Business retail market: Customer bad debt – Ofwat consultation on adjustment to REC price caps from April 2022

10 January 2022

Consultation Question 1 – Do you agree with our methodology (as set out in Annex A3 and in the accompanying Excel spreadsheet model) for calculating the temporary uplift to REC price caps to apply from April 2022?

We do not agree with the methodology for calculating the temporary uplift in one major area, that being the use of solely 2020-21 revenues to calculate the level of excess bad debt suffered by retailers.

Ofwat has been clear throughout the series of bad debt consultations that retailers should expect to absorb bad debt costs up to 2% of revenue, being a level that a prudent retailer should expect to suffer in a normal economic downturn. Specifically, Annex A1, point 1 makes clear that the revisions to regulatory protections were warranted because the cost for the 2 years ended March 2021 was 2.5%. This indicates that the intention was to assess the 2-year period as a whole and adjust for bad debt recovery based on this.

The figure of £14,316,000 which has been calculated as the value of retailer portion of excess bad debt costs arising from 2020-21 is arrived at as per the following:

(2.87% - 2.00%) x 75% x £2,194,000,000 = £14,315,850

Retailers have suffered bad debt costs in excess of 2% for a 2-year period, with the majority of the bad debt suffered in 2019-20 being right at the year-end of 31 March 2020 when the pandemic struck. As a result, the excess bad debt (bad debt above 2%) that retailers have actually suffered (taking the figures from Table 1 on page 10 for bad debt costs as a proportion of turnover) is as follows:

2019-20	(3.35% - 2.00%) x 75% x £2,565,000,000 = £25,970,625
2020-21	(2.31% - 2.00%) x 75% x £2,194,000,000 = £5,101,050
Total	£31,071,675

When the 25% proportion borne by retailers is added back, this comes to 2.87% of revenue for the 2-year period, in line with the 2.87% shown in Table 1.

We would be pleased for Ofwat to confirm that this change is correct, as if the current methodology is maintained it would be a significant departure from the message which has been given to the market over the past 12 months.

We agree with all other aspects of the methodology, including the price adjustments to base year, the revenue figures being included in the model, and how the temporary REC uplift has ultimately been calculated.

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Consultation question 2 – Do you agree that that it is reasonable, for the purposes of revising regulatory protections in respect of excess customer bad debt costs arising following the Covid-19 pandemic, to approximate efficient financing costs for Retailers at 3.5%? Please provide evidence or supporting materials for your views.

We are comfortable with the proposed level of efficient financing costs proposed by Ofwat. A significant additional amount of work could be performed to arrive at a more accurate figure, but we believe the cost of doing so would outweigh the potential benefits.

Consultation question 3 – Do you have views concerning forecast business retail market revenue out to 2023-24 for the purposes of calculating the proposed adjustment to REC price caps to take effect from April 2022?

We believe that the proposal to use the revenue figure for the market from 2019-20, adjusted for inflation, represents an appropriate figure to take. Using retailers' own revenue forecasts is likely to cause problems, in part because forecasting the likely consumption levels for businesses in 2 years' time is difficult because of the changes in working patterns seen this side of the pandemic. This is coupled with the fact retailers will have differing views over what customer switching will take place and normalising for this is difficult. We therefore believe that Ofwat's proposal represents a reasonable position to take.

Consultation Question 4 – Do you agree with our proposals to temporarily increase REC price caps by 0.31% with effect from April 2022?

No, for the reasons set out in our response to question 1.

Consultation Question 5 – Do you agree that the proposed amendments to the Retail Exit Code as set out in Annex A4 are correct in terms of implementing the proposed adjustment to REC price caps we have set out? If not, please specify why and how you think these should be adjusted.

Subject to the issues highlighted above, we agree with the application of the proposed adjustment to REC price caps.