Support Measures in Response to the COVID-19 Pandemic

1. Introduction and Summary

A small Working Group chaired by CAS and comprising five LPs, Scottish Water and the CMA, was established in December to consider the challenges posed by WICS in its November consultation paper on the impacts of COVID-19 on the NHH water market.

The Group held discussions throughout January and February, and considered a range of options designed to:

- provide continued support to customers affected by the pandemic;
- provide support to LPs that would allow them to continue do so; and
- ensure that as we transition back to normal operations, the market is well placed to meet future challenges.

After an initial discussion of proposed options with WICS, the Commission provided further clarity on their expectations and the options that would be acceptable from a regulatory perspective. There were four particular points from that discussion which shaped our proposal:

(i) proposals must avoid any detrimental impact on Scottish Water that could in turn adversely affect domestic customers;

(ii) WICS would not support a bad debt relief mechanism for LPs to recover any of the exceptional bad debt arising as a result of the pandemic;

(iii) NHH customers should remain liable for charges to ensure parity with domestic customers, and hence any proposal for waiving charges would not be acceptable; and

(iv) that concerns over the financial strength of LPs is uppermost in the Commission's mind and that any form of support for LPs would be contingent on being able to demonstrate their ongoing financial resilience to any shock of a similar scale in the future.

In light of this guidance, the Group discarded options that were focused directly on alleviating the accumulation of customer bad debt, and focused instead on solutions that provide customers and LPs with temporary relief, to give both customers and the market time to recover from the COVID-19 restrictions. That recovery will be contingent on customers being able to repay their debt and LPs being able to collect it, and we may yet see customer bad debt in excess of that which was allowed for within the default retail margins, especially if LPs' right to disconnect customers for non-payment is withdrawn, as currently proposed. In order that the scale of the impact of the COVID-19 restrictions can be assessed objectively, we are proposing that regular monitoring of debt and customer payment levels within the market is undertaken on a quarterly basis going forward.

The proposal set out below is a considered package of measures which is designed to support customers and ensure the resilience of the market as we transition back to 'normal'. We are proposing a reciprocal deferral scheme, which allows impacted customers an extended period of time (up to two years) to repay all of their charges, with a back-to-back mechanism in place to allow LPs to defer the payment of the associated wholesale charges for those customers to Scottish Water. It sets out a timeframe for the reintroduction of wholesale charge pre-payment, but proposes the introduction of alternative payment options that would give LPs greater flexibility in the management of their working capital, whilst continuing to protect Scottish Water.

We are fully committed to the need to improve the financial resilience of LPs and the market as a whole and have included a proposal in relation to a new licence condition that would require licence holders to demonstrate adequate financial strength to Scottish Water and the Commission, once the market has recovered from the impacts of COVID-19.

Our proposal is based on the assumption that the existing COVID-19 restrictions will start to be lifted in the Spring. However, considerable uncertainty remains about the pace and scale of the recovery, and we recognise that the impacts will continue to be felt for many months and potentially years to come. We have set out a proposed timetable and roadmap in the paper below, but acknowledge that the arrangements will need to be kept under review (hence the need for regular monitoring), and if circumstances change, the timetable may need to be amended in response.

2. The Impact of COVID-19

Background:

Since the COVID-19 restrictions were first introduced in March 2020, cash receipts from customers have declined and aged debt continues to increase steadily. SME customers have on the whole been more badly affected than larger customers, however, there are exceptions in sectors such as retail and hospitality where a number of high-profile brands have already gone into Administration.

Many customers have continued to pay, some funded by Government support schemes including furlough, rates relief, COVID Loan schemes etc. Of those customers most significantly impacted, some have engaged with their LP and agreed payment deferrals and extended repayment plans, but others have simply stopped paying and are choosing not to engage despite repeated attempts on the part of LPs to make contact. This will include customers who can't pay and others who can but who are choosing not to.

Uptake of the Commission's customer deferral scheme has been very limited despite LPs actively promoting it to customers.

Impact on customers:

NHH customers continue to face uncertainty on when they will be able to reopen their businesses, to what extent they'll be able to operate, and if and when they will eventually be able to return to pre COVID-19 levels of trading.

Many customers have relied on Government support schemes, without which insolvency levels would have been much higher, however for many companies this will provide little more than a stay of execution. The true extent of the economic impact on SME businesses will only become apparent once the support schemes are withdrawn. The FSB has predicted that over 250k small businesses in the UK will close during the next 12 months. The Enterprise Research Centre's annual review of trends affecting small and medium sized enterprises stated that the COVID-19 pandemic has had a major, visible effect on the UK's small business community. The ONS Business Impact of COVID-19 Survey (BICS) revealed a low level of confidence among business leaders in the early part of Q4 2020, diminishing cash reserves and almost 1 in 6 businesses trading insolvently.

From our interactions with customers it is clear that:

- some don't believe that they should have to pay for services they are not consuming when they have been instructed by the Government to close their business premises;

- some believe the WCDS scheme is overly complex and that the deferral of only a part of their charges doesn't go far enough; and
- some have chosen to preserve cashflow by only paying those suppliers they deem business critical.

Those who have chosen to defer their payments will need to repay both their accrued debt and their new bills as they become due, which will increase the pressure on them as they attempt to rebuild their businesses.

We have considered all of the above factors when developing our proposals, with the aim of finding a solution that provides customers with the support they need to continue trading and which is easy to administer and transparent.

Impact on LPs:

Whilst the impact on each LP will depend on their customer mix, those with a sizeable SME base are reporting significant increases in aged debt since March 2020. The removal of temporary disconnection, as currently proposed by Scottish Water, will leave LPs exposed to increased bad debt risk, removing an early intervention to prevent further build-up of debt and the only means of capping their liability for customers who refuse to pay. By removing such a critical tool for LPs at a time when some customers have had no late stage debt recovery action for almost a year, there is real concern that bad debt will exceed the levels allowed for within the retail price control.

From a cashflow perspective, the temporary suspension of the prepayment of wholesale charges has been welcomed by LPs, and has allowed them to pass the benefit on to their customers, but it is important to note that wholesale charges are still being paid to SW in full in the month of supply, despite many customers not paying their LP at all. The only exception is for charges deferred under the WCDS, but uptake of the Scheme has been limited, with many LPs citing the complexity of the Scheme and the requirement to assign customer debt to SW, as being significant deterrents.

There is concern that as the prepayment of wholesale charges is reintroduced, the cashflow of LPs will be further squeezed and some LPs may fail, leading to a disorderly exit from the market, in which case our aim is to ensure that the market arrangements are robust and resilient to LP failure.

3. Proposal to Support the Future Resilience of the NHH Market

COVID-19 is an unprecedented 'external shock' of a magnitude that no-one could have foreseen or made provision for. It has highlighted vulnerabilities and the need to ensure that the market is appropriately resilient and able to meet future challenges.

The proposal outlined below is designed to:

(i) provide continued support to customers affected by the pandemic;
(ii) provide support to LPs to allow them to continue to do so; and
(iii) future-proof the market – as we transition back to normal operations, make changes to the market that will ensure that it is stronger, more resilient and well placed to meet future challenges.

It does not directly address the issue of the excess bad debt that is accruing as a result of COVID-19.

(i) Support to customers

The objective is to establish a scheme that meets customers' needs and provides sufficient flexibility to help those customers who can, to remain financially viable and continue to trade, whilst they transition back to normal payment terms.

Proposal:

- Extend the existing customer deferral scheme until the end of [March 2021] for affected customers;
- Replace it with a new scheme from [April 2021], which would allow SME customers (defined as unmeasured sites and those with meters smaller than 25mm) extended credit terms, with up to [24 months] to repay their deferred charges while they get back on their feet. As well as customers with existing debt, it would be available to customers who have continued to pay to date, but who may experience difficulty once the Government support schemes come to an end;
- Using the same principles as the current deferral scheme but simplified to ensure that it meets customers' needs, with **all** charges deferred not just volumetric charges (whilst ensuring that no customers are worse off than they are under the existing scheme);
- LPs will restart debt recovery for all customers with a clear call to action for customers to re-engage with the offer of extended payment plans;
- Those customers who don't engage and who continue to withhold payment will progress through the debt recovery process until the customer either pays, elects to take a deferred payment plan, or all debt recovery activity is exhausted.

It would be for consideration whether the Scottish Government could announce the availability of this support, to help raise awareness and drive uptake amongst customers in need.

(ii) Support to LPs

In order that LPs can provide this level of support for their customers, the aim is to provide LPs with a reciprocal deferral arrangement with Scottish Water for the wholesale charge element of the deferred/unpaid customer charges[1].

Proposal:

- Extend the deferral of the wholesale charge prepayment to SW by another 3 months to allow time for the deferral scheme proposed below to be fully developed and implemented;
- Re-introduce the wholesale charge prepayment as previously proposed using a staggered approach to minimise the impact on LP resilience (avoid the cliff edge). Contingent on the timing of other measures proposed below, this is proposed as 1 month from July 2021, 2 months from December;
- Introduce a new wholesale charge deferral scheme accessible to all LPs who have extended credit to SME customers who have not paid as a result of COVID-19;
- Deferral would be on a 'like for like' basis and would apply to both fixed and volumetric charges, with LPs able to receive deferral of the associated wholesale charges over the same time period as their customers;

[1] During Working Group discussions this seemed in principle to be acceptable to Scottish Water.

- The deferral would apply to the charges for all customers for whom an LP is able to demonstrate they are providing an approved COVID-19 repayment plan, covering both new invoices and existing debt; and
- The deferral would also apply to the debt of customers who have not engaged with an LP but who have simply stopped paying. For these customers the deferral would be for a shorter time period, aligned to the debt recovery process and timescales set out in the Disconnection Document, to allow LPs to complete their debt recovery cycle. LPs would take the risk that cash can be recovered during this period, with payment in full due to SW at the end of the deferral period regardless of whether or not the customer has paid.

Repayment:

- The principle would be that LPs repay Scottish Water in the same timeframe that customers repay their LP, to ensure reciprocity;
- There are a number of options for the administration of the scheme, including how the deferred amounts are calculated and verified, which will require further engagement with the CMA and SW to work through their feasibility. The principle should be to keep the administration as simple as possible, whilst being sufficiently robust and transparent;
- We anticipate the debt recovery process for COVID-19 debt being more challenging than under normal circumstances, as debt recovery has either been suspended or significantly reduced for almost a year. This will be further exacerbated if LPs are no longer able to disconnect customers for non-payment; and
- It is proposed that the 'end-date', by which all deferred wholesale amounts would have to be repaid to SW, whether or not customers have paid their LP, would be 31 March 2023.

Alternative options: As an alternative to the deferral scheme proposed above, the Group considered the option of simply extending the suspension of the two-month wholesale charge pre-payment requirement for a further period. The key issues with this option are the inability to make it reciprocal to the deferral offered by LPs to customers, in terms of both the amounts deferred and the timescales for repayment, i.e. the wholesale charges still have to be paid in full in the month of service to SW, regardless of whether or not customers have paid their LP, and the fact that the continued deferral of wholesale payments could leave SW exposed to bad debt risk.

A bad debt relief option for LPs and an empty property relief option for customers were also discarded at this stage following feedback from the WICS.

Meeting the Commission's success criteria: In its December email to the Working Group, the Commission set out a series of criteria that any proposal would have to meet. A more detailed assessment is included in the Appendix attached, but we consider the primary issue in relation to the proposal above is the impact on Scottish Water (SW) and whether the proposal would constitute a 'detriment' to SW. We recognise that as a result of sharing the responsibility for supporting customers in the short term, there will be two consequences for SW:

(a) SW is likely to under-recover cash from wholesale charges in 2021/22.

However, providing the deferred wholesale charges are repaid by LPs in full by 31 March 2023 as proposed, with a level of interest reflecting SW's WACC, there should be no detriment to SW as a result, with all amounts fully recovered during the SR21 price review period;

(b) If LPs are allowed to accumulate debt by deferring wholesale charges then SW will have a greater exposure to bad debt risk should an LP became insolvent.

However, that risk could be limited by capping the amount that each LP is allowed to defer based on their credit risk and recent payment history, and the risk could be mitigated completely if SW is allowed to recover any bad debt costs incurred as a result of LP insolvency from future NHH wholesale charges within the SR21 review period.

Data reporting and validation: To accurately assess the financial impact of COVID-19, we are proposing that levels of debt, bad debt and payment deferrals are reviewed on a quarterly basis. This data would be collated, reviewed and validated by independent accountants, to verify the financial impact of COVID-19 across the market.

In section 4 below, we have made a proposal to mitigate the increase in risk and liabilities on LPs, if the right to disconnect customers for non-payment is withdrawn. Through regular reporting on debt and debt recovery levels, the impact of the withdrawal of disconnection could also be monitored in order to inform any further action required.

(iii) Future-Proofing the Market

Below are proposals for three changes to the market arrangements that we believe would increase the ability of the NHH market to withstand shocks in the future.

(a) Financial resilience of LPs

Aim: to "*ensure that licence providers have the appropriate financial strength to perform their licensed activities*" …. and "*to withstand external shocks*" (WICS Nov consultation).

Considerations: In an effective, well-functioning market, players will come and go, therefore the aim is to ensure that the market arrangements themselves are robust and resilient to LP failure, rather than to ensure that every LP passes a 'resilience test' and continues to trade.

The wholesale deferral proposal outlined in section (ii) above will help LPs' immediate financial resilience and allow them to continue to support customers through COVID-19 and during the transition back to 'normal'.

Following discussions with the Commission, we understand that the financial resilience of LPs and their ability to be able to respond to unforeseen external shocks is uppermost in the Commission's mind. In order to achieve this, the Commission has proposed that LPs should be required, through a new licence condition, to hold a liquidity buffer which, when combined with the prepaid wholesale charge, would be equivalent to a minimum of 3.5 months of wholesale charges, or a level of financial resilience that satisfies both WICS and Scottish Water.

We understand the Commission's concern, and recognise that a new licence condition requiring greater transparency around an LP's financial strength could provide the Commission and other stakeholders with confidence in the future resilience of the market. On the whole, we believe that LPs would be supportive of the need to demonstrate their financial strength in order to ensure the market is financially resilient and that customers are protected. However, the additional liquidity requirement proposed by WICS is substantially more than has been required in the past, and may be difficult for some LPs to meet – although this may depend on the options permitted for demonstrating liquidity.

While the Group supports the principle of a new licence condition of this nature, LPs would have to be confident that there is support in place to help the market transition back to 'normal', that the liquidity requirement is appropriate and reasonable given current circumstances and that the scale is both proportionate to the risk and informed by data. Even if the condition did not become effective immediately, in order to commit to it, LPs would need to clearly understand the implications, i.e. the level of commitment required, how it would be applied (same requirement for all or different options depending on an LP's creditworthiness for example) and the consequences of being unable to meet it. Hence the Group proposes that:

- in order to help determine the appropriate level of liquidity required of LPs, a review is undertaken by a firm of independent experts, who would be asked to assess the appropriate level of financial resilience for this market, and the potential impact of the proposed measures. As part of the review they would consider the aims and objectives of a range of stakeholders, review alternative approaches from other markets and sectors, analyse data to assess the true impact of COVID-19 to date including the ability of LPs to withstand future substantial shocks, and use that insight to propose a market wide solution. As the review would be beneficial for the market as a whole, the Group would like to explore whether the review could be commissioned by the CMA, as an impartial party, and funded using the market performance fund; and
- the wording of the proposed licence condition and the detail of how it would be applied, is developed by the Working Group and shared with WICS as a draft for discussion.

Timing: The Commission has indicated that although it would expect an early commitment from LPs to a new licence condition, it would be reasonable to transition towards the implementation of new resilience measures over a period of time as the market transitions back to 'normal'. It is therefore proposed that any new measures are implemented from April 2023 to align with the timescale for the deferred wholesale charges being fully repaid to SW, in line with the proposal above. In order to avoid a cliff-edge for LPs where all new liquidity has to be provided at the same time as wholesale charges have to be repaid, it is proposed that the financial resilience requirement would be phased-in over a period. It is also important that LPs have sufficient time to build the cost of additional liquidity into their contract prices, which could take up to three years, as contracts are renewed.

If the market data which is collated and reviewed on a quarterly basis, suggests that the financial impact of COVID-19 is not as pronounced as originally feared, or the pace of recovery is quicker than anticipated, the financial resilience measures could potentially be introduced earlier. In the meantime, any concerns about the resilience of individual LPs, would be addressed directly through the existing regulatory mechanisms.

In order to provide certainty as soon as practical, the independent review could be commissioned in March 2021 (or before that if possible), and the licence condition drafted and consulted on in parallel, which would allow the new measures to be agreed by July 2021 at the latest. This timeframe would align with our proposal for the reintroduction of the first month's pre-payment of wholesale charges.

The Working Group has also considered the following additional measures:

- increasing the range of options available for the future payment of wholesale charges to allow LPs alternative options to manage their working capital (see below);
- an [annual] review of an LP's financial resilience by a reputable independent auditor, as part of which they issue a Going Concern statement; and
- a forward-looking annual statement from an LP's Board as an augmentation to the SLC A9 process, warranting that the LP is a Going Concern and that it has the financial resources required to meet its commitments and protect customers and SW.

(b) Alternative wholesale payment options

Aim: to explore alternatives to the requirement to pay wholesale charges two months in advance, that would give LPs greater flexibility to manage their working capital demands, whilst maintaining SW's protection against LP bad debt.

WG Considerations: Scottish Water has indicated a willingness to consider forms of credit security from Licensed Providers as an alternative to returning to the two month prepayment of wholesale charges. To ensure no detriment to Scottish Water's core business, it would be necessary to remove the wholesale bad debt risk which has been created by the temporary suspension of prepayment and return to the levels of protection which were in place prior to COVID. Potentially acceptable forms of credit may include cash security account, guarantee, letters of credit and surety bonds, but SW would want to determine minimum acceptable standards for each mechanism.

Proposal: In order to ensure no detriment to Scottish Water, the value of the credit security would need to cover 100% of the value of any wholesale charges which could be outstanding were an LP to exit the market. The Group therefore proposes to review invoicing and/or payment timings alongside a review of the POLR process to assess whether it is possible to reduce SW's exposure in the event that an LP defaults on payment. The final proposal would need to be developed alongside the licence condition on LPs' financial resilience, to ensure consistency.

(c) Increased transparency of LP activities

Aim: to consider additional accounting or reporting requirements to "*improve the transparency between the activities of retailers operating in both the English and Scottish market*…" and to "*ensure that customers are not unfairly disadvantaged nor exposed to any detriment by the activities of licensed providers operating in both the English and Scottish market*" (WICS November consultation).

Considerations: Where LPs operate in both English and Scottish markets (as well as other utility sectors), they don't tend to operate separate businesses (for reasons of economy of scale) and it is common for services such as customer service, credit control, finance, legal and IT to be shared across the business. Customers are likely to benefit from their retailer operating in both markets, receiving higher discounts from economies of scale, a single consolidated bill for all services, reducing their administrative burden etc.

Proposal: It is proposed that rather than producing separate regulatory accounts for their Scottish business, which would be based on a subjective cost allocation exercise, the requirements of the existing SLC A9 statement which LPs are obliged to submit each year, could be augmented to provide WICS with greater assurance in relation to the activities of LPs operating in both markets. For example, the LP's Board could provide assurance that in the coming year, it will conduct its affairs to ensure that its Scottish customers are not unduly disadvantaged by its activities in the English water market and specifically that its English activities are not being subsidised by its Scottish customers. The statement could also include a commitment that charges in both markets reflect the costs of operating in each market. These forward-looking assurances would complement the existing backward-looking assurances currently required by the SLC A9 statement. There could also be a requirement to audit this statement through the Market Health Check process.

4. Proposed Withdrawal of Disconnection for Non-payment

Since the outbreak of the pandemic, SW has reviewed the arrangements around the disconnection of NHH premises and concluded that disconnection for non-payment, either by Scottish Water or an Accredited Entity, is not permitted in a number of scenarios, including where water for domestic purposes would be impacted. The definition of "domestic purposes" is sufficiently wide to apply to many non-household customers.

The statutory right for LPs to disconnect a customer for non-payment has been available since market opening and is critical to LPs in two respects:

(i) it is an essential tool for LPs' to manage debt. Businesses can't legally operate without water and hence the prospect of disconnection is a genuine incentive on customers to engage and pay; and

(ii) temporary disconnection is the only means of capping an LP's liability for some of the charges that a non-paying customer incurs. Legal recovery is costly and it only recovers debt at a point in time, it doesn't limit the liability for future debt.

Proposal: Scottish Water is arranging an industry workshop on 25th February to consider potential *technical alternatives* to disconnection to support LPs' debt management.

If SW permanently withdraws the right to disconnect, as currently proposed, it would constitute a material change of circumstance which will substantially increase LPs' bad debt risk. Given that the recovery path from COVID is contingent on an LPs' ability to recover the debt that has accrued over the last 10 months, the loss of such a key tool will be felt particularly hard. Unless a solution can be found that both mitigates the increase in bad debt risk and caps an LP's liability for wholesale charges, LPs would propose that retail margins are increased to recover the increase in risk and cost. Given that the impact of the withdrawal of disconnection will be immediate, if there is no satisfactory outcome following the Scottish Water workshop, we propose that the next step would be a review of the financial impact, to inform a mid-year amendment to default charges.

5. Milestones and Timescales

Given the uncertainties of the pandemic and the need to allow sufficient time to phase out the existing support measures and to introduce new measures to ensure the orderly functioning of the market, the Group proposes the following timescales for the transition:

Date	Measure/Milestone
March 2021	Extended WCDS closed
	Review of retail margins to reflect material change of circumstance if the removal of temporary disconnection is made permanent
	Consultation on the wording and application of new financial resilience licence condition
	Independent review of market resilience commissioned
	New SLC A9 forward-looking requirements apply for the first time

April 2021	New customer COVID deferral scheme introduced and reciprocal wholesale charge deferral scheme introduced
	First review/validation of debt data for FY 2020/21
July 2021	First month of wholesale charge pre-payment reinstated
	Independent review of market resilience concluded, licence condition consultation concluded, and agreement on financial resilience measures and level to apply from [1 April 2023]
	New wholesale charge payment options introduced (consistent with financial resilience licence condition)
	Quarterly review/validation of debt data [FY21/22 Q1]
October 2021	Quarterly review/validation of debt data [FY21/22 Q2]
December 2021	Second month of wholesale charge pre-payment reinstated
January 2022	Quarterly review/validation of debt data [FY21/22 Q3]
April 2022	Review/validation of debt data [FY21/22]
March 2023	All deferred wholesale charges (and interest) repaid in full to SW
April 2023	Phased introduction of new financial resilience measures

6. Next Steps

The proposals set out above have been prepared in a relatively short period of time. A number of the proposals will require further work to develop detailed proposals, implementation plans and timescales for delivery. Given the compressed timescales for the review, other LPs, who will be affected by the proposals presented within this paper, have not yet been consulted. It is important that we do so, and we will be reaching out to them in the coming weeks.

The key areas for further work include:

Deferral Scheme

- Agree definition of eligible customers [propose all unmeasured customers and sites where meter size is <25mm, consistent with existing WCDS];
- Size the potential impact of the proposed wholesale charge deferral on SW's cashflow in 2021/22;
- Work through options for the practical implementation of the wholesale charge deferral with the CMA and SW;
- SW to develop proposals on wholesale charge deferral capping to minimise bad debt exposure;
- Agree process by which an independent auditor would be appointed to review debt data.

Future proofing the Market:

- Develop detailed proposals with Scottish Water to establish a list of available wholesale payment and credit assurance options (in parallel with the financial resilience licence condition, to ensure consistency);
    - SW then to develop guidance on how LP proposals would be assessed;
- Review invoicing and payment timings alongside a review of the POLR process to assess whether it is possible to further reduce SW's exposure to LP bad debt;
    - SW to consider additional early warning signals of the risk of LP payment default.
- Commission an independent review on the appropriate level of liquidity required from LPs to demonstrate financial resilience, or alternative methods of proving financial stability;
- Consultation on the wording and applicability of new financial resilience licence condition; and
- Develop a detailed proposal on the annual Board Resolution to provide assurances on financial resilience and transparency on LP activity in both markets (although this may not be required, depending on the terms of the proposed licence condition on resilience).

Disconnection for non-payment:

- Workshop to take place 25th February to consider options proposed as alternatives for temporary disconnection;
- Assessment of the increase in bad debt risk to LPs, if temporary disconnection is withdrawn without an adequate alternative, with a view to mid-year amendment to default charges.

The Group would also like to propose that a Senior Stakeholder Forum is established with representatives from all key stakeholders with the aim of operating to ethical business practice principles, further improving the efficiency and effectiveness of the market and delivering better outcomes for customers.

Appendix - Meeting the Commission's Criteria

We have assessed the proposals above against each of the criteria set out in the Commission's email of 18th December, and set out below how we believe that each is met.

1. Is consistent with the Commission's statutory duties to
   (a) to ensure there is no detriment to Scottish Water;

   Revenue allowance:
   - Under the wholesale charge deferral proposal set out at section 2(ii), LPs and Scottish Water would share proportionately the responsibility for supporting customers in the short term;
   - Scottish Water would as a result temporarily under-recover its cash allowance from wholesale charges in 2021/22. However, providing the deferred wholesale charges are repaid by LPs in full by 31st March 2023 as proposed, with a level of interest reflecting SW's WACC, there would be no detriment to SW as a result of this proposal.

   Bad debt risk:
   - If LPs are allowed to build up debt under the wholesale deferral scheme, SW has a greater exposure to bad debt risk should an LP become insolvent;
   - However, our proposals are likely to significantly increase the resilience of LPs in the short term and reduce the risk of LPs failing;
   - SW's bad debt risk could be limited by capping the amount that each LP is allowed to defer; and
   - The risk could be mitigated completely if SW was allowed to recover any bad debt costs incurred as a result of LP insolvency from future NHH wholesale charges, as permitted under the revenue recovery profiling in the SRC.

   (b) promote the interest of customers
   - A back-to-back deferral scheme allows LPs to continue providing support to customers who are affected by COVID-19, which is essential given that the future remains so uncertain. By allowing extended payment plan options it will provide customers with continued support over an extended period of time as they attempt to re-establish their business;
   - It is efficient – the provision of wholesale charge deferral does not diminish the incentive on LPs to recover customer debt. The deferred wholesale charges will have to be repaid in full by March 2023 and from a pace of recovery perspective, as the deferral is only for wholesale costs, LPs still need to recover the retail margin in order to cover their own operating costs;
   - It increases the resilience of the NHH market, reducing the prospect of systemic retailer failure, which would not be in the interests of customers;
   - It makes no demands on domestic customers.

2. Is consistent with Scottish Government's Principles of Charging;
   - The Government's Principles of Charging are:
     - Stability and certainty
     - Full cost recovery
     - Harmonised charges

- Cost reflective charges
- Fair, equitable and affordable

- Nothing in our proposals would be inconsistent with these principles, providing that SW is able to recover its full costs, including interest from LPs (NHH customers) over the period of the price control, even if this has to be on a phased basis.
- This set of proposals would help increase the resilience of the NHH market and would help to provide business customers with stability and certainty.

3. Is easy to monitor and transparent;
   - The administration of the scheme would need to be further developed with input from the CMA and SW, with the aim of avoiding the complexity of the WCDS.
   - It is anticipated that there will be a role for an independent firm of accountants to monitor and validate LPs' data on a quarterly basis. The scope of work would need to be determined as would the funding.

4. Provides a clear roadmap for transitioning the market back to its normal operations with clear trigger points and with specific and reasonable implementation timescales. The proposal should be ready for implementation in February 2021 and include the key steps required over the subsequent 3 to 6 months;
   - See proposed timescale and milestones at section 6 above.

5. Is sufficiently flexible to allow us to respond to material changes of events.
   - The quarterly monitoring and review process will provide data to accurately assess the impact of COVID-19 on customer payment trends, aged debt and bad debt levels.
   - If necessary, the deferral scheme could be extended to give customers support over a longer period.