UTILITIES AND THE £6 BILLION DEBT CHALLENGE

Just. Insights

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Recent analysis by Arum-Just of debt in the UK retail energy and water utility sectors has shown that cumulative debt is now sitting at over £6 billion. All the more worrying is that most of the published accounts reviewed were published prior to COVID-19 having an impact on the reported financial numbers. Utilities have already provided over £1.5 billion in bad debt provisions, excluding the debt that they have already written-off, which will be substantial.

Bad debt expense has made a significant contribution to losses with more than 50% of retail energy and water utilities reporting losses in their last published accounts. Over the last three years over 20 energy retailers have ceased trading whilst in the B2B water sector all of the major retailers (including joint ventures) have reported trading losses. Trading losses of water retailers in the B2B water sector are particularly acute based on their last published accounts. Are such market conditions unsustainable? A number of the retailers have already sought and received huge injections of cash to enable them to continue trading. Unless strategic changes are made then we should expect more utility retailers to cease trading and/or more cash being required to allow them to continue trading.

In this blog, we explore what could be done to mitigate the risks to the utility retailers and ultimately consumers including vulnerable customers.

So what could be done to help:

1. Utility retailers;
2. Vulnerable customers; and
3. Charities such as Citizens Advice and StepChange to support vulnerable customers

There are a number of changes that could be considered and implemented:

- Bad Debt Levy: Regulators could allow a bad debt levy as Ofgem has proposed
- Legislative Changes: Regulators could seek changes to legislation to have debt remain with the premise
- Collaboration & Innovation

Bad Debt Levy on Bills

The increasing bad debt risk has prompted action from Ofgem following submissions from some suppliers to include an allowance to reflect the higher debt costs in the price cap. Following consultation, Ofgem obtained evidence of a material increase in bad debt levels due to COVID-19 beyond the level already covered by the existing cap allowance. Ofgem has decided to make an adjustment of around £24 per customer, for a limited time period. Suppliers will have to recover some of the costs in a phased approach between April 2021 and March 2022. Ofgem acknowledges there is huge uncertainty over the total debt-related costs of COVID-19, but its likely to be high.

This additional charge will be welcomed by energy retailers, but it is a temporary fix and does not address the underlying problem.
Additionally, this approach simply passes on cost to those customers who choose to pay their bills whilst continuing to allow those who can pay, but choose not to pay, to continue to avoid paying for the services they have enjoyed. It is not equitable to ask customers who pay their debts to pay a subsidy in respect of those who can pay but choose not to pay. A different medium-to-longer term approach needs to be developed.

Legislative Change

Ofgem and Ofwat should consider lobbying for legislative change to have utility debt attached to the property rather than the account holder. This would mitigate the bad debt risk associated with customers who can afford to pay evading their debts. A significant source of bad debt expense is associated with COT (change of tenancy) accounts where the outgoing tenant fails to notify their current supplier that they are moving property or indeed moving into a property. The latter having implications for both revenue and expenses. Utilities companies are then faced with increased costs in determining where these customers have gone. In the majority of cases they fail to locate the customers and cannot collect the outstanding debt. By attaching the debt to the property the risk is reduced as the outgoing home or business owner would be required to settle the debt as part of the sale or termination of a lease. This of course leaves gaps in the process, but it would go a long way to mitigating the risk of bad debt arising and would reduce collection and billing charges.

Collaboration & Innovation

Ofwat has launched an innovation fund which is part of their strategy "Time to act, together". A key theme is meeting long-term challenges through increased collaboration and partnerships. These partnerships could be with other utilities or private sector organisations. Rising debt and increasing vulnerable customer numbers is an immediate and long-term challenge for water and energy retailers. Collaboration between companies in the water and energy sectors and with the private and third sector has, I believe, huge potential to benefit everyone. The debt challenge is everyone's problem so let's collaborate and use our combined knowledge and experience to tackle this perennial issue.

In December 2020, Energy UK launched a Vulnerability Commitment. So far 15 energy suppliers, including most of the larger providers, have signed up to the commitment. Once again, collaboration and innovation are key themes promoted by Energy UK.

The level of doubtful debt provisions vary considerably across the sectors and within the sectors. Therefore, companies should consider collaborating to understand what's causing those differences. What's driving, what appears to be superior performance? Is it simply down to the doubtful debt provisioning methodology or is it superior billing and collection systems, higher quality data and billing, excellent processes, customer engagement .... How can companies collaborate and share best practice across and within sectors.

It's important for Ofgem and Ofwat to continue to promote innovation and collaboration and the sharing of best practice, wherever possible and practicable, given the scale of debt levels and the impact of bad debt expense on the profitability and future viability of energy and water retailers.

Vulnerable Customers

Failing to collect debts that are due from customers who can afford to pay reduces the scope of utility retailers to provide support to vulnerable customers. The financial pressure is also limiting the scope utility retailers have to provide funding to the third sector where funding is required to meet the increased demands on charities such as Citizens Advice and StepChange. The recent introduction of the new Breathing Space regulations will increase the number of people seeking debt advice. The UK Treasury has estimated that up to 700,000 people could be helped by the scheme in its first year.

Its clear from what Ofgem, Ofwat and Energy UK are doing that there's a growing appetite for collaboration and innovation to address the challenges that energy and water retailers face. We now need to see more action to transfer and leverage that huge knowledge and experience base that exists in the UK, across many sectors, to tackle the £6billion debt challenge.

About Arum and Just: we partner with clients across the utilities sector to optimise debt resolution strategies. From consulting support across a range of services via Arum - digital enablement/reducing cost to serve, dunning path optimisation, provisioning policy, platform and technology stacks – through to late stage recoveries execution via Just.

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