Proposals to deal with un-invoiced wholesaler charges

Severn Trent Water response

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WONDERFUL ON TAP

SEVERN TRENT

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

We welcome the opportunity to respond to this consultation. Given the events in the energy market, the impact of retail failure on the wider customer base is very much a live issue, although the pressures on water retailers are significantly lower than in the energy sector.

We recognise that the current arrangements mean that, should a Retailer fail, wholesalers would be unable to recognise a bad debt on any revenue that had not been invoiced. The upshot is that totex cost-sharing would not apply, because no additional cost would be recognised under the rules of the wholesale revenue controls. This very much looks like an unintended outcome and, as such, we support Ofwat's objective of putting un-invoiced revenue on the same footing as the amount that has been invoiced.

We also agree that wholesalers should be able to draw on credit protections or securities in respect of the whole amount that is outstanding. The distinction that prevents wholesalers from applying this against amounts which have not yet been invoiced does look somewhat arbitrary given the circumstances. We therefore support the proposed amendment to the Wholesaler-Retailer Code and we agree that companies should deduct credit protections from the full outstanding balance before cost-sharing is applied (whether invoiced or not).

One area we would suggest building on for the RFI approach is for Ofwat to provide further guidance on accounting treatment.

Our responses on the individual questions are set out below.

Does our proposed approach deliver the following policy aim in a way that is consistent with our statutory duties?

"in the event of a Retailer's unplanned exit from the business retail market, a Wholesaler should be able to recover relevant un-invoiced revenues for services that the Wholesaler has provided to that Retailer - but were not due for invoicing or had not been invoiced - at the point of Retailer failure."

This would appear to imply that wholesalers should be able to recover 100% of the un-invoiced revenue. This proposal changes the objective to making sure that the cost-sharing arrangements for un-invoiced and invoiced revenue are "equivalent"(p7) and we would agree that the proposal would succeed in achieving this modified objective.

Do you agree that it is appropriate to apply company-specific totex cost-sharing rates to amounts relating to un-invoiced revenue to be recovered via the RFI mechanism in the event of a Retailer failure?

Company totex-sharing rates were based on Ofwat's assessment of their business plans. A key component of this was the forecast of costs that they put forward. In this context, it feels to us to be a step too far to apply this sharing rate to Retailer bad debt when all companies included zero cost.

Wholesale cost allowances are derived from econometric models where the historic costs used in these models do not provide for bad debt. Given our lived experience over the last while, we cannot assume that there's zero risk from Retailers, especially as the prescribed credit terms require wholesalers to provide some credit. Alongside this, we’re aware that if wholesalers started making a provision for this, then it would automatically lead to a variance against the Final Determination.

Our thinking is that the degree of exposure to this variance can largely be controlled and managed by regulation. When it comes to credit, there’s a certain level that is required by the market rules. And, while companies can offer bespoke credit terms under Schedule 3, our experience is that these tend to increase the credit on offer rather than reduce it. It’s also worth recalling that wholesalers have been encouraged to use Schedule 3 to increase market competition. In the context of a baseline assumption of zero and any bad debt being deemed inefficiency, the more credit that is offered then the greater that potential inefficiency becomes.

Do you have views that alternative approaches may be more effective or straightforward to implement?

As it stands, the proposed approach could lead to a discrepancy in the accounts, because un-invoiced revenue could be recognised as income <u>but</u> not be considered as bad debt if a retailer fails. With this in mind, we think it helpful for Ofwat to give extra guidance on the way that this should be reported in the APR given that it could lead to a further difference with the statutory accounts.