Ofwat
[redacted]

Via email: covidbusinessretailmarket@ofwat.gov.uk

Dear Ofwat,

RE: Business retail market - Customer bad debt – March 2021 Consultation

I am writing to you on behalf of independent Water Networks Limited (“IWNL”), part of the BUUK Infrastructure Group of companies, in response to your consultation on Covid-19 and the business retail market: Customers Bad debt. We can confirm that this consultation response is not confidential, and we are happy for Ofwat to publish this on their website.

We have been working with WaterUK and its members and support their consultation response with the following additional comments. We specifically welcome Ofwat’s recognition that the provision of additional liquidity to the business retail market must not come at the expense of the financial viability of wholesalers. We also welcome the clarity that wholesalers should be compensated for the provision of additional “bridging” liquidity that was not foreseen under the previous market arrangements. We also recognise that there is a continued need to review arrangements as the situation developers further. For these reasons, in April 2020 we welcomed Ofwats initial decision that Retailers should be expected to bear bad debt costs up to at least 2% (of non-household (NHH) revenue) in full. Historical levels of market-wide bad debt have been around 1% and we estimated that bad debt levels of around 2% would reflect a ‘normal’ recession-type scenario that an efficient and prudent Retailer should have planned for. Given that it is very likely that market-wide bad debt costs will exceed the threshold of 2%, we agree that it is now the time for Ofwat to clarify how these excess bad debt costs will be reflected in the ongoing regulatory framework.

We are supportive of Ofwats initial proposals and see them as fair and pragmatic for all stakeholders. For the avoidance of future doubt, we would welcome the clarification of the definition of wholesalers to explicitly cover NAVs and other wholesale licensees. We have taken this wider definition as the basis for our support for the WaterUK consultation response. We remain committed to work constructively with all market participants to ensure protection of consumers and the industry in the long term.

We have provided answers, where relevant to each of the consultation questions in appendix 1. We would be willing to discuss this consultation with you in more detail if that would be helpful.

Your Sincerely

[redacted]

Keith Hutton
Regulation Director (Heat, Fibre and Water)

Appendix 1. Consultation question responses.

Section 2 – Customer bad debt costs: the 2% threshold

[redacted]n the basis of data available to date suggests that market- [redacted] are likely to, exceed 2% of total NHH revenue. What is your [redacted]t costs for the year 2020/21 and into 2021/22?

[redacted]d debt levels for both HH and nHH customers in 2021/22 compared to 2020/21. For nHH customers this is very likely to exceed 2% of total NHH revenue in the regulatory year.

Consultation 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?

We have not observed any differential in the Bad Debt rate between larger and smaller consumption customers.

Section 4 – Timing issues

Consultation 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?

Yes, given that restrictions on business operation will continue beyond March 2021 and overall economic activity is not forecast to return to pre pandemic levels for some time, we expect bad debt levels to remain higher for some time and into 2022/23.

Consultation 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'?

We would agree that a multi stagged process to estimate bad debt costs and updates to regulatory protections would be the best way forward. This could be targeted at a regulatory year update starting with the annual returns for 2021/22.

Consultation 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.

We would hope that there remains sufficient time to put in place a correction mechanism for the regulatory year 2021/22. A revision in October 2021 for the regulatory year 2020/21 would also be welcome.

Section 5 - Mechanism to recover costs from customers

[redacted] **with our presented ‘minded to’ view that amendment of** [redacted]**t meets our objectives concerning customer bad costs?**

[redacted]

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

No further comment.

Section 6 – Sharing parameters

Consultation 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 Business Retail Market: Customer Bad Debt - Consultation 55 stated policy objectives? Please explain your position and provide supporting evidence (including evidence on costs of recovering bad debt from customers).

We accept that customers and Retailers should bear the increased cost of bad debt. We agree that this is in line with Ofwats stated policy objectives.

Section 7 - Approach to adjusting REC price caps

Consultation 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?

We remain unclear how a small-licenced operator (NAV) that isn’t covered by the Retail or Wholesale price control process would be able to recover the increased costs of Bad Debt in line with Ofwats general principles. We believe that the final mechanism should allow for this.

Consultation 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?

No further comment.

Consultation 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.

[redacted] do not see the merit of splitting bad debt costs into two [redacted] **views concerning the data and information Ofwat intends** [redacted] **ing of adjustments to the REC price caps?**

No further comment.

Consultation 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?

We think the adjustments to price caps should be for a minimum of two years and there is a strong case that they may run until the end of the next full retail price control.