December 2021

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

Ofwat

About this document

This document sets out and seeks views on our proposal to temporarily amend the Retail Exit Code (REC) with effect from April 2022. The small and temporary amendment would increase the maximum prices that Retailers are allowed to charge business customers who are on default tariffs. The temporary increase is intended to allow Retailers to share some of the unexpected costs associated with bad debt that have arisen due to the Covid-19 pandemic. We are making market-wide adjustments to the business retail (REC) price caps to maintain strong incentives on Retailers to manage bad debt costs so that only efficiently incurred excess bad debt costs are shared with business customers.

These proposals do not affect household customers.

Executive summary

Measures in place since March 2020 to combat the Covid-19 pandemic have had significant effects for the UK economy and businesses, including business customers and Retailers in the business retail water market. Impacts could include an increased likelihood of business customers defaulting on payment, meaning that Retailers may face levels of customer bad debt costs beyond which an efficient and prudent Retailer could have been expected to plan for. Business retail price caps set out in the Retail Exit Code (REC) prevent Retailers from sharing these elevated costs with business customers on default tariffs.

In July 2021 we published our decision that, since, on the basis of Retailer reported data, bad debt costs applying across 2019-20 and 2020-21 were around 2.5% of business market turnover, additional regulatory protections were warranted. We decided this should take the form of an adjustment to the business retail (REC) price caps to provide Retailers with additional flexibility to price upwards in response to elevated bad debt levels, and so protect customers' interests in the longer term by mitigating risks of systemic Retailer failure. This approach preserves incentives on Retailers to manage their bad debt costs, with those who manage these costs most effectively likely to reap a competitive advantage, in line with normal commercial practice. This helps protect customers' interests in the shorter term.

This document consults on our proposed adjustment to REC price caps, to take effect from April 2022 for a minimum of two years. **We are consulting on temporarily amending the REC price caps by increasing net and gross margins by 0.31%.** We also seek views on the assumptions and underlying approach and have published a model setting out the basis of our calculations. These proposals do not affect prices paid by household customers.

Our July 2021 document also sought views on whether a subsequent 'true up' would be warranted. On balance, noting latest Retailer reported outturn bad debt costs – at 2.87% of business market turnover - are not materially higher than those we reported in July 2021, **we have decided not to commit to pursuing a 'true up'**. Nevertheless, noting that Retailers will in due course provide audited accounts and other operating cost data, where we find that any such revisions at an industry level are material, we remain open to the idea of revisiting or revising any adjustments to REC price caps that we may have made in respect of customer bad debt costs.

Next steps

Following responses to this consultation (due by 5pm Wednesday 12th January 2022), we intend in February 2022 to publish our Decision on the temporary amendments to apply to the REC from April 2022.

Contents

1. Introduction and background

1.1 Purpose

Measures in place since March 2020 to combat the Covid-19 pandemic have had significant effects for the UK economy and businesses, including business customers and Retailers in the business retail water market. Impacts could include an increased likelihood of business customers defaulting on payment meaning that Retailers may face levels of customer bad debt costs beyond which an efficient and prudent Retailer could have been expected to plan for. This in turn could increase risks of systemic Retailer failure, which we consider would not be in customers' longer-term interests.

Furthermore, Retailers' abilities to respond to increased bad debt costs have been constrained. First, Ofwat's measures to protect business customers during the pandemic included temporary restrictions on Retailers' ability to pursue debt and enforcement activity. Second, Retailers' pricing flexibility for small and medium business customers is constrained since price caps apply to such customers who have not engaged in the market.

Following consultation, in July 2021 we published our decision[1] that Retailers had faced levels of customer bad debt beyond which an efficient and prudent Retailer could have planned for. To address these issues and risks and with a view to protecting the longer-term interests of customers by minimising risks of systemic Retailer failure, we said we would allow a small and temporary uplift to the business retail (REC) price caps to apply from April 2022. We said we would make market-wide adjustments to the REC price caps to maintain strong incentives on Retailers to manage bad debt costs so that only efficiently incurred excess bad debt costs are shared with business customers.

Our July document also sought views concerning the merits of pursuing a 'true up' i.e. a subsequent check on outturn bad debt costs across the market.

This document sets out:

- our proposed temporary uplift to the REC price cap, and seeks views;
- the corresponding proposed amendments to the Retail Exit Code and seeks views; and
- our decision, in the light of updated data concerning outturn bad debt costs, not to pursue a subsequent 'true up'.

[1] See: July 2021 Decision and consultation and October 2021 Update: Business retail market – Customer bad debt

1.2 Responding to this consultation

We seek views and evidence from all interested stakeholders. **We welcome views on the issues relevant to the consultation, in particular regarding questions 1 to 5 in chapter 3, by 5pm Wednesday 12th January 2022.** Please submit email responses to covidbusinessretailmarket@ofwat.gov.uk, with the subject 'Customer Bad Debt December 2021 Decision and Consultation'.

You can submit your responses by post to: 'Customer Bad Debt December 2021 Decision and Consultation', Ofwat, 21 Bloomsbury Street, London WC1B 3HF.

We intend to publish responses to this consultation on our website at www.ofwat.gov.uk. Subject to the following paragraphs, by providing a response to this consultation you are deemed to consent to its publication.

If you think that any of the information in your response should not be disclosed (for example, because you consider it to be commercially sensitive), an automatic or generalised confidentiality disclaimer will not, of itself, be regarded as sufficient. You should identify specific information and explain in each case why it should not be disclosed and provide a redacted version of your response, which we will consider when deciding what information to publish. At a minimum, we would expect to publish the name of all organisations that provide a written response, even where there are legitimate reasons why the contents of those written responses remain confidential.

In relation to personal data, you have the right to object to our publication of the personal information that you disclose to us in submitting your response (for example, your name or contact details). If you do not want us to publish specific personal information that would enable you to be identified, our *Privacy policy - Ofwat* explains the basis on which you can object to its processing and provides further information on how we process personal data.

In addition to our ability to disclose information pursuant to the Water Industry Act 1991, information provided in response to this consultation, including personal data, may be published or disclosed in accordance with legislation on access to information – primarily the Freedom of Information Act 2000 (FoIA), the Environmental Information Regulations 2004 (EIR) and applicable data protection laws.

Please be aware that, under the FoIA and the EIR, there are statutory Codes of Practice which deal, among other things, with obligations of confidence. If we receive a request for disclosure of information which you have asked us not to disclose, we will take full account of your explanation, but we cannot give an assurance that we can maintain confidentiality in all circumstances.

In developing this document, we have used information and evidence already obtained, including responses to our July 2021 document and via requests for information ("RFI"s) from Retailers. We welcome the constructive discussions thus far and the set of questions for consultation in this document is an opportunity for stakeholders and any interested parties to provide further views and perspectives.

1.3 Structure of this document

The remainder of this document is structured as follows:

Chapter 2 - sets out our decision not to pursue a 'true up' and our reasoning for this. In support of our decision, this chapter also summarises data from Retailers to the end of September 2021, which confirm that outturn bad debt costs were on average around 2.87% of market turnover for the 2 years ended March 2021.

Chapter 3 - sets out our proposed adjustments to REC price caps with effect from April 2022 and our reasoning for these adjustments. It includes our view on the efficient costs to Retailers of financing the portion of excess bad debt costs that are to be recouped from business customers in the interval between their arising and the time period over which they may be recouped via revised regulatory arrangements.

Chapter 4 - sets out our next steps.

1.4 Summary of questions for consultation

Chapter 3 puts a number of consultation questions, summarised here:

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?

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.

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?

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

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.

2. Outturn bad debt costs and decision on 'true up'

2.1 Summary

Retailer reported data in response to our October 2021 Request for Information (RFI) suggest that **outturn bad debt costs on average over the periods 2019-20 and 2020-21 were 2.87%.** This is higher but not materially different from the 2.5% reported in our July 2021 document. Furthermore, responses to the July document supported the view that there was little merit in pursuing or conducting a subsequent 'true up'. Reasons included that undertaking a 'true up' would involve considerable effort and costs by Retailers and that this would be disproportionate where outturn bad debt costs across the market were only marginally above the 2% threshold. **We have decided therefore not to pursue a subsequent 'true up' exercise.**

2.2 Introduction

With the objective of protecting customers' interests, we have been clear during our consideration of whether or not revisions to regulatory protections are warranted on account of elevated levels of bad debt costs that it is important to ensure that outturn bad debt costs are measured to a sufficient degree of accuracy and do not overstate such costs[2]. This is important for two reasons.

First we need to understand if market wide bad debt costs have exceeded 2% of market turnover threshold, since we have indicated that revisions to regulatory protections may only be warranted where this is the case.

Second, we need to understand bad debt costs to calculate the temporary adjustment to REC price caps with a view to enabling Retailers to recoup a portion of such excess bad debt costs from business customers. Given that bad debt costs take time to materialise and be recognised as such by Retailers – for example as over time it becomes clear whether outstanding bills may be paid or not – we also need to assess likely bad debt costs arising and calibrate REC cap price adjustments before Retailers have reached a full and final view on whether outstanding amounts are recoverable or not.

We therefore suggested a 'true up', with the objective of reconciling these aims. That is, we would for the purposes of assessing whether or not the 2% threshold has been reached and calculating the REC price cap adjustment, use Retailer reported data. At a later stage, we would undertake a 'true up' in the light of more robust and audited Retailer data on outturn bad debt costs, including assurance that such bad debt costs arise in respect of customer consumption just prior to and over the period of the pandemic. We would for example look to

[2] See for example: §2.2.1 30th November 2020 CFI: Business retail market- Customer bad debt ; §2.1 5th March 2021 Consultation: Business Retail Market – Customer bad debt

exclude bad debt costs that may have arisen in respect of customer consumption prior to October 2019, as we consider that Covid-19 would not have materially affected a prudent Retailer's ability and motivation to pursue recovery of such debt.

We set out that, should the true up indicate that outturn bad debt costs were not above the 2% threshold, we will unwind additional regulatory protections as appropriate.

2.3 Update on outturn bad debt costs

Retailer responses to Ofwat's Request for Information (RFIs)

In October 2021 we asked Retailers, via our October 2021 RFI, for updated information and data concerning indicators of customer bad debt costs and other relevant information. This was for the purposes of understanding developments in customer bad debt costs for Retailers as well as obtaining the most up to date information on these costs for the purposes of calculating the adjustment to REC price caps to apply from April 2022 (see chapter 3).

The October 2021 RFI sought updates on turnover and bad debt costs to end March 2021 which Retailers had already provided in response to Ofwat's May 2021 RFIs; this was on the basis that May RFI responses were likely based on management accounts whereas for the October 2021 RFI we requested turnover and bad debt costs expected to be disclosed in the audited accounts for the year ended 31 March 2021. The October 2021 RFI also requested data on bad debt costs and turnover for the six months to 30 September 2021.

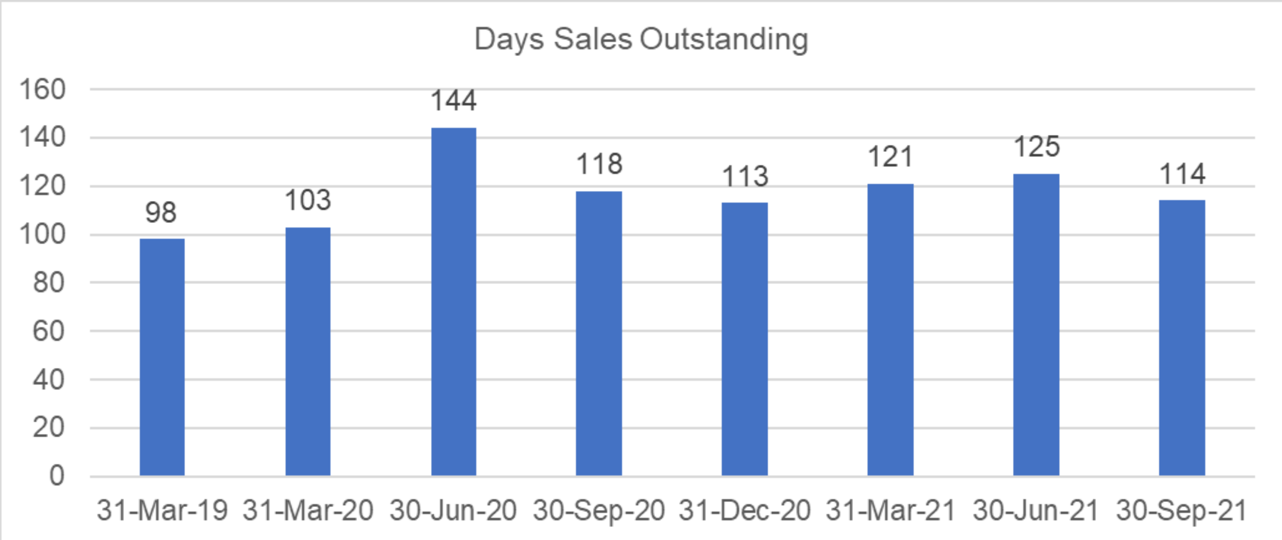
The following sections summarise Retailer reported data concerning indicators of bad debt and outturn bad debt costs.

Sector overview

Updated Retailer data indicate that, at an industry level, business activity continues to recover towards pre-pandemic levels. Market revenue in the six months ended 30 September 2021 was around £1.183bn, down by around 8.5% compared to market revenue for the corresponding six month period in 2019/20.

Days sales outstanding (DSO) has stabilised and at 30 September 2021 was 114 days – see Figure 1. This is not yet back to pre-pandemic levels but the reduction suggests that significant losses arising from unpaid debts are now less likely.

Figure 1 – Business retail market - Days sales outstanding



Source: Retailer returns to RFIs

This picture is supported by Retailer estimates of bad debt costs for the six months ended 30 September 2021 at 0.5% of revenue. This compares with bad debt costs of around 1% of business market turnover prior to the pandemic. This supports the view that current provisions are adequate and that further significant losses are not being anticipated by Retailers.

Market wide bad debt costs for 2021

Retailers have responded to the October 2021 RFI by updating their previous responses to our May 2021 RFI, including by refining their analysis of customer bad debt costs. Some Retailers reassessed their provisions for bad debts for the final quarter of 2019--20 and as a result increased the amounts to be included within the effective bad debt cost. Overall, Retailers in their October 2021 RFI responses have slightly revised upwards their reported bad debt costs for both 2019-20 and 2020--21, giving data as set out in Table 1.

Table 1 – Updated Retailer bad debt costs as proportion of turnover

	2019-20		2020-21		2 years to 2021	
	May 2021 RFI	October 2021 RFI	May 2021 RFI	October 2021 RFI	May 2021 RFI	October 2021 RFI
Retailer reported customer bad debt costs. Proportion of turnover, weighted average across Retailers	2.89%	3.35%	2.13%	2.31%	2.54%	2.87%

We note that Retailers continue to report a range of bad debt costs with the updated bad debt costs for 2020-21 ranging from 0% to 19.9%. Overall, at an industry level, October 2021 reported outturn bad debt costs for 2020-21 are now 2.31%. This remains lower than the reported cost for 2019-20 at 3.35%. We note that reported bad debt costs for 2019-20 and 2020-21 reflect a mix of approaches to provisions and write-offs by Retailers. In particular some Retailers chose to make relatively early and heavy provisions in 2019-20 in respect of possible bad debt costs arising following the pandemic. Other Retailers, where they saw an expectation of elevated levels of customer bad debt, made provisions in 2020-21. We have accordingly chosen to take a weighted average of reported bad debt cost across the two years ended 31 March 2021 (i.e. 2.87% of turnover) as more properly indicative of the customer bad debt costs arising for 2020-21.

2.4 Question of 'True up' - What we said in the consultation

Our July 2021 document (§5.8) recapped our rationale for considering introducing and pursuing a 'true up' – particularly that it could better meet our objectives to ensure customers' interests are best protected, by ensuring any excess bad debt costs passed to them are sufficiently accurately measured. We also noted drawbacks, in that a 'true up' would involve implementation costs for Retailers. We further noted that Retailers reported bad debt costs, at around 2.5%, did not significantly exceed the 2% threshold for regulatory support. Hence the likelihood of error - i.e. passing through to business customers a too large quantum of excess bad debt costs via adjustment to REC price caps - is much reduced, particularly after application of sharing factors.

Question of pursuing 'true-up'

Accordingly we said – and invited views – that we were minded to remain open to the idea of not undertaking a formal 'true up' process if outturn levels of bad debt were not materially greater than the 2% threshold. We consulted as follows:

July 2021 Consultation Question 2 – Do you see merit in the idea of not pursuing a 'true up'?

Question of approach to any 'true up'

Noting that we had not reached a decision on whether or not to pursue a 'true up', our July 2021 document (§6.3) also suggested an approach for undertaking a 'true up', should we choose to pursue this. We said we would look to collect, after March 2022, more detailed data from Retailers in respect of bad debt costs arising on the basis of usage between October 2019 and March 2021. We would expect this more detailed data to have been subject to relevant quality assurance processes such as an independent audit. We said that, on the basis of such data, we would either look to:

- unwind the adjustment to REC price cap - where the more detailed data indicate that, on the basis of the period October 2019 to March 2021, bad debt costs did not exceed the 2% threshold,.
- make a corresponding adjustment to the REC price cap to apply from April 2023, where the more detailed data indicate that, during the period October 2019 to March 2021, bad debt costs exceeded the 2% threshold by a different amount used to adjust REC price caps from April 2022.

We consulted as follows:

July 2021 Consultation Question 3 – Do you agree with our approach to the 'true up', in the event we pursue one? Please explain your views.

2.5 Question of 'True up' - Consultation response summary

Seven Retailers and the Consumer Council for Water (CCW) responded to our July 2021 document. In response to question 2 all seven Retailers said that they agreed or were minded to agree that there was merit in not pursuing a 'true up'. The reasons they gave included that that the administrative burden of pursuing a true up is likely to be disproportionate to the benefits and that given the proposed use of a relatively straightforward method of assessment and the relatively small amounts at issue, it would run counter to the aims of both to seek to true up retrospectively. One Retailer commented that Ofwat's fuller REC price cap review presents a route to incorporate an element of 'true up'. Another Retailer called for further clarity on the interaction between the temporary bad debt measures and the upcoming REC price cap review.

CCW thought that it is too early at this stage to decide whether or not there is merit in pursuing a 'true up', and for this reason welcomed Ofwat's decision to issue a further Retailer RFI. CCW also commented that business customers are already expected to bear 75% of excess bad debt costs, so the impact of this could be worse were the current estimates of bad debt revised upwards ahead of adjustments to the REC price caps taking effect. CCW noted that a true-up may therefore exacerbate an already inequitable situation for business customers.

One Retailer emphasised that some Retailers may have reported bad debt costs to date, without yet having made provisions which would, to the extent such Retailers' data are included in the market average, likely reduce the market wide estimate of bad debt costs. This Retailer accordingly called for use of audited accounts for year ended March 2021, which need to be filed by end December 2021.

In response to question 3 one Retailer agreed with the approach we proposed to take were we to undertake a true-up. CCW also indicated their agreement, noting that the approach aims at ensuring consistent reporting by Retailers and accurate data.

Three Retailers said that they disagreed with our approach or elements of our approach. Their reasons for disagreement included that it would cast doubt retrospectively on Retailers' existing provisions and write offs, and the presentation of these in their accounts, and so undermine investor confidence. Another Retailer argued that measurement of customer bad debt costs across October 2019 to March 2021 would not capture the longer-term impacts of the pandemic on UK businesses. This Retailer also commented that a more accurate assessment of bad debt costs cannot be made until March 2023. A third Retailer commented that it has no mechanism for apportioning bad debt costs using consumption periods, only by bill date.

Further comments included:

- Further scrutiny of Retailers' debt recovery processes – CCW noted that Ofwat should seek assurance that Retailers have attempted, reasonably, to recover their (bad debt) costs.
- Sharing factors – CCW commented that were Ofwat to proceed with implementing a true-up, and this results in bad debt costs increasing, this provides further rationale for revising the 75:25 sharing factor.
- Use of Retailers' audited accounts - would avoid the complexities of Ofwat's true-up approach, and would be more accurate and transparent than using data reported by Retailers in response to Ofwat's RFIs.
- REC price cap review – two Retailers suggested between them that Ofwat should consider amending the bad debt cost allowances within the REC price cap review regardless of, or as a form of further, 'true up'.
- Market wide or individual retailer basis – one Retailer sought clarification, asking in the event of a 'true up', whether it would be applied on a market wide basis or on an individual retailer basis.

2.6 Question of 'True up' - Our decision

We have decided that it will not be necessary or proportionate to commit to pursuing a formal 'trueup'. This is because outturn bad debt costs, at 2.87% of market turnover, are not sufficiently higher than the 2% threshold to raise concerns that a subsequent true up would result in a material revision to either our policy intent to revise regulatory protections or the level of this protection (i.e. the adjustment to REC price caps). Furthermore, pursuit of such a 'true-up' would result in significant compliance costs for Retailers, which, noting our reduced concerns about the materiality of any possible revisions in the light of a 'true up', would in our view be disproportionate.

Nevertheless, we are aware that – as a number of Retailers have commented – customer bad debt costs take time either to be realised or recovered. It is possible that as pandemic measures are lifted and the wider economy recovers, Retailers are able to recover amounts owed by business customers, and that such amounts had previously been allowed for and measured by Retailers as customer bad debt costs, so leading to a downward revision of customer bad debt costs overall. We would, as CCW have noted, expect in any case that Retailers, with due regard to the need to recognise and facilitate business customers who may face difficulties in payment, to carefully manage and minimise bad debt costs including through recovery of amounts due.

On the basis of Retailer or industry level data, including reference to audited accounts, where we find that any such revisions at an industry level are material, we remain open to the idea of revisiting or revising any adjustments to REC price caps that we may have made in respect of customer bad debt costs. This is likely to be particularly relevant to the REC price cap adjustment applying from April 2023.

We note respondents' views concerning the question of true-up and if and how this will or should fit with our wider review of REC price caps. We will be consulting on our approach to the REC price cap review in December 2021, including the question of where and how to gauge the forward-looking costs an efficient Retailer incurs from serving customers. Consultation here will be an opportunity for Retailers to express views on how such costs – including bad debt costs – should be gauged.

3. Adjustment of REC price caps

3.1 Summary

In July 2021 we published our decision that Retailers had faced levels of customer bad debt beyond which an efficient and prudent Retailer could have planned for. To address these issues and risks and with a view to protecting the longer-term interests of customers by minimising risks of systemic Retailer failure, we are allowing a small and temporary uplift to the business retail (REC) price caps.

We propose to temporarily increase net and gross margins in the business retail (REC) price caps by 0.31%.

This increases the maximum price Retailers are allowed to charge business customers who are subject to maximum price caps by 0.31%. It also provides headroom for Retailers to increase prices for business customers not subject to price caps, subject to the extent of competitive pressure and whether other Retailers can manage their bad debts more efficiently. We have therefore calculated the increase to price caps on the basis that Retailers in aggregate recoup from all[3] business customers three quarters of excess bad debt costs arising in 2020-21, as well as efficient financing costs. This helps to avoid the risk that smaller, unengaged business customers bear a disproportionate burden of higher bad debt costs. Furthermore, we are making market-wide adjustments to the REC price caps to maintain strong incentives on Retailers to manage bad debt costs so that only efficiently incurred excess bad debt costs are shared with business customers. To be clear, these proposals do not affect household customers.

3.2 Introduction

This chapter sets out and seeks views on our approach to, and proposals for, adjusting REC price caps with a view to enabling Retailers greater pricing freedom to recoup from business customers the relevant portion of excess bad debt costs. We begin by summarising the form of the present REC price cap. We go on to discuss how the parameters of this need to be amended in order to implement a small and temporary adjustment to REC price caps that creates the necessary additional pricing freedom for Retailers in respect of recouping excess bad debt costs to be passed through to business customers.

[3] This includes business customers subject to REC price caps as well as those business customers who are not subject to REC price caps.

3.3 Current REC price cap protections

Retailers must set terms and tariffs in accordance with the Retail Exit Code (REC) in respect of business customers where there are no agreed terms, i.e. where a business customer has not switched to a new Retailer or negotiated a new deal with their existing Retailer, as well as where a customer's contract has expired with the Retailer and no new terms have been agreed. The REC sets out the determination of maximum prices for two customer groups: those with annual consumption up to 0.5Ml ('Group One'); and those with annual consumption 0.5Ml to 50Ml ('Group Two'). No maximum prices are specified in respect of customers with annual consumption exceeding 50Ml ('Group Three'). Further details on current price caps are set out at Annex A2.

3.4 Approach to adjusting REC price caps

Our July 2021 document (§6.2.3) set out our approach to calculating the temporary uplift to apply to REC price caps, and our October 2021 document[4] set out our decision to pool the portion of excess bad debt costs to be recouped from business customers across all business customers.

Hence we are looking to adjust REC price caps so that, were such an uplift applied to retail prices to all business customers, Retailers in aggregate would recoup 75% of excess bad debt costs arising in 2020-21, together with efficient financing costs. We have also indicated that the portion of excess bad debt costs to be passed through to business customers should be recouped over two years, so the REC price cap adjustment needs to be attenuated to allow a two year period of recovery.

We set out in Annex A3 the methodology for calculating the uplift to the REC price caps on this basis. **We have also, alongside this consultation, published an Excel spreadsheet that sets out the calculation.** Note there are three key parameters for the calculation:

(i) outturn customer bad debt costs as a proportion of business market turnover;
(ii) efficient financing costs; and
(iii) forecast market wide revenue for financial years 2021-22, 2022-23 and 2023-24.

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?

[4] See October 2021 Update: Business retail market – Customer bad debt

3.4.1 Single efficient financing cost

Our July 2021 document (§5.5.3) confirmed that in determining an adjustment to the REC price caps, we would make an allowance for the efficient cost of financing (the Retailer portion of) of excess bad debt costs that have arisen in 2020-21 up to the period that revised REC price caps come into effect (i.e. from April 2022). That is, we are looking to allow the efficient financing costs of such bad debt costs between when they arose in 2020-21 through to the introduction of greater pricing freedom for Retailers from April 2022, i.e. a period of three to four years.

To help our understanding of additional finance costs for Retailers, we sought information on their financing costs as part of our May 2021 and October 2021 Retailer RFIs. Responses indicated that Retailers use a range of equity and debt facilities (sometimes via parent company loans) to finance additional borrowing requirements, with financing costs varying significantly. Nevertheless, the responses to our October RFI indicate that the majority of Retailers by market revenues have been able to secure funding at competitive rates. In particular, Retailers where they have reported debt finance costs have often reported paying LIBOR or Bank of England base rate plus up to around 3.5%. Those that are more reliant on equity capital have reported finance costs above these levels.

We note in addition that in respect of regulatory measures put in place as a response to measures to combat the pandemic, we introduced a liquidity support scheme. The scheme enabled Retailers to defer a portion of their wholesale charges at a financing (interest) cost of 5.98% nominal. This is equal to the PR19 nominal wholesale allowed return on capital plus 1%. We set out that this was a ceiling, meaning that individual Wholesalers could if they wished provide liquidity at lower rates than this.[5]

With the above in mind, we consider that, for the purposes of providing additional regulatory support to Retailers in respect of the impact of Covid-19 measures, an appropriate efficient financing cost should be set at 3.5% (real). We think this is in line with competitive debt financing costs as reported by Retailers. Furthermore, we note that REC price caps currently applying to Retailers were set on the basis of a market wide 2.5% net margin. In line with our reasoning for liquidity support, we consider applying a further 1% uplift to give 3.5% gives a reasonable retailer efficient financing cost benchmark.

It is important to note that our view of 3.5% is as an appropriate benchmark for the efficient financing cost of the Retailer portion of excess bad debt costs following the pandemic; this value should not be seen as a regulatory statement or mandate concerning efficient forward-looking financing costs for Retailers or business retail market activities more generally.

[5] See Ofwat §3.2 - Covid-19 and the business retail market: Proposals to address liquidity challenges and increases in bad debt - decision document April 2020

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.

3.4.2 Market revenue

Revisions to REC price caps in respect of excess bad debt costs are due to take effect from April 2022, and remain in effect for two years, i.e. 2022-23 and 2023-24. This means that the REC price cap adjustment will need to be calibrated against forecast market revenue for those two years. Given that we have specified our model for the REC price cap adjustment in constant price terms (2020-21 prices), we need to take a view on forecast market revenue in each of the years 2021-22, 2022-23 and 2023-24, expressed in constant 2020-21 prices.

Over-optimistic assumptions about revenue may result in under-recovery of bad debt costs by Retailers because higher future revenue implies a smaller increase in REC price caps is needed to provide headroom for Retailers to recoup their portion of excess bad debt costs. Similarly, under-optimistic assumptions may result in over-recovery of bad debt costs.

We asked Retailers, as part of their returns to the October 2021 RFI, to set out historical levels of revenue in respect of the business retail market for 2020-21 and for April – September 2021, as well as forecasts for 2021-22 through to 2023-24 and to set out their underlying assumptions for these forecasts. Retailers differed in their views concerning potential revenue growth. At an aggregate level, Retailers forecast strong revenue growth through to 2023-24, at around 10.5% per year in total, or 8.5% per customer, over the three years 2020-21 to 2023-24.

To some extent this view on revenue growth reflects some Retailers' assumptions about inflation. It also in part represents some Retailers' views that revenue levels will return to pre-pandemic levels and/or that, for any one Retailer, revenue growth will come from net customer acquisition. Not all Retailers provided full sets of assumptions regarding their revenue growth forecasts. To the extent we have been able to, adjusting Retailers' revenue forecasts for inflation suggests that revenue is forecast to increase in real terms at 9.5% per year in total or 7.4% per customer per year over the three years 2020-21 to 2023-24., with a return to pre-pandemic levels some time in 2022-23.

We note that to date, increases in corresponding wholesaler revenue charges have been slightly more modest. On the basis of Retailer reported and wholesaler settlement data, Retailer revenue and wholesale charge revenue fell by around 13-14% between 2019-20 and 2020-21. Over the period April to September 2021, Retailer reported revenue compared to the same period 2020 increased by around 12% whereas wholesaler charge revenue increased by about 4%. We note the data set is indicative and reflects among other things differences in billing and settlement cycles.

A further point of comparison at the macro-economic level may be the Office for Budget Responsibility's (OBR) forecasts of real GDP growth for 2021 Q3 and beyond.[6] The OBR's medium-term outlook foresees GDP regaining its pre-pandemic levels around the turn of 2022.

On balance, for the purposes of calculating the adjustment to REC price caps, we think it is reasonable to assume that real revenue at a market level returns to pre-pandemic (i.e. 2019-20) levels by 2023-24. We consider this strikes a balance between protecting customers' shorter term interests in terms of potential price increases, and our objective to protect the longer term interests of customers by minimising risks of systemic Retailer failure. Table 2 summarises our assumptions concerning revenue for the retail business market: Note it also sets out the inflation indices we have used, based on the CPIH in each October.

Table 2 – Assumptions concerning revenue for retail business market

	2019-20 £'000s	2020-21 £'000s	2021-22 £'000s	2022-23 £'000s	2023-24 £'000s
Nominal prices	2,565,000	2,194,000	2,400,000	2,540,000	2,565,000
2020-21 prices	2,586,316	2,194,000	2,311,111	2,445,926	2,586,316
CPIH inflation index October	*108.30*	*109.20*	*113.40*	*113.40*	*108.30*

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?

3.5 Proposed adjustments to REC price caps

Taken together, the parameters that we have set out above (§3.4.1 and §3.4.2) enable calculation of the adjustment to REC price caps from April 2022. Note regarding outturn customer bad debt costs as a proportion of market turnover item, we have set out in chapter 2 that on the basis of Retailer reported data, outturn customer bad costs are 2.87% of market turnover.

Annex A3 sets out the calculation underlying our proposed adjustment to the REC price caps. To aid understanding, we have also separately published the calculation in the form of an

[6] See p.49 Chart 2.11 Real GDP: Office for Budget Responsibility Economic and fiscal outlook October 2021

Excel spreadsheet model. With the parameters as specified above, we are proposing to uplift the net and gross margins in the REC price caps by 0.31% with effect from April 2022.

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

3.6 Proposed amendments to Retail Exit Code

The business retail (REC) price caps are expressed in the Retail Exit Code (REC). Hence the adjustments we are proposing to make to REC price caps, as set out above, will be expressed and take effect through amendments to the REC.

Amendments will comprise changes to the way maximum price caps are specified for Group One and Group Two customers. For Group One customers, we propose that the allowed net margins as set out in Table 1 of the REC are increased by 0.31 percentage points. For Group Two customers, we propose that the allowed gross margins as set out in Table 2 of the REC are increased by 0.31 percentage points.

Annex A4 sets out the detailed amendments we would propose to make.

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.

4. Next steps

We welcome views on the issues relevant to the consultation, in particular regarding questions 1 to 5 in chapter 3. Section 1.2 above sets out further details of how to respond and how we will process and where relevant publish responses. In summary, **responses should be provided by 5pm Wednesday 12th January 2022.** Please submit email responses to covidbusinessretailmarket@ofwat.gov.uk, with the subject 'Customer Bad Debt December 2021 Decision and Consultation'. Responses may also be sent by post.

We intend, in February 2022, to publish our Decision document on the amendments to apply to the REC with a view to implementing our policy concerning customer bad debt costs. We intend that our Decision document will also be the formal amendments to the REC, such that amendments to REC price caps take effect from April 2022.

Note that in parallel we are beginning a full review of the REC and the price and non-price terms set out therein. We intend in December 2021 to publish a consultation on the approach to our review, followed later in 2022 with proposals and subsequently with decisions. We intend that our review leads to, where warranted, revisions to the REC to take effect from April 2023.

A1 Background: Business retail market and customer bad debt costs

Between April 2020 and May 2021[7], we consulted on measures and approaches seeking to mitigate the potential impacts of Covid-19 measures on customer bad debt costs. In particular, we committed to revise regulatory protections if bad debt costs across the market exceeded 2% of business market revenue, which we considered was the level of bad debt an efficient and prudent Retailer should have planned for. We consulted and reached decisions with reference to three policy objectives – see Box 1 below.

In July 2021[8] and October 2021[9] we published our decisions that revisions to regulatory protections are warranted on account of increased levels of customer bad debt costs. Our two documents together set out five principal decisions:

1. Revisions to regulatory protections warranted since 2% threshold reached.

   Retailer reported data suggest that outturn bad debt costs for 2019-20 were around 2.9% of business market revenue, and for 2020-21 around 2.1%, giving a cost for the 2 years ended March 2021 of 2.5%. On this basis, we decided revisions to regulatory protections are warranted.

2. Adjustment of REC price caps to provide additional regulatory protections.

   We consider that a small and temporary increase to REC price caps provides Retailers with sufficient additional flexibility to price upwards in response to elevated bad debt levels, and so protect customers' interests in the longer term by mitigating risks of systemic Retailer failure. The approach also preserves incentives on Retailers to manage their bad debt costs, so helping to protect customers' interests in the shorter term.

3. Retailers should bear 25% of bad debt costs for the part of bad debt costs in excess of 2%.

   We have decided that - on a market wide basis - Retailers should bear 25% of bad debt costs for the part of bad debt costs exceeding 2%, and that business customers should bear the remaining 75%. This means we apply a 75:25 sharing factor to relevant excess bad debt costs in determining the adjustment to REC price caps.

4. Approach to adjusting the REC price caps, to take effect from April 2022.

[7] See in particular: 16th April 2020 Consultation: Business retail liquidity and bad debt; 30th April 2020 Proposals: Covid-19 and the business retail market; 30th November 2020 CFI: Business retail market- Customer bad debt ; 5th March 2021 Consultation: Business retail market - Customer bad debt; 4th May 2021 Update: Business retail market- Customer bad debt
[8] See July 2021 Decision and consultation
[9] See October 2021 Update: Business retail market - Customer bad debt

We set out our approach to calculating the uplift to REC price caps to take effect from April 2022, including that such adjustments should apply for a minimum of two years.

We also decided that efficient financing costs should be included within the regulatory support. These relate only to the costs of financing excess bad debt costs to be passed through to customers by Retailers from the point at which they arise through to the period over which they are recovered. We would look to estimate a single efficient financing cost across the market.

5. Pooling

   We decided to set the REC price cap adjustment so that the portion of excess bad debt costs to be recouped by Retailers from business customers is 'pooled' and recovered across all business customers. Hence we will apply a correspondingly uniform uplift to REC price caps.

Our July 2021 document sought views on the merits of, and approach to, a possible 'true up'. Measurement and adjustment of REC price caps would be on the basis of Retailers' initial estimates of bad debt costs. A 'true up' would be a subsequent and more detailed check of such estimates, and might if necessary include a further adjustment of REC price caps where the 'true up' found material differences. Our July 2021 document noted, and sought views on, that we are exploring the possibility of not pursuing a true up – for example if estimated bad debt costs are not materially higher than the market-wide 2% threshold. We also set out, and sought views on, our intended approach to a 'true up', were we to pursue it.

Box 1 – Policy objectives

1. Protect customers' interests

   We want to protect business customers, including from the risk of systemic Retailer failure.

2. Promote efficiency

   Any approach should minimise perverse incentives, unforeseen consequences, and any distortions to competition – including by ensuring transparency. For example it should maintain incentives on Retailers to minimise bad debt costs arising now and in future. Any approach or mechanism should not distort competition or competitive outcomes. Any approach or mechanism should be capable of being audited or checked, to ensure that Retailers submit accurate and verifiable data.

3. Provide clarity and minimise implementation costs

   Any approach or mechanism for reimbursing monies to Retailers should be clear and as simple as possible. It should also seek to minimise implementation costs.

A2 REC price caps

Retailers must set terms and tariffs in accordance with the REC. The table below summarises present REC price protections:

Customer Group	Customer Group One (0 – 0.5Ml / year)	Customer Group Two (0.5Ml – 50Ml / year)	Customer Group Three (>50Ml / year)
Form of protection	Default tariffs not to exceed the wholesale charge plus a company specific cost to serve and net Margin.	Default tariffs not to exceed the wholesale charge plus a Gross Margin: 8% (Water), 10% (Wastewater)	Default tariffs to be reasonable and non-discriminatory

Group One customers

For each Group One customer type, the maximum price to be charged to a customer subject to a price cap by a Retailer in a particular wholesaler region is set as:

$C = [(rc + w) / (1 - m)]$ where:

rc = (£) allowed average retail cost component for a given customer type (set by Ofwat)

w = (£) the wholesale charge for a given customer

m = (%) the allowed net margin for a given customer type (set by Ofwat)

Table A2.1 sets out illustrative parameters in the case of the Yorkshire region.

Table A2.1 REC price cap parameters for Yorkshire region

Customer type	rc† £	m %	w‡ £
Water unmeasured	£18.90	11.71%	£300
Wastewater unmeasured	£19.04	7.03%	£300
Water 0-0.5Ml measured	£28.75	3.55%	£300
Wastewater 0-0.5Ml measured	£31.04	2.93%	£300
Wastewater 0-0.5Ml measured (trade effluent)	£24.79	2.35%	£300

† From REC, no inflation adjustment for rc

‡ Assumed for purposes of illustration here

Hence the maximum price to be charged to a Group One customer subject to a price cap consuming water on measured basis in Yorkshire region would be £340.85 (=(£28.75+£300)÷(1-0.0355)).

Group Two customers

Each Group Two customer subject to a price cap, in all wholesaler regions is to be charged a maximum of:

$C = (1 + gm) \times w$ where:

gm = (%) the allowed gross margin (set by Ofwat: 8% for water, 10% for waste water)

w = (£) the wholesale charge

For example, a Group Two customer whose wholesale charge for water is £300 should not be charged more than £324 for water (= (1+0.08)x£300).

A3 REC price cap adjustment

This annex sets out the method of calculation of the adjustment to apply to REC price caps.

Note we have separately published alongside this consultation document an Excel spreadsheet model setting out the calculations behind the REC price cap adjustment. Table A3.2 below summarises the main elements of the calculations and the published Excel model.

There are four principal steps to calculating and applying the adjustments to REC price caps:

Step 1 Assess the quantum of excess bad debt costs which Retailers in aggregate may pass through to customers.

We assess this as follows:

$$EBPC = R_{2020\text{-}21} \times (OB_{2020\text{-}21} - 2\%) \times SF$$

where:

EBPC = excess bad debt costs which Retailers in aggregate may pass through to customers (£ million)

$R_{2020\text{-}21}$ = business retail market turnover in 2020-21 (£ million)

$OB_{2020\text{-}21}$ = outturn turn bad debt as proportion of market turnover in 2020-21 (%)

SF = proportion of market wide excess bad debt costs Retailers may pass through to customers via revised regulatory protections. Ofwat has set this proportion at 0.75[10].

On the basis of the numbers we have set out in chapter 2 and 3, we calculate:

EBPC = £14,316 million = £2,194,000,000 x (2.87%-2.0%) x 0.75

This is the sum, plus efficient financing costs, that we see Retailers are warranted to recoup from customers via price increases.

Step 2 Set out counterfactual market revenue

Absent any revisions to regulatory protections, we assume business retail market revenues would return to pre-pandemic levels by 2023-24. Chapter 2 has set out our reasoning behind our assumptions. We have expressed revenues in 2020-21 prices using the inflation assumptions set out below.

[10] See: §4.4 July 2021 Decision and consultation

Table A3.1 – Assumptions concerning revenue for retail business market

	2019-20 £'000s	2020-21 £'000s	2021-22 £'000s	2022-23 £'000s	2023-24 £'000s
Nominal prices	2,565,000	2,194,000	2,400,000	2,540,000	2,565,000
2020-21 prices	2,586,316	2,194,000	2,311,111	2,445,926	2,586,316
CPIH inflation index October	*108.30*	*109.20*	*113.40*	*113.40*	*108.30*

Step 3 Set out factual market revenue, including efficient financing costs

We look to give Retailers additional pricing flexibility via increase in net margins in REC price caps for Group One customers and increase in gross margins for Group Two customers, and that – in line with our decision concerning pooling – that Retailers apply such price increases across their customer base (i.e. customers subject to price caps and customers not subject to price caps). We also assume that such pricing flexibility applies across two years 2022-23 and 2023-24, as we have said that Retailers should recoup relevant excess bad debt costs across at least two years.

As a result, we assume that market revenue increases in 2022-23 and 2023-24, compared to the base (counterfactual) case set out in step 2 above.

Step 4 Determination of the increase in net and gross margins

We calibrate the assumed price increase such that increased market revenues, compared to the base case, deliver the excess bad debt costs as set out in step 1, plus allowance for efficient finance costs.

The calibration is made with reference to a present value calculation, discounted at the benchmark efficient financing cost of 3.5%. That is, the increase in prices are assumed to deliver an increase in market revenue in 2022-23 and 2023-24 (the factual case) compared to the base (counterfactual) case.

Step 5 Amend the Retail Exit Code accordingly.

To give effect to the increased net and gross margins, we will need to amend the REC. Annex A4 sets out our proposed amendments to the REC on the basis that we are increasing net and gross margins by +0.31%.

Summary calculation

Table A3.2 – Summary calculation of adjustment to REC price caps

Constant 2020-21 prices	Business retail market revenue			
	Outturn	Forecast		
	2020-21 £'000s (2020-21 prices)	2021-22 £'000s (2020-21 prices)	2022-23 £'000s (2020-21 prices)	2023-24 £'000s (2020-21 prices)
Excess bad debt costs which Retailers in aggregate may pass through to customers	14,316			
Counterfactual: – i.e. assume no REC price cap adjustment				
Market revenue	2,194,000	2,311,111	2,445,926	2,586,316
Factual: i.e. after adjusting REC price cap and prices by +0.3101%†				
Market revenue			2,453,512	2,594,337
Difference delivers:				
Unadjusted for finance costs			7,586	8,021
Present value of differences:				
Two years out: i.e. reflects efficient financing costs two years out			7,081	
Three years out: i.e. reflects efficient financing costs three years out				7,235
Sum of discounted values equals excess bad debt costs to be recouped	14,316			

†Note this price increase is the output of the model. It is calculated such that the present value of incremental revenue, relative to the counterfactual, equals the excess bad debt costs which Retailers in aggregate may pass through to customers (i.e. as given by EBPC in step 1 above). Hence market revenues under the factual case, after application of price increases, are 0.3101% higher than the base case (i.e. 1.003101 = 2,453,512÷2,445,926 = 2,594,337÷2,586,316).

Use of the Excel spreadsheet model

We have set out our determination of the proposed adjustment to the REC price cap as an Excel spreadsheet model, published alongside this document. The model is formatted according to Ofwat's adoption of the 'FAST' Standard – *Flexible*, *Appropriate*, *Structured* and *Transparent*, with the aim of presenting spreadsheet models in a consistent and clear format. Note the following features and use of the spreadsheet model:

- Inputs tab

  Sets out key parameters, i.e. outturn bad debt costs used to drive adjustment to REC price caps, assumptions on market revenue 2019-20 to 2023-24, and the efficient financing cost. It also records the CPIH inflation indices used to move from nominal to 2020-21 prices.

- Time tab

  Records information concerning the timing and horizon assumptions. In particular we are assuming market revenue is given as outturns for 2019-20 and 2020-21, with forecasts for 2021-22 to 2023-24.

- Index tab

  Sets out constant price adjustments and deflators used to move from nominal to 2020-21 prices, based on CPIH indices as given in *Inputs* tab.

- Calculations tab

  This calculates the adjustment to the REC price caps (cell F35). Note following any changes to input parameters, the REC price cap adjustment needs to be recalculated using the "Recalculate REC price cap adjustment" button located in this tab. This button runs a macro to recalculate the REC price cap adjustment.

  The REC price cap adjustment is determined such that the present value (discounted at the efficient financing cost) of revised market revenue (on the basis of price increases) (cell F58) equals the portion of excess bad debt costs to recouped by Retailers from customers (cell F57).

- Output tab

  This recaps the key results from the model. Note the uplift to the REC price caps is given in cell F12. (Further note that, where any inputs are changed, the REC price cap uplift must be recalculated using the button in the *Calculations* tab).

- Check tab

  Checks modelling time period is consistent, and that the present value calculation as set out in the *Calculations* tab delivers a number not different from the portion of excess bad debt costs to recouped by Retailers from customers.

A4 Proposed amendments to Retail Exit Code

This Annex sets out the amendments we propose to make to the REC. These amendments, and hence the increase in the maximum retail prices that Retailers are permitted to charge under the REC, will take effect from April 2022. The amendments apply to Group One and Group Two customers.

Group One customers

For Group One customers we are proposing an uplift to net margins of 0.31%. Accordingly, we propose the following amendments to *Table 1 Customer Group One, allowed average retail cost components and allowed net margins (2020/21)* of the REC. Proposed changes are given in strike out and replace text (underlined).

Table 1 Customer Group One, allowed average retail cost components and allowed net margins (2020/21)

Area	Customer type	2020/21 allowed retail cost per customer (rc)	2020/21 allowed retail net margin (m)
AFW	Water 0-0.5 Ml measured or assessed; water unmeasured	£49.18	~~2.94%~~ <u>3.25%</u>
ANH	Water unmeasured	£14.42	~~1.54%~~ <u>1.85%</u>
ANH	Water unmeasured (Hartlepool)	£13.96	~~2.06%~~ <u>2.37%</u>
ANH	Water 0-0.5Ml measured or assessed	£45.69	~~3.76%~~ <u>4.07%</u>
ANH	Wastewater unmeasured	£14.95	~~1.12%~~ <u>1.43%</u>
ANH	Wastewater 0-0.5Ml measured or assessed	£41.97	~~3.26%~~ <u>3.57%</u>
ANH	Wastewater unmeasured (trade effluent)	£16.00	~~1.17%~~ <u>1.48%</u>
ANH	Wastewater 0-0.5Ml measured or assessed (trade effluent)	£120.97	~~3.55%~~ <u>3.86%</u>
BRL	Water 0-0.5Ml measured or assessed	£26.60	~~3.66%~~ <u>3.97%</u>
BRL	Water unmeasured	£8.32	~~4.07%~~ <u>4.38%</u>
NES	Water unmeasured	£18.60	~~6.68%~~ <u>6.99%</u>
NES	Water 0-0.5Ml measured or assessed	£30.59	~~4.00%~~ <u>4.31%</u>
NES	Wastewater unmeasured	£19.59	~~4.36%~~ <u>4.67%</u>
NES	Wastewater 0-0.5Ml measured or assessed	£32.81	~~2.56%~~ <u>2.87%</u>
PRT	Water unmeasured	£18.22	~~2.19%~~ <u>2.50%</u>
PRT	Water 0-0.5Ml measured or assessed	£21.93	~~2.40%~~ <u>2.71%</u>
SVT	Water 0-0.5Ml measured or assessed; water unmeasured	£49.31	~~3.73%~~ <u>4.04%</u>
SVT	Wastewater 0-0.5Ml measured or assessed; wastewater unmeasured	£49.47	~~2.85%~~ <u>3.16%</u>
SEW	Water unmeasured	£39.69	~~1.14%~~ <u>1.45%</u>
SEW	Water 0-0.5Ml measured or assessed	£39.69	~~2.73%~~ <u>3.04%</u>

SRN	Water unmeasured	£13.53	~~2.17%~~ 2.48%
SRN	Water 0-0.5Ml measured or assessed	£25.64	~~6.32%~~ 6.63%
SRN	Wastewater unmeasured	£16.67	~~1.95%~~ 2.26%
SRN	Wastewater 0-0.5Ml measured or assessed	£28.03	~~3.62%~~ 3.93%
SSC	Water 0-0.5Ml measured or assessed; water unmeasured	£48.65	~~2.96%~~ 3.27%
SWT	Water unmeasured (South West)	£14.45	~~1.87%~~ 2.18%
SWT	Wastewater unmeasured	£16.17	~~1.87%~~ 2.18%
SWT	Water 0-0.5Ml measured or assessed (South West)	£17.11	~~3.13%~~ 3.44%
SWT	Wastewater 0-0.5Ml measured or assessed	£16.58	~~2.74%~~ 3.05%
SWT	Water unmeasured (Bournemouth)	£16.14	~~1.82%~~ 2.13%
SWT	Water 0-0.5Ml measured or assessed (Bournemouth)	£23.45	~~3.01%~~ 3.32%
SES	Water unmeasured	£20.92	~~2.61%~~ 2.92%
SES	Water 0-0.5Ml measured or assessed	£32.44	~~2.61%~~ 2.92%
TMS	Water 0-0.5Ml measured or assessed	£25.23	~~2.88%~~ 3.19%
TMS	Wastewater 0-0.5Ml measured or assessed	£34.11	~~3.15%~~ 3.46%
TMS	Wastewater 0-0.5Ml measured or assessed (trade effluent)	£34.84	~~3.39%~~ 3.70%
TMS	Water unmeasured	£24.71	~~2.50%~~ 2.81%
TMS	Wastewater unmeasured	£33.16	~~2.50%~~ 2.81%
UUW	Water 0-0.5Ml measured or assessed; water unmeasured	£38.10	~~2.84%~~ 3.15%
UUW	Wastewater 0-0.5Ml measured or assessed; water unmeasured	£57.30	~~2.84%~~ 3.15%
WSX	Water unmeasured	£20.84	~~1.45%~~ 1.76%
WSX	Wastewater unmeasured	£16.70	~~1.57%~~ 1.88%
WSX	Water 0-0.5Ml measured or assessed	£24.79	~~3.30%~~ 3.61%
WSX	Wastewater 0-0.5Ml measured or assessed	£18.53	~~3.41%~~ 3.72%
WSX	Wastewater 0-0.5Ml measured or assessed (trade effluent)	£24.77	~~3.31%~~ 3.62%
YKY	Water unmeasured	£18.90	~~11.71%~~ 12.02%
YKY	Wastewater unmeasured	£19.04	~~7.03%~~ 7.34%
YKY	Water 0-0.5Ml measured or assessed	£28.75	~~3.55%~~ 3.86%
YKY	Wastewater 0-0.5Ml measured or assessed	£31.04	~~2.93%~~ 3.24%
YKY	Wastewater 0-0.5Ml measured or assessed (trade effluent)	£24.79	~~2.35%~~ 2.66%

Group Two customers

For Group Two customers, we are proposing an uplift to gross margins of 0.31%. Accordingly, we propose the following amendments to *Table 2 Customer Group Two and allowed gross margins* of the REC. Proposed changes are given in strike out and replace text (underlined).

Table 2 Customer Group Two and allowed gross margins of the REC

Customer group	gm%
Water supplies 0.5 Ml to 50 Ml	~~8%~~ <u>8.31%</u>
Wastewater services 0.5 Ml to 50 Ml	~~10%~~ <u>10.31%</u>

Note we seek views concerning our proposed amendments to the REC. We have set out a question for consultation in chapter 3 – ***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.***

Ofwat (The Water Services Regulation Authority) is a non-ministerial government department. We regulate the water sector in England and Wales.

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