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OFWAT
Centre City Tower
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6th April

By email: covidbusinessretailmarket@ofwat.gov.uk subject 'Customer Bad Debt 2021 Consultation'

Dear Sirs,

Response to Business retail market – Customer bad debt - Consultation

Many thanks for the opportunity to input into this CFI; we are responding on behalf of both Waterscan and 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 relating to water industry customers; we are keen to help support in the management of market risks and participate in key market decisions. Having reviewed the consultation fully, we have responded where appropriate below:

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?

The self-supply community does not have visibility so can provide no view on predicted outturn bad debt costs for the industry but is supportive of the assumptions made that costs are likely to exceed 2% given the analysis and data collected to date and the impact Covid has had on business operations in the UK.

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?

The graph detailed in figure 4 clearly supports this: however, this will have been adversely impacted by the complete closure of many lower consuming independent premises such as retail and pub businesses, whilst larger groups have continued to maintain head office staff to deal with billing issues. With regards to larger consumers, manufacturing sites have continued to operate at normal or in some cases higher capacity, whereas several larger consuming sites in the hospitality and leisure sector, large hotels, airports, etc that have been significantly impacted have maintained so it may be more diverse than it first appears. The challenge is perhaps more that lower consuming, small businesses pose a greater risk as far as bad debt is concerned due to potentially ceasing to trade because of Covid. There have been many examples of this particularly in the latest lockdown with retail operators changing their model to concessions or online.

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?

It is highly likely that the impacts of the pandemic and bad debt costs will continue to accrue during 2021/22, estimating beyond that is extremely challenging as we cannot predict if there will be future spikes and are so reliant on government intervention. However, this will be a primary focus for Retailers and as the proposed solution is for a two-year minimum period, this allows for a continuation. With further review in 2021/22 ensuring that any further issues identified can be appropriately addressed.

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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'?

Given that it is impossible to accurately predict the period over which the excessive Covid bad debt will be experienced this feels like a pragmatic approach and enables a solution to be defined with the 'true up' with validated data identifying any required amendments.

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.

Given we are not directly impacted it would be easy to support Ofwat's 'minded to position,' however as always in our response we look at the overall market impact and stability not just our individual positions. The logic for Ofwat's 'minded to position' is sound and concerns with regards to data accuracy and robust calculations are valid; however, this is a calculation based on estimated data in any event and so is potentially flawed, with an interim adjustment final adjustment in April and 'true-up' in accuracies would be flushed out.

Whilst not ideal given the broad consensus of CFI responses suggesting Retailers would like this to be implemented as soon as possible we have to assume that it is a significant challenge and therefore earlier intervention would be beneficial and likely to be of indirect benefit to the customers.

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, we agree with this approach whilst there may be some rough justice in a uniform approach it provides strong incentive for all to address bad debt in combination with other metrics i.e. earlier amendments to caps in April 2020 and the review of allowances for efficient working capital costs this provides a well-rounded solution to address the challenges faced by bad debt, whilst allowing the Retailers flexibility in their approach. Both the alternative options have a level of complexity which will result in slower application, which contradicts the Retailers' desire for swift implementation detailed in CFI responses.

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

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).
We agree this meets your policy objectives but have no supporting evidence to provide regarding the costs of recovering bad debt from water industry customers.

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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, it is measured and well considered. We acknowledge that no measure of approach will serve as an appropriate treatment for every instance particularly in the current climate, and as such there is likely to be varying degrees of benefits across trading parties; but we would hope that once shared it would not be a significant burden on the market.

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?

This should be the effective interest rate method which spreads the interest income or expense over the life of the financial asset or liability and is an effective way of estimated rate of change over the Covid period.

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.

Whether pooled or not this is a challenging decision, with concerns regarding data quality to apply effectively and potential disproportionate allocation to customers who have been most greatly affected by the pandemic. However, there is a solid argument that given this grouping already exists in the REC the data should arguably already be understood, therefore simplifying the application. Given Ofwat have seen no compelling evidence with regards to the differential in the costs to recoup debt and the significant diversity within group two we would favour combining the two customer groups in a single pool.

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?

Nothing to add the data request is appropriate for the assessment required.

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?

The time horizon is logical, given the anticipated timeframe for the impact of bad debts to be realised and fully understood also it aligns with a wider review of the REC price controls. There is absolute merit for the adjustment, the reasons for which have been superbly detailed in both the scene setting and positioning presented in the CFI document and this consultation paper, with the protection against market risks being essential. In addition, and of primary focus, customer protection which is addressed with the attenuation of proposed increases is welcomed and reflects Ofwat's objectives in protecting customer interests.

Yours faithfully

Claire Yeates
Strategy Director