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Business Retail Market: Customer Bad Debt Consultation

Dear Ofwat

Thank you for the opportunity to respond to the consultation. In general, we are supportive of the approach proposed and our responses to the specific question are below.

Consultation 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?

Payments for the last quarter have taken a notable downturn so as yet there exists a significant degree of volatility for outturn 20/21. For the year 2021/22 our view is that the bad debt costs will exceed 2% of total NHH revenue.

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?

It is difficult to determine the extent as it depends on the mix of customers you have. Some low consumption customers are actually part of large corporates so would have a different credit risk profile to SME low consumption. In general, there is little doubt that SMEs have been more greatly affected than Corporates.

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?

We do agree because of course customers that have been affected continue to consume and continue not to pay bills. We will bill some of this consumption in 21/22. Therefore, we have debts from the beginning of the pandemic but also potentially debts that are from bills yet to be raised. Over time this will tail off so the question is one of materiality, but at present there is little doubt the impacts will be felt beyond the next financial year.

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'?

Agreed, but in time the materiality of the tail of bad debts may not be worth the effort of auditing and verifying once we reach a threshold of accepted bad debts.

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.

Agreed, it will be based on audited data and would avoid the logistical difficulties of a mid-year price change. Provided the quantum of recovery stays the same then we are in agreement with this approach.

Consultation 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?

Yes, simple and uses current methods to implement.

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

Yes.

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 stated policy objectives?

Please explain your position and provide supporting evidence (including evidence on costs of recovering bad debt from customers).

Since the beginning of this process the degree of bad debt exposure retailers have been expected to take has shifted. When first proposed it was protection for anything above 2%, although little evidence has been provided for why 2% is a reasonable threshold. The degree of protection has now shifted further such that it is not everything above 2%. We believe that the original 2% was arbitrary and any sharing above this is equally arbitrary. Given the 2% threshold is unlikely to be reviewed we believe retailers should be able to recover all costs in excess of 2%.

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?

No

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?

The efficient finance cost of bad debt should be the amount of bad debt above norm multiplied by the cost of capital for the company concerned. There should also be an allowance for the working capital costs of payments made later than otherwise would have been made given the extended terms provided to customers and the restrictions retailers have been working under.

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.

We would agree with the pools approach as it more reasonably allocates the costs where they fall.

Consultation 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?

No

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 do agree that we spreading the rise over 2 years makes sense provided the overall quantum recovered stays the same.

We would be happy to discuss any of the above questions with you.

Yours Sincerely

[redacted]

Sasee Rajah

Financial Controller

SES Business Water