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Riverside Park
Campbell Road
Stoke-on-Trent
ST4 4DA

15th September 2021

Emailed to: covidbusinessretailmarket@ofwat.gov.uk

Reference: Business Retail Market Customer Bad Debt Decision and Consultation

Dear Sir/Madam,

Thank you for providing us with an opportunity to respond to the latest consultation on customer bad debt in the business retail market. The impact of Covid-19 on the non-household retail market has been material, and the levels of bad debt incurred as a result of the associated government restrictions represent a level of exposure that was never envisaged within the regulated price controls.

We welcome the acknowledgement that the market-wide 2% bad debt threshold is likely to have been exceeded and therefore the need for additional regulatory protections. We believe this continues to be supported by the evidence available and remain eager to engage with Ofwat on the matter. At a high level, we agree that the use of an adjustment to the REC price caps represents a simple and cost-effective methodology to support recovery of excess bad debt. In line with this simplicity, we welcome the movement towards a single uniform 'sharing factor' of excess bad debt costs between NHH customers and Retailers.

We continue to support the intention to align the upcoming increase to the already scheduled April 1st tariff update. The need for additional regulatory protections is clear, it is important that any potential disturbance to market participants is kept to a minimum. In line with this we are keen to know more about how the upcoming REC review will interact with, and potentially overlap, any temporary REC adjustment related to Bad Debt, both of these REC changes relate to different issues and will require separate consideration.

We have included our complete responses to each of the 3 consultation questions in the appendix to this letter. In summary, we believe:

- The approach to pooling all customers does not represent an effective trade-off between simplicity and cost reflectivity, with larger customers representing a significantly different bad debt exposure.

- A true-up mechanism is unlikely to be beneficial to the market.

- We do not yet have a view on the appropriate mechanism for any such 'true-up' but are keen to engage if a 'true-up' should be required.

Finally, we would like to raise an additional concern that the proposed timelines for publishing the final adjustment rate are not currently aligned to existing tariff deadlines. The annual price-setting process for deemed contract customers is currently scheduled for a mid-January release of final Wholesale Charges, which already represents a constrained delivery timescale. As such, we believe that an earlier publication of the planned adjustment, in line with the deadline for Wholesale Charging will reduce the level of disruption and better enable Retailers to provide clarity to the customer base.

We would be more than happy to discuss these points in more detail, so please do not hesitate to contact me or someone from the Legal and Regulation team (contact details below or simply email regulation@water-plus.co.uk).

Yours sincerely,

[redacted]

Joe Clapham
Financial Controller
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Appendix 1: Consultation Questions

Part A. Market functioning

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?

Whilst we broadly agree that some degree of pooling will be required to ensure an effective and simple delivery of a bad debt mechanism, we believe that the currently proposed approach to pool across all customers may lead to a major dilution of the support that this benefit was intended to provide and result in the overall aims not being achieved.

The approach to 'pooling' customers represents a clear trade-off, with greater levels of pooling leading to higher levels of simplicity and deliverability, and greater granularity leading to better cost reflectivity and reduced distortion on competition. By pooling all customer groups, this represents a step away from truly reflecting issues and costs faced by the Retail Market.

Ofwat has clearly communicated throughout this process that retailers of customers outside the retail price control (either due to being contracted customers or within the large customer segment, which is no longer price regulated) do not require any changes to regulation to allow prices to reflect the increased risk of bad debt. The suggestion, therefore, that for the purpose of calculating what support is required to allow an increase in prices for the customers within the price regulated section of the market, that all customers should be pooled for this calculation, is counter intuitive.

Our own analysis of specific write offs during this period have shown that [redacted] of write-offs are related to customers in the smallest usage customer group with a further [redacted] related to customers with usage between 0.5 and 50Ml, leaving [redacted] of the write-offs relating to customers in the largest usage customer segment. This compares to revenue splits of [redacted] [redacted] and [redacted] respectively, so the level of additional bad debt incurred by customer group is not proportional to the size of that group. We acknowledge that specific write-offs might not fully align to provisions calculated during this period as actual businesses that fail may be different to those that we predict, but we expect that the mix of customers will be consistent with our analysis. The on-going economic support measures mean that very little of the bad debt provision booked during Covid has yet crystallised as a write off, but of the write offs seen so far there is a relative overrepresentation of higher volume customers as we typically can identify these insolvencies much sooner than for smaller companies.

As we believe that the highest volumetric customer group has proportionally caused the least amount of additional covid-related bad debt, and we already have mechanisms to reflect and recover the additional bad debt, we are of the opinion that this segment of customers should be excluded from the relevant bad debt REC increase calculations. We therefore believe that the proposal should revert to the option previously discussed of pooling customer groups 1 and 2 (0-0.5Ml and 0.5-50Ml), while treating 50Ml+ differently, to represent a fairer and more equitable solution.

Question 2. Do you see merit in the idea of not pursuing a 'true up'?

It is our view that the process of a 'true-up' could be overly complex and require significant resource, while making little difference to the customer. As such we believe that a specific process may not be worthwhile provided that the initial data is reasonably robust and representative. We do not believe that there is a need for a scheduled 'true-up', however we would welcome further discussions at a later stage should a clear issue with the initial figures emerge.

Alongside the true up, we are keen for further clarity on the interaction between the temporary bad debt measures and the upcoming REC Review process. We believe it is critical that whilst the impact of the Covid-19 related Bad Debt Recovery is considered in the context of establishing any price changes for April 2023, any such 'true-up' is not simply absorbed into the planned price change. The upcoming REC review represents a key opportunity to identify and respond to the long-term challenges raised by the recent Economic Insight Report, which is a separate issue to the temporary shock of the pandemic.

Question 3. Do you agree with our approach to the 'true up', in the event we pursue one? Please explain your views.

At this stage we do not have any particular views on the approach to the 'true up'. As we believe that any such process will only be necessary should there be significant variation from expectation, we would welcome consideration and discussion of a targeted solution closer to the specific issue should any such situation emerge.