The voice for water consumers
Y corff sy'n rhoi llais i ddefnyddwyr dŵr

CCW response to the Water Services Regulation Authority (Ofwat) Business Retail Market Consultation on Customer Bad Debt

CCW response **April 2021**

1. Introduction

1.1 The Consumer Council for Water (CCW) is the statutory body representing the interests of household and business customers of water and sewerage companies and licensed retailers in England and Wales.

1.2 We welcome the opportunity to respond to Ofwat's consultation on customer bad debt in the business retail market, which follows the November 2020 call for inputs.

2. General Comments

2.1 Out of the options proposed in the consultation, we support amending price controls under the Retail Exit Code (REC) to allow for excess bad debt costs to be recovered from customers. However, if customers are going to bear some of the responsibility for bad debt costs, then this should not be confined to one group. We therefore want to ensure that it is not solely those subject to price controls that bear the burden of any price rises.

2.2 It is also clear that the effects of the pandemic will continue to endure for a significant timescale, which therefore should be taken into account when setting the recovery period. In order to minimise the impact on affected customers, we believe any price increases should be spread over a longer timeframe than the 2 year period suggested.

2.3 In order for customers to have confidence that any price increases are justified, there is also a need for robust evidence to be required on the scale of bad debt costs. Retailers reporting of data needs to be as robust and consistent as possible, which can only be achieved by Ofwat adopting a prescriptive approach to the reporting of bad debt costs.

2.4 We are concerned with the proposed split in costs between retailers and customers if bad debt exceeds a 3% threshold. Customers being responsible for such a high proportion does not seem appropriate, so Ofwat need to reconsider what we consider to be an inequitable sharing of bad debt costs.

3. Response to Ofwat Questions

Question 1 – Our analysis on the basis of data available to date suggests that market-wide customer bad debt costs have, or are likely to, exceed 2% of total NHH revenue. What is your view concerning likely outturn bad debt costs for the year 2020/21 and into 2021/22?

3.1 We are supportive of Ofwat having requested information from trading parties and the wider industry to get a greater understanding into, and enable analysis of, the impact of the pandemic on customer bad debt costs. We agree it is important to continue to gather and analyse information throughout 2021 in order to test the regulatory protections proposed before implementation.

3.2 Based on the evidence set out in the consultation document, we recognise that COVID-19 restrictions may have caused an increase in ‘regular’ debt levels in 2020-21, and we agree it will take longer for the true impact on debt to materialise. The financial support on offer so far in 2020-21 (e.g. payment relief between March and September 2020 for some under the temporary vacancy scheme, access to government financial support, repayment plans etc.) may have enabled affected business customers to continue to make payments, albeit at a reduced rate. Therefore, bad debt levels will need to be monitored closely over the next few years, as the true cost is unlikely to be apparent at this stage. The outturn bad debt costs for 2020-21 and 2021-22 may be felt for some years as the economy recovers from the pandemic and its impact.

Question 2 - To what extent do you consider that lower consumption customers have been affected more significantly by Covid-19 measures resulting in a potentially larger rise in bad debt costs, relative to larger consumption customers?

3.3 While the November RFI evidence collected by Ofwat suggests that bad debt costs have increased across all customers, they also show low income customers have been significantly impacted by the COVID-19 restrictions. It is highly likely that many businesses historically using less than 0.5Ml a year have been required to close under government guidance due to the nature of their business, and as such may have suffered financially. It is therefore important that measures taken to alleviate bad debt do not exacerbate the financial impact on lower income/consumption customers.

3.4 However, as the consultation evidence is based on retailer submissions last year, it is important to collect more recent data to ensure decisions are based on the latest debt position. We would want to see data collected following the second national lockdown in December and then again after businesses are allowed to open their doors and start trading.

Question 3 - Do you agree that it is likely that the impacts of the pandemic, and possibly increases, in bad debt costs will continue to accrue during 2021/22 and possibly beyond?

3.5 As set out in our response to question 1, we agree that the impacts of the pandemic will continue into 2021-22 and beyond. At this stage in time, we do not know when, or if, many businesses will return to ‘normal’ trading as a result of the impact of the pandemic. This is why it is important to continue to request information from retailers to enable analysis of the latest data on bad debt costs.

3.6 In addition, we agree with Ofwat that it would be sensible to take into consideration relevant increases in bad debt costs related to usage from 1 January 2020 onwards.

Question 4 – Do you agree that, since bad debt costs may take time to manifest, there is merit in using available Retailer accounting data to estimate an initial revision to regulatory protections, followed at a later stage by a ‘true up’?

3.7 It is important that information being requested by Ofwat is not subject to interpretation by retailers. In our response to the call for inputs, we agreed that there may be a risk of retailers over-estimating their levels of bad debt, which could arise if there is more freedom for them to determine the basis on which they report. We supported a prescriptive approach on a ‘non statutory accounts basis’ to help safeguard against such over-estimation, and achieve a consistent approach to data submission.

3.8 We agree there is merit in analysing retailer accounting data to help determine initial revisions to regulatory protections. However, there will be uncertainty around the full extent of eventual bad debt costs at this point. While a ‘true up’ at a later stage could correct any over-estimation that takes place, customers could be unnecessarily impacted by this if a significant timeframe elapses before the ‘true up’ occurs. We therefore urge Ofwat to be more prescriptive in the data it requests from retailers, even when determining the initial revisions

3.9 As referenced above, we also support a subsequent ‘true up’ based on actual bad debt costs once more accurate and audited information is available. We recognise that this may necessitate further revisions to regulatory protections, following industry consultation, in the light of the ‘true up’.

Question 5 – Where we revise any regulatory protections, we are minded to implement them such that they take effect from April 2022. We note that an alternative, basing any revisions on the basis of currently available data, could take effect from October 2021. Do you agree with our minded to position? Please explain your answer.

3.10 We know that the financial effects of the pandemic will likely be felt by many businesses for years to come. Therefore, we need to allow for an extended recovery period to take place before any potential increase in prices are introduced. We therefore believe October 2021 is too soon to revise any regulatory protections and, as indicated in the RFI, mid-year price changes could be problematic for both customers and retailers.

3.11 It is important that the timing for the measurement and recovery of a portion of excess bad debt takes into account the need for robust reporting and auditing processes to be in place, and for the impacts of the pandemic to start to materialise. As the costs of bad debt are unlikely to be apparent for some time, in principle, we generally support the ‘minded to position’ of regulatory protections taking effect from April 2022. However, it is important that the recovery mechanism is applied over a number of years so the impact is spread out in order to lessen the impact on business customers.

3.12 We also note that Ofwat plans to carry out a wider review of the retail-exit code (REC) price caps in 2021-22, with any adjustments expected to be implemented from April 2023. We would like to understand the likely impacts on customers of this wider review before any regulatory protections for bad debt costs are implemented. It would be concerning if some customers experienced a price rise as part of the solution to mitigate excess bad debt costs, only to see a further rise as a result of any adjustment to price caps that may occur. As part of this review, we would urge Ofwat to also measure customer acceptability of any proposals that are made, which we would be happy to assist with.

Question 6 – Do you agree with our presented 'minded to' view that amendment of REC price caps is the approach that best meets our objectives concerning customer bad costs?

3.13 We believe an amendment to the REC may be the most straightforward option for recouping a portion of excess bad debt costs, as this will provide an allowance for bad debt cost recovery through default tariffs. An amendment to the REC also appears to be less complex and places less of an administrative burden on retailers, which could ultimately have been passed onto customers.

3.14 However, while we see the merit in Ofwat's 'minded to' view, we also feel that there is a risk that only customers subject to price controls will bear the burden of price increases under this proposal. While retailers are free to increase tariffs for those not subject to price controls, there is no guarantee that this will take place, and there may even be commercial incentives to avoid such a course of action. Therefore, we would like Ofwat to explore how any price increases could be weighted across all customer groups in order to mitigate the risks we have outlined.

Question 7 - Do you agree with our assessment of the options for revision of regulatory protections?

3.15 We feel that Ofwat's assessment of the options clearly sets out the benefits and disbenefits of each for trading parties and customers.

Question 8 - If market-wide bad debt costs are 3% or lower, we propose Retailers and NHH customers should each be expected to bear 50% of excess bad debt costs. If market-wide bad debt costs exceed 3%, we propose Retailers should be expected to bear 25% of excess bad debt costs and NHH customers 75%. Do you agree this proposal meets our stated policy objectives? Please explain your position and provide supporting evidence (including evidence on costs of recovering bad debt from customers).

3.16 We acknowledge that there needs to be a sharing mechanism for bad debt costs over the stated thresholds, but we want to see the right balance struck. It does not feel appropriate for customers to bear such a large proportion of costs where these exceed the 3% threshold. To avoid customers potentially bearing an undue share of bad debt costs, we would like Ofwat to reassess their proposal. This could include an assessment of how well retailers are managing bad debt, and whether or not this is genuinely unrecoverable. Any retailer performing poorly against these indicators could be responsible for a higher percentage of excess costs.

3.17 In our response to the CFI we also recognised that wholesalers may be able to take a proportion of the bad debt costs due to their monopoly position, size, ownership, and access to current lower cost of financing. However, we are disappointed that this option has been discounted at this stage. We urge Ofwat to reconsider their position on this, as excess bad debt costs shared three ways should reduce the level of individual contributions, which would lessen the burden on customers.

Question 9 - Do you have views concerning the approach to setting the revision of the REC price caps with respect to excess bad debt costs?

3.18 As stated above, we support an adjustment that allows for recovery of the costs over a longer period than the usual timeframe for the REC price control. The exceptional nature of the pandemic means that two years may not be sufficient to spread the bill impact in a way that may be palatable for customers. A longer period would therefore lessen any adverse impacts, particularly at a time when many are struggling financially.

3.19 In setting the revisions of the REC, we do not want to see small and micro business customers paying a higher proportion of the bad debt costs than they have incurred. We therefore support the principle of 'pooling' the recovery of costs across both customer groups in order to minimise the possibility of such customers being affected disproportionately.

Question 10 – How in your view should efficient finance costs of bad debt be defined and estimated where we make an allowance for efficient working capital costs?

3.20 In general we believe that bad debt costs should be measured in terms of amounts due from customers where there is clear evidence that payment is not recoverable, or expected to be. We agree that there is merit in making an allowance for working capital costs as this would help ensure that retailers can finance their functions whilst recovering bad debt costs. However, Ofwat would need to demonstrate that such an allowance is based on an assessment of efficient financing assumptions. In order to receive a working capital allowance, retailers should also give assurance that their quality of service to customers will not be affected during the period of recovery.

Question 11 – Do you agree that there is merit in enabling recoupment of (a portion of) excess bad debt costs in two 'pools'; one relating to customers with annual consumption below 0.5Ml, and another for customers with annual consumption 0.5Ml to 50Ml? Or should we pool bad debt arising from both groups of customers and calculate an average uplift to the price caps across this combined group? Please explain your answer.

3.21 We support the principle of 'pooling' recovery across both customer groups and calculating an average uplift across the combined group. We feel this could help to prevent small and micro business customers paying a higher proportion of the bad debt costs than they have incurred. However, the final decision should be based on more recent information collected from retailers.

Question 12 – Do you have views concerning the data and information Ofwat intends to seek with a view to enabling the setting of adjustments to the REC price caps?

3.22 We largely welcome the data that Ofwat intends to seek in order to make its decision on regulatory protections for bad debt costs. However, we also feel there is merit in asking retailers to document the reasons why debt has been written off. This may be useful as it will show how much bad debt has been caused by insolvencies, or other reasons. This may also act as evidence that bad debt is genuinely unrecoverable from customers.

3.23 We note that retailers will be asked for this in April 2021, and we also want to see a further RFI in September 2021 to reflect any change in position.

Question 13 - What are your views about the time horizon over which any amendment to the REC price caps made in respect of excess customer bad debt costs should apply? Do you agree that there is merit, in adjusting REC price caps, both to committing to such adjustments enduring for at least two years, and that such increases should be attenuated to minimise potential price rises for customers?

3.24 We welcome and support the proposal to adjust the REC price caps over a minimum of two years. Many businesses remain closed and, as such, are struggling financially as a result of the pandemic restrictions. It is important that any price increases are minimised, and one means to achieve this is by recovering costs over a longer period of time. Implementing adjustments across at least two years should also enable the financial impacts to materialise and be responded to accordingly.

Enquiries

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