly complicated approach as per our response to question 9.

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.

We do not propose an alternative approach.

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

What is proposed feels reasonable, we have no basis or argument to suggest a different approach.

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?

Agreed. This is a national problem and so to apply at regional level would seem inappropriate, however this must take into consideration underlying bad debt levels.

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?

It is appropriate to review the levels the Retailer must bear over and above an industry wide level. The current mechanism seems fair and reasonable; with industry levels increasing to 2%, then maybe a small flexing to the current mechanism would be appropriate so maintaining a shared basis i.e., Retailer to bear an additional 0.5% rather than the 1% currently set out and then the balance over and above recovered from customers. This would need further analysis to determine appropriate levels. Ideally customer price increases are avoided where possible, but realistically this will have a longer-term customer impact if not effectively addressed in the short, to medium term.

Yours faithfully

[redacted]

Claire Yeates
Strategy Director