

Webinar summary

19 January 2021

Summary of 11th January 2021 webinar on Call for inputs on Customer bad debt and amending regulatory protections for retailers

Introduction

Ofwat on 30th November 2020 published a [Call for Inputs \(CFI\)](#) on customer bad debt in the business retail market. The CFI seeks views on our approach to assessing whether and how revisions to regulatory protections may be warranted in the business retail market in respect of risks of elevated customer bad debt resulting from the effects of the Covid-19 pandemic. The deadline for the responses to the CFI is 5pm on Friday 22nd January 2021.

To give interested parties an opportunity to seek clarifications on the CFI and issues arising, Ofwat on Monday 11th January 2021 1pm hosted a Customer Bad Debt webinar. The webinar provided an opportunity for interested parties to ask questions on the CFI and issues arising.

Around 30 participants, representing retailers, wholesalers and other interested parties, attended the webinar. This document is a summary of questions put by participants and Ofwat's responses.

Ofwat preface

Ofwat prefaced the webinar with some introductory remarks and clarifications:

- Responses to the CFI are due by 5pm Friday 22nd January 2021 and Ofwat would encourage as many interested parties as possible to respond. The pandemic continues to have an impact on all sectors of the economy and the full impact on retailers in terms of the scale and form of customer bad debt costs is not yet fully apparent. Ofwat emphasised that it is important to have as many views as possible on the CFI to aid its decision making.
- Ofwat noted that it had sent a request for information (RFI) to retailers at end November 2020 seeking information and data relating to the potential scale of customer bad debt costs arising in the business retail market. Ofwat in particular:

- Reminded retailers attending in the webinar that responses to the RFI are due by Friday 22nd January 2021 (ie. in line with those to the CFI).
- Noted that the scale of the customer bad debt issue for the business retail market is currently unclear and that the further information Ofwat had requested via the RFI should help give more clarity. Hence Ofwat emphasised that data returned through the RFI should if at all possible be stated on the basis of actual figures through to 31st December 2020.

Summary of questions and answers

Decision making and certainty

Q. The participants emphasised the need for certainty to maintain the support / confidence of investors / funders. Participants called for early sight of an Ofwat decision, eg. before the end of the current financial year, on whether amendments to regulatory protections in respect of bad debt costs are warranted and, in the event such amendments are warranted, introduction of such amendments in early 2021/22 such that retailers may receive some recompense for additional bad debt costs incurred. Some participants emphasised that such costs also include financing costs in respect of customer bills not yet paid.

Ofwat: Ofwat acknowledged that early steer and clarity for industry would be helpful. At present, the potential scale of bad debt costs arising is not yet clear. Ofwat confirmed it is seeking to achieve a balance between providing clarity for industry, against the risks of making early decisions on the available (incomplete) information – for example concerning pass through of early estimates of bad debt costs – that may not be in the best interests of customers. Ofwat noted it is looking to consult on its preferred approach before 31st March 2021 and the final decision later in 2021.

Ofwat also noted that retailers, following amendment to the Retail Exit Code (REC) and maximum price restraints from April 2020, now have more commercial freedom to adjust prices, within the context of competitive constraints, where they see cost increases. This is particularly the case in respect of customers with annual consumption exceeding 50ML, where retailers are not subject to maximum price restraints set by regulation.

Question of wholesaler support in respect of customer bad debt costs

Q. One participant suggested it would be appropriate, given that it is in the interests of all customers and the industry more widely for the challenges presented by Covid-19 to be overcome and that these challenges would remain for the immediate and mid-term, for wholesalers also to contribute to – where warranted – the relief available to retailers in respect of elevated levels of customer bad debt costs. This participant asked if Ofwat would consider this.

Ofwat: Ofwat will consider all evidence received in response to the CFI but noted that wholesaler support for retailers had been explicitly treated and given separately under arrangements for liquidity support for retailers introduced in April 2020. Ofwat also noted that we have been consistent in our view – as set out for example in our [30 April 2020 Decision document](#) – that we have been guided by the principle that Retailers are, in the first instance, responsible for managing bad debt risks and costs in the business retail market.

Question of bad debt costs across industry exceeding 2% of turnover

Q. Participants asked about the question of bad debt costs at an industry level exceeding 2% of turnover, with questions as follows:

- (a) Is it Ofwat's view that bad debt costs across industry are likely to exceed 2% of turnover and, if so, whether Ofwat is taking the initial view that amendments to regulatory protections will be warranted.
- (b) One participant commented that it would be useful to understand the thinking around the 2% level. For example, has the cut introduced a new level of complexity? What is the likely approach if the sector outturn is only marginally above 2%?

Ofwat: In respect of:

- (a) Ofwat noted that information and data available to Ofwat at present, including data returned by retailers in August 2020 in response to Ofwat's Request for Information (RFI), do not give a clear indication that bad debt costs to industry increased significantly to June 2020. Our more recent (November 2020) RFI to retailers, seeking data to December 2020, should help give a clearer indication. However Ofwat also noted that bad debt costs can take time to crystallise and that it may take some time for a clear picture to emerge, including for example, the assessment of whether unpaid invoices have crystallised or are likely to crystallise as bad debt costs.
- (b) Ofwat commented that it had set out the 2% level as a point of certainty for the industry, ie. that at an industry level they should at least expect to bear outturn bad debt costs to 2% of turnover (or, for any one retailer, its historical bad debt costs as a proportion of turnover, plus 1%). Ofwat would need to consider the proportionality of pursuing and implementing any solution or regulatory intervention if outturn industry level bad debt costs are expected to be only marginally above the 2% level. Ofwat also noted that were the level of outturn bad debt costs at an industry level to significantly exceed 2%, it may need to consider recovery of such costs over an extended period.

Bad debt costs arise over an extended period

Q. Participants commented that bad debt costs arise over an extended time period and can take considerable time to crystallise; one participant for example said that a six year time horizon may be needed fully to assess crystallisation of bad debt costs. For these reasons, participants commented and put questions as follows:

- (a) Participants emphasised that simply waiting to assess outturn bad debt costs after the event would imply too long a delay concerning any decision on regulatory protections and the relief available to retailers.
- (b) One participant emphasised that the pandemic has gone on much longer than many had originally thought likely, including that it is continuing into 2021, and that to capture the full cost is likely to mean waiting many months. On this basis, the participant asked if Ofwat had considered a phased / interim approach?
- (c) One participant asked whether it may make sense to base early estimates of bad debt costs arising on the basis of analysis of aged debt costs.

Ofwat: Ofwat addressed the points as follows:

- (a) & (b) Ofwat acknowledged that the time period for intervention may be extended by the ongoing situation. Accordingly the CFI includes consideration of a possible interim solution with subsequent reconciliation (a 'true up').
- (c) Ofwat acknowledged that companies may take into account the aged debt profile and payment performance of its customers when making provision for bad / doubtful debts. Ofwat commented that, to the extent a reasonable basis of provision is applied which takes into account such factors, consideration could be given to using such estimation as a basis for estimating bad debt costs, subject to a subsequent 'true up', but that we would also need to consider this alongside other relevant factors.

CFI approach (1) Amending the REC

Q. Participants asked about approach (1) set out in the CFI, adjustment to the price cap via the REC, with a particular enquiries as follows:

- (a) Whether any adjustment to the cap would be tailored to each retailer or would be uniform across retailers. One participant suggested for example that where any increase to the cap is uniform across retailers, there would be 'winners' and 'losers' in respect of any one retailer's ability to recoup bad debt costs it had incurred.

- (b) How quickly any amendment to the REC could be implemented, for example could this happen during 2020/21? Had Ofwat considered the impacts on within year retail price changes?
- (c) Can the Retail Exit Code and the maximum price restraints applying under it be modified by the retailers if all parties agree? The participant putting this question noted for example that if this were possible, retailers themselves could in a sense mimic the competitive process in response to a cost increase by seeking to increase their own prices.

Ofwat: Concerning:

- (a) Ofwat confirmed its intention that under approach (1), there would be a uniform adjustment to price caps, meaning that this would apply equally to each retailer. Regarding the consequential question of ‘winners’ and ‘losers’. Ofwat noted that consistent with a competitive and unregulated market, suppliers that had better managed their bad debt costs would, all other things equal, tend to reap a competitive advantage.
- (b) Ofwat said its initial understanding was that the REC could be amended at any point in time, with retailers free to amend their own prices within any new price constraint that the amendment introduced, from the date the REC amendment took effect. Ofwat acknowledged this could happen within a financial year, which – given that most retailers amend prices at the beginning of the financial year – potentially cuts across retailers’ tariff cycle. Ofwat invited views concerning the potential impacts of such an approach.
- (c) Ofwat can clarify that retailers are unable, under the Retail Exit Code, independently to seek and implement changes to maximum price restraints. Ofwat, as the sector regulator, has powers to seek and implement amendments.

CFI approach (2) Recovery from business customers via wholesale charges

Q. Participants asked about approach (2) set out in the CFI, recovery of bad debt costs from business customers via wholesale charges, with a particular enquiry about whether this approach would require amendment to price control arrangements applying to wholesalers, eg. would recovery through wholesale charges be outside the wholesale revenue controls? Would there need to be a licence change?

Ofwat: Ofwat commented that, were relevant bad debt costs to be recovered via wholesale charges, then we hadn’t anticipated any need or desire to ‘re-open’ PR19 determinations. However Ofwat acknowledged that this is not a straightforward solution and the implication

on the wholesale allowances and licence conditions would need to be fully explored before any decision was taken to proceed with this option.

Post-webinar update

We have noted views expressed by interested parties concerning their desire for clarity and early sight of Ofwat's likely policy position concerning whether and how revisions to regulatory protections may be warranted in the business retail market in respect of risks of elevated customer bad debt resulting from the effects of the Covid-19 pandemic.

We are currently considering whether and to what extent we can expedite timescales, including bringing forward publication of our next consultation document on a preferred option, and will issue an update on this shortly.