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Ofwat
Centre City Tower
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By email: covidbusinessretailmarket@ofwat.gov.uk

26th October 2021

Dear Ofwat,

Proposals to deal with un-invoiced wholesaler charges in the event of an unplanned Retailer exit

Thank you for the opportunity to respond to your proposal on how to deal with un-invoiced wholesale charges in the even of an unplanned Retailer exit.

We agree that wholesalers should invoice retailers in a timely manner, according to the standard settlement timetable. We also agree that where wholesalers have invoiced according to the standard settlement timetable, then uninvoiced amounts at the point of a retailer failure would not be included in revenue, and therefore not be included in bad debt. The current regulatory regime and incentives have, deliberately, reflected these principles.

Questions 1 & 2

We do not believe circumstances have changed in terms of the regulatory framework, and as we explain later we are not sure this proposal directly relates to the Covid liquidity support that the consultation starts with. If it was limited to this mechanism only, we may take a different view, but it appears to be a wider change to the regulatory framework.

We therefore disagree that Ofwat should change the standard regulatory accounting and revenue control treatment, in order to apply the totex cost sharing mechanism as part of the policy arising from the Covid-19 intervention. This allocation of bad debt risk arising from Ofwat's decision to require wholesalers to provide additional liquidity to retailers was on the basis that it would increase bad debt, and did not relate to uninvoiced usage. The April 2020 consultation was clear that it was only bad debt involved, not uninvoiced usage, and this was reflected in both the decision to use the totex sharing rate, as well as the separate £m cap that was applied. This was a minimal set of changes to provide this balance, including recognising at the time that uninvoiced revenue would be shared through the RFI according to the reconciliation rulebook.

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Ofwat should not move away from the principle of charges, revenue controls and RAG3 in this way. The regulatory framework and revenue controls have been set on this principle, and the adjustments Ofwat make following the Covid-19 intervention should be as minimal as possible to achieve the objective, which was a decision to use the totex cost sharing mechanism should a retailer failure occur.

We fully accept your logic that usage that is un-invoiced is equivalent in cash terms to invoiced revenue that has not been paid. However, there was equally no particular logic in using a totex cost sharing rate, particularly one that varies by company, which was the original decision. We therefore consider your previous decision should stand. In addition, it is not clear that this change relates to the Covid-19 mechanism specifically, as it is not clear that this only applies to where the Covid related mechanisms applies rather than the regulatory framework in general. We assume this proposed change applies in general (e.g. the cap on wholesaler liability during the liquidity period no longer applies – this applies in general rather than specifically because of the Covid-19 mechanism). If there was such a cap, there would be a stronger reason for Ofwat to amend the PR19 approach; but as it stands this does not appear to be linked directly to Covid-19 but a proposed and potentially substantive (although we recognise is unlikely to be material) change in the risk balance in the regulatory framework. As it is not material except in extreme circumstances, we do not feel there is sufficient reason to make this change.

In addition, the regulatory judgement that the clause would introduce in proving that the un-invoiced revenue should be recovered (alongside bad debt), whilst consistent with the proposal, is also an additional unwelcome complication to the regulatory framework and the judgement involved could potentially result in disputes. We prefer the current, consistent, simpler approach to the price control and its reconciliations as has applied up to the point of this consultation.

In conclusion, we therefore do not agree that the proposed licence change and reconciliation rulebook change should be made in-period, as Ofwat are proposing. We note your view that you would not pursue the modification if we did not consent. We want to be clear that we have not reached a view on this regards and will consider the responses to this consultation and Ofwat's consideration of our and other points before we reach a view.

Question 3: We have not identified any alternative approaches as we disagree with the principle that the change is necessary to meet the statutory duties, as these reflect the intention of the regulatory framework at the time of PR19 which is that un-invoiced usage is not revenue and therefore cannot be bad debt.

Question 4 & 5: We agree with the proposed WRC wording change to refer to amounts "owed" rather than "owed and due". This retains the original intention of the credit provisions in the market design.



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Yours faithfully,



Iain McGuffog
Director of Strategy & Regulation