Mick Watson
Head of Regulatory Finance Reporting
Systems & Networks
Ofgem
10 South Colonnade
London E14 4PU

4th September 2020

Dear Mick,

Re: Managing network charge bad debt – proposal enabling networks to recover potential bad debts arising from COVID-19 related deferred network charge payments and to introduce an enduring solution to bad debt recovery in general.

I am writing on behalf of the 14 GB electricity DNOs, who are members of the Energy Networks Association, and in response to your open letter of 7th August 2020 setting out options for enabling networks to recover any potential bad debts arising as a direct result of the network payment deferral scheme in the regulatory year 2021/22.

The DNOs support the introduction of an appropriate mechanism to ensure timely recovery of bad debt arising and protection for DUoS paying customers as a result. We welcome Ofgem's consideration of the options detailed in the open letter and this opportunity to provide comment. As follows:

Q1: Do you agree that our proposals would allow the recovery of bad debts, by network licensees, relating to Network Charge Deferral scheme (COVID-19) in 2021-22?

We would agree that, in principle, Option 3 would allow recovery of COVID-19 Bad Debt in Regulatory Year 2021/22, subject to the drafting of the licence condition and the relevant formulae being appropriate.

We believe that Ofgem should consult on the principles to be applied to the treatment in the RIGs of the "true-up" of the COVID-19 Bad Debt amount via the Revenue Reporting Pack at the same time as the statutory consultation on the licence modifications.

Q2: Do you agree with the introduction of a pass-through term in the RIIO-2 licence as an enduring solution for the recovery of bad debt?

We are broadly supportive of Ofgem's preferred option 3 noting that it may be easier to implement and maintain and introduces an element of forecasting and true-up against the forecast on an enduring basis that is not currently present in the existing condition in the distribution licence.

If Ofgem decides to modify the existing condition in the distribution licence, we would favour Ofgem's preferred option 3, subject again to the drafting being appropriate. As noted above, Ofgem should consult on the principles to be applied to the treatment of the "true-up" in the RIGs of bad debt amounts on an enduring basis via the Revenue Reporting Pack at the same time as the statutory consultation on the licence modifications.

In addition, we have the following comments:

Net cost of capital:

We note Ofgem's proposal to adjust any bad debt recovery with the interest accrued, net of the cost of capital, with the cost of capital being the relevant sector's RIIO-1 weighted average cost of capital for COVID-19 Bad Debt and a fixed margin over a floating bank rate for RIIO-2.

We are still considering our position but currently consider that short term bank debt measures would not be an appropriate benchmark for the cost of capital of providing this funding. Equity holders are placing their capital at risk in providing this funding, whether debt facilities are used or not, and the appropriate benchmark for the financing cost is well above the cost of short-term debt.

It is our understanding that licensees will be able to recover the principal debt and:

i) Deduct the cost of capital (as it is ultimately defined) from the amount of interest accrued; and

ii) Retain, therefore, the amount equating to the net cost of capital such that the licensee returns to customers less interest than it received because the licensee financed the bad debt.

Consistent with the principle that any bad debt recovery will be on an NPV neutral basis.

Ofgem should confirm whether our understanding is correct, such that an appropriate definition of "cost of capital" for this purpose can be drafted for inclusion in the relevant licence condition.

ED Indicative Timeline:

Licensees will notify Ofgem of their forecast COVID-19 Bad Debt values in January 2021 and will know in early April 2021 whether a supplier has ceased trading during the time it participated in the deferred network charge scheme. Licensees will also have a view on the bad debt incurred in time for inclusion of that information in the Revenue Reporting Pack to be submitted in July 2021, which would be consistent with the current bad debt process in the licence.

Consequently, there should be a step in the timeline in July 2021 to allow for an adjustment to be made to revenue in the 2022/23 Regulatory Year.

The COVID-19 Bad Debt value notified to Ofgem in January 2021 will not change because the deferred network charge scheme closes on 31 March 2021 so the step in the timeline in January 2022 (and each subsequent year) is not needed.

We would very much welcome the opportunity to discuss our comments in more detail. Please contact Paul McGimpsey (paul.mcgimpsey@energynetworks.org) to arrange this.

Yours sincerely,

David Smith
Chief Executive