

## **Business retail market: Customer bad debt – Decision and consultation**

### **Introduction and summary**

This is the response of Castle Water Limited (“**Castle**”, “**We**”) to the Ofwat document ‘Business retail market: Customer bad debt – Decision and consultation’ issued on 26 July 2021 (the “**Document**”).

We generally welcome the decision element of the Document, in particular in relation to the choice of sharing factor and of an earlier (October 2019) consumption point for assessing bad debt.

The answers below follow the numbering of the questions posed in the consultation element of the Document. References to our previous responses are to those made on 6 April and 28 May 2021.

### **Chapter 5 – Adjustment of REC price caps**

#### **Consultation Question 1 – We are presently minded to ‘pool’ (the customer portion of) excess bad debt costs across all customers and apply a corresponding uniform uplift to REC price caps. Do you agree with our approach here?**

Yes.

We agree with the reasons for this approach that Ofwat gives in the Document, including that it allows for use of more reliable and verifiable data than attempting to attribute the relevant portion of bad debt between customer groups.

In addition, we agree with those who thought attribution would have a greater impact on smaller customers who are least able to afford it (having already been most affected economically by the pandemic).

In these circumstances the use of an existing regulatory instrument is justified in the interests of simplicity.

#### **Consultation Question 2 – Do you see merit in the idea of not pursuing a ‘true up’?**

Yes.

Given the proposed use of a relatively straightforward method of assessment, and the relatively small amounts at issue, it would run counter to the aims of both to seek to true up retrospectively.

As Ofwat notes, the purposes of a true up would include ‘to ensure that bad debt costs measured by Retailers do not overrepresent bad debt costs arising since Covid-19 measures were put in place’; and that a true up would require the devising of a system of measurement that would inevitably call for a detailed quality assurance measurement, independent review and consequently higher implementation costs. We agree that this is disproportionate to the nature of the assessment and recovery mechanisms, as well as to the quantum.

In relation to the latter, while we appreciate that the aim of any true up would be to confirm that any bad debt recovery is no more than is reflected in accounting records, as noted in our previous responses the incidence of bad debt and its being reflected in the accounting records is not contemporaneous. In particular, bad debt will continue to emerge as, for example, further customer insolvencies work through retailers’ finances; this and other lags in the crystallisation of bad debt

will offset any estimating variances, but these factors are not proposed to be taken into account beyond 2020/21.

## **Chapter 6 – Implementing our decisions**

### **Consultation Question 3 – Do you agree with our approach to the ‘true up’, in the event we pursue one? Please explain your views.**

No.

The Document states that ‘A subsequent true up would *review the initial assessment at a later date* using a defined approach to the measurement of bad debt costs’. [Emphasis added]

There are several issues with the basis on which the initial recovery took place later being subject to a different approach and thus potentially fundamentally re-opened:

- It would cast doubt retrospectively on retailers’ existing provisions and write offs, and the presentation of these in their accounts.
- It would therefore undermine any investor confidence that would otherwise arise from the prospect of (albeit limited) recovery under the original assessment and recovery mechanisms.

As a result, any true-up would need to be based on the same method used to make the original assessment, and this would not be meaningful unless retailers were allowed to update their provisions and write-offs to take account of subsequent events. This would extend the true up process much further into the future.

**Castle Water Limited**

**15 September 2021**