

February 2022

# **Business retail market: Customer bad debt - Decision on adjustment to REC price caps from April 2022**

## About this document

This document sets out our decision, and reasoning underpinning our decision, to amend temporarily REC price caps in order to reflect excessive levels of bad debt costs arising from the Covid-19 pandemic. The maximum prices that Retailers can charge business customers subject to price caps will increase by 0.49% from April 2022. This uplift will apply for two years.

Our decision represents a change from our December 2021 proposals, which consulted on an increase of 0.31%.

This document also sets out the revisions to the REC that will be necessary to implement our decision. A revised model, with the calculations setting out the basis for the 0.49% uplift, has been published alongside this document.

This decision does not affect household customers.

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# 1. Introduction and background

## 1.1 Purpose

This document sets out our decision, and reasoning underpinning our decision, to amend temporarily the Retail Exit Code (REC) price caps from April 2022 such that the maximum prices that Retailers are able to charge business customers subject to price caps will increase by 0.49%. This uplift will apply for two years. Our decision represents a change from our December 2021 proposals, which consulted on an increase of 0.31%.

This document also sets out the revisions to the REC that will be necessary to bring our decision into effect, and a revised model with the calculations setting out the basis for the 0.49% uplift.

## 1.2 Background

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. These have included an increased likelihood of business customers defaulting on payment meaning that Retailers have faced the risk of levels of customer bad debt costs beyond which an efficient and prudent Retailer could have been expected to plan for.

Furthermore, Retailers' abilities to respond to increased bad debt costs arising from Covid-19 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 given under the REC apply to such customers who have not engaged in the market.

In April 2020 we published our [decision](#) to provide additional regulatory protections if bad debt costs arising from Covid-19 exceeded levels which an efficient and prudent Retailer would reasonably have expected to have planned for. Our November 2020 [call for inputs](#) set out three policy objectives regarding this issue, as set out in Box 1 below.

## 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.

In July 2021 we published our [decision](#) that, since customer bad debt costs had exceeded levels which an efficient and prudent Retailer would reasonably have expected to have planned for, we would provide additional regulatory protection to reflect excessive bad debt costs arising from Covid-19. We said we would allow a small and temporary uplift to the REC price caps, to apply from April 2022. We said we would make market-wide adjustments to the price caps to maintain strong incentives on Retailers to manage bad debt costs.

In December 2021 we [consulted](#) on the level of this temporary uplift to REC price caps; ie. an increase of 0.31%, to be implemented via increased net and gross margins which underpin price cap levels. We proposed, and sought views, that this uplift would take effect from April 2022 and apply for two years. We also sought views on the assumptions and underlying approach to calculating this uplift and published a model of our calculations. We also consulted on the revisions to the REC that would be necessary to bring our proposals into effect.

Our December 2021 document also set out our decision not to pursue a 'true up' in respect of excessive customer bad debt costs arising from Covid-19. A 'true up' would be undertaking, after the implementation of the uplift to REC price caps, a forensic review of bad debt costs and if and how these had changed for Retailers. We have decided that we will not commit to undertaking such a 'true up'. Instead, the temporary uplift to the REC price caps would be based on Retailers' reported estimates of bad debt costs that they have provided for.

We received eight responses – seven from Retailers and one from the Consumer Council for Water (CCW) – to our December 2021 consultation. We have reached our Decision set out in

this document following careful consideration of all available evidence, including these responses.

### **1.3 Structure of this document**

The remainder of this document is structured as follows:

Chapter 2 - summarises responses to our December 2021 consultation and sets out our decision concerning the calculation of the uplift to REC price caps.

Chapter 3 - sets out our decision to uplift REC price caps from April 2022 by +0.49%.

Chapter 4 - sets out our next steps, including that the REC price cap uplift will take effect from April 2022, and that we are currently undertaking a more wide ranging review of the REC price and non-price protections, with a view to any revisions taking effect from April 2023.

## 2. Decision on uplift to REC price caps

### 2.1 Introduction and objectives

In July 2021 we published our decision that, since customer bad debt costs had exceeded levels which an efficient and prudent Retailer would have been expected to plan for, we would provide additional regulatory protection to reflect excessive bad debt costs arising from Covid-19.

Our July 2021 decision and consultation document also confirmed the basis of our calculation of the uplift to REC price caps. In particular, we confirmed that Retailers should expect – at a market wide level – to bear bad debt costs up to 2% of market turnover, and one quarter of such costs above this 2% threshold. We said we would adjust REC price caps to give Retailers additional pricing freedom in respect of three quarters (75%) of bad debt costs in excess of the 2% threshold. We said this additional pricing freedom should also reflect efficient financing costs of excess bad debt costs between the time they were accrued and the point from which they could be recovered through the pricing uplift in the REC (i.e. April 2022).

Our December 2021 consultation applied the methodology set out in the July 2021 decision and consultation document and set out the bases, parameters for and calculation of the uplift to the REC price caps. We consulted on our approach and on the parameters underpinning the calculation of the uplift.

This chapter recaps our consultation, summarises respondents' views, and sets out our decisions and reasoning. Section 2.2. sets out our approach to calculating the temporary uplifts to the REC price caps; 2.3 sets out our approach to estimating an efficient Retailer financing cost; and section 2.4 sets out our approach to estimating future market revenues.

### 2.2 Approach to calculation of uplift to REC price caps

#### What we said in the consultation

Our December 2021 consultation proposed that we would look to adjust REC price caps so that, were an uplift applied to retail prices to all business customers, Retailers in aggregate would be able to recoup up to 75% of excess bad debt costs arising in 2020-21, together with efficient financing costs. We 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 (ie. over 2022-23 and 2023-24).

We then said that this meant that our approach to calculating the uplift would rely on three key parameters:

- (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.

Following the methodology we had set out in our July 2021 decision and consultation document (see in particular §6.2.3), we consulted in December 2021 on the calculations to derive the uplift on the basis of these parameters (further details in Annex A3 December 2021 consultation and accompanying [Excel spreadsheet model](#)).

Consistent with the methodology set out in our July 2021 decision and consultation document, our calculations included that the excess bad debt costs (£ million) underpinning the derivation of the uplift to REC price caps would be derived via two elements. The first would be to estimate the proportion of market revenue given as bad debt costs, which we took as the (weighted) average over 2019–20 and 2020–21. The second would be to apply this average to 2020–21 revenue to derive an estimate of the £ million number, after taking account of the 75% sharing factor<sup>1</sup>.

Applying the parameters we had set out resulted in our proposals to uplift REC price caps by 0.31% from April 2022.

**December 2021 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?**

**December 2021 Consultation Question 4 – Do you agree with our proposals to temporarily increase REC price caps by 0.31% with effect from April 2022?**

## Consultation responses

One Retailer and CCW agreed with our methodology, with the Retailer also signalling their agreement with our proposal to increase REC price caps by 0.31%. CCW nevertheless emphasised their concerns that in their view, customers are being required to bear a disproportionate level of excess bad debt costs, as a result of Ofwat's previous decision to split this 75:25 in retailers' favour. CCW on this basis noted that they disagreed with Ofwat's proposal to increase REC price caps by 0.31%.

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<sup>1</sup> See Step 1, Annex 3, December 2021 consultation

Retailers made further points as follows:

(1) **Ofwat methodology.** Six out of seven Retailers disagreed with one or more aspects of our methodology for calculating the temporary uplift to REC price caps to apply from April 2022, and consequently our proposals to increase REC price caps by 0.31%. These Retailers in particular highlighted in their view two key objections:

(a) Ofwat has set out, or indicated, that customer bad debt relief for Retailers would be assessed and given on a year-by-year basis.

Some Retailers argued that Ofwat's earlier consultation and decision documents on Covid-19 related customer bad debt had set out the principle that Retailers should expect to bear bad debt costs (on a market wide basis) of up to 2% per year and that this principle would be applied on an annual basis. One of those Retailers quoted from Ofwat's [November 2020 Call for inputs](#) (§2.2.1): "If the time period impacted by Covid-19 measures extends to more than one financial year then we would expect the basis of the calculation to be applied to each financial year".

(b) Ofwat's decision to calculate the bad debt costs across the market as an average across 2019-20 and 2020-21 but apply this only to market revenue to 2020-21 is incorrect.

One retailer summarised retailers' views here by arguing that in calculating relief due, either: 2019-20 provisioning should be applied to 2019-20 revenue and 2020-21 provisioning to 2020-21 revenue; or total provisioning should be applied to total revenue over both years together. Retailers also argued between them that Ofwat's approach (of applying an average calculated over two years to one year of revenue) would roughly halve the estimated relief (£million) that would underpin the calculation of the uplift to REC price caps. One Retailer commented that "Ofwat has taken the 2.87% average cost over the two year period (which is derived from revenues and costs in BOTH years) and applied that to just 2020/21 revenues. This halves the recoverable benefit to Retailers and actually allows recovery of 75% of 0.43%, not 75% of the 0.87% excess."

(2) **Basis of 2.87%.** One Retailer requested that, as Ofwat had not provided underlying calculations, Ofwat should explain, where appropriate on a redacted basis, how the 2.87% figure has been derived.

(3) **Disadvantages to individual retailers.** Two Retailers argued that Ofwat's methodology and proposals could or would disadvantage individual Retailers, compared to outcomes that might occur were proposals more aligned to individual Retailers' positions.

- (4) **Duration of pandemic effects.** Two Retailers argued that Ofwat's methodology would tend to under-estimate relief due to Retailers because for example the pandemic effects are more ongoing and/or Ofwat's approach does not take account of ongoing effects or later crystallisation of bad debt costs.
- (5) **Recovery from contract customers.** One Retailer argued that it may under-recover bad debt costs in the market as they may not be able to recover some element of these costs from fixed priced negotiated contracts, as opposed to customers on default (price capped) tariffs.
- (6) **Recovery of efficient financing costs.** One Retailer commented that it is not clear in Ofwat's Excel model how estimated efficient financing costs were incorporated in the model as set out in Annex A3 of Ofwat's December 2021 document Annex A3, and that there does not appear to be a separate calculation adding estimated financing costs.
- (7) **Parameter assumptions.** One Retailer also suggested that Ofwat should revisit assumptions concerning the cost of capital and revenue parameters. Most Retailers, including on the basis of the arguments above concerning methodology, consequently suggested an uplift of above 0.31% would be justified, with four arguing for an uplift of above 0.6%.
- (8) **Applying equal uplift to net and gross margins.** One Retailer suggested that Ofwat's methodology to apply the same uplift to the net margin for Group One customers as well as the gross margin for Group Two customers could mean that the outturn uplift for Group One would be slightly higher than the intended 0.31% for Group One customers and slightly lower for Group Two customers, and that the combined effect – depending on assumptions made about the relative sizes of Group One and Two customers – could give an uplift slightly lower than the intended 0.31% (in their example, 0.3053% rather than 0.31%). They further argued that this could result in unforeseen consequences due to the uncertain nature of the uplift split across customer groups. This Retailer proposed as a solution increasing the REC price cap uplift by a further 0.1%, rather than re-writing the methodology.

## Our decision

We have decided to calculate bad debt relief by taking an average of bad debt costs across 2019–20 and 2020–21 (ie. 2.87%) and applying this to October 2019 to March 2020 market revenue plus 100% of 2020–21 market revenue, subject to the 2% threshold and the application of the 75% sharing factor. This means we have decided to uplift REC price caps by 0.49%, an increase compared to our December 2021 proposals for an uplift of 0.31%.

Our reasoning is as follows.

We want first to emphasise the context and policy objectives for considering possible elevated levels of customer bad debt costs arising following the pandemic and our consideration of the case for revision of regulatory protections ie. an adjustment to REC price caps. That is, our aim is to make an adjustment that creates additional pricing freedom for Retailers to reflect a risk – increased customer bad debt costs – that prudent and efficient Retailers could not have reasonably foreseen or planned for. Put differently, we are not aiming through our adjustment here to anticipate or ensure Retailers are insulated from all continued uncertain cost developments; these remain commercial risks under which Retailers that are best able to manage their costs will reap a competitive advantage.

Concerning view raised on point (1), Ofwat methodology, we comment as follows.

Our early consultation documents emphasised two points relevant to the extent to which customer bad debt costs might arise following the pandemic, and the measurement of such costs. These were:

- Our original approach to timing questions

We noted that at the early stage of the pandemic, it was not yet clear when, how and for how long measures to combat Covid-19 would affect customer bad debt costs. For this reason our early consultation documents, including our November 2021 Call for inputs (CFI), explored for discussion and comment how relief for Retailers might be measured. This exploration included the question of time periods over which any incremental bad debt costs could or should be assessed.

Nevertheless, we were also clear in our early consultations – including the November 2020 CFI – that it was possible and likely that any elevated levels of bad debt costs arising from Covid-19 would manifest principally in the financial year 2020-21. Our November 2020 CFI for example explained that our "view is that, since Covid 19 measures were introduced from the end of March 2020, any consequent impacts on business customer ability to pay and elevated levels of bad debt would manifest principally in the financial year 2020/21."

We were also clear that we would need to consider carefully the question of provisions or write-offs made for bad debt costs prior to 2020-21. We said in our November CFI for example that "On this basis we suggest assessing bad debt costs on the basis of provisions and/or write offs made by Retailers in respect of invoices due to end March 2021. Note that we anticipate that such invoices, and any provision and/or write offs for bad debt, would relate for usage of water and waste water services dating back to, at the earliest, January 2020."

- Measurement questions

We recognised and emphasised that it is not straightforward to measure objectively or consistently customer bad debt costs. Our November 2020 CFI (§2.2.1) for example noted "that Retailers will need to exercise their judgement concerning risks of customer non-payment and the need to make provisions and write-offs." We outlined two approaches for measurement – "statutory accounts basis" and "non-statutory accounts basis", and we positioned the non-statutory basis as a more explicitly defined basis which would reduce a Retailer's own scope for judgement to be applied in deriving the provisions for bad and doubtful debt.<sup>2</sup>

We went on, including in our March 2021 consultation, to suggest that this more defined non-statutory accounts basis for a more objective measurement of bad debt costs could be achieved via a subsequent 'true up'. We also said that, were we to pursue a 'true up', this would be based on bad debt costs on usage back to October 2019. We decided, for the reasons set out in our July 2021 Decision and consultation and December 2021 consultation documents, not to commit to pursuing this more detailed and resource intensive 'true up'.

We committed instead to measuring customer bad debt costs, and the calculation of bad debt relief which would be oriented to Retailers (after the application of the 2% threshold and the 75% sharing factor), on the basis of Retailer reported provisions.

We drew two key conclusions from the above. First, given our view that bad debt costs following measures to combat the pandemic would manifest principally in 2020-21, we should therefore anchor and limit any calculated bad debt relief to market wide revenue in 2020-21. Second, we would use – and rely on – Retailer accounting estimates and reports of provisions to understand the portion of 2020-21 market revenue that may be considered customer bad debt costs. This in turn would determine the extent of relief to be oriented to Retailers through upward revisions to REC price caps.

We were also mindful of the need to protect customers' interests in the shorter term through ensuring that any increases in REC price caps flowing from our intent to grant Retailers bad debt cost relief should be limited to the extent necessary to recognise increased bad debt costs that Retailers had incurred or were likely to incur for 2020-21.

Retailers made, and reported, provisions concerning their expectations about recovery of amounts owing and the extent to which customer bad debt costs might crystallise in future. Some Retailers took the view that the pandemic would significantly affect payments due for usage that had already occurred in 2019-20 and made relatively large provisions for 2019-20, and some continued to make further provisions during 2020-21. Other Retailers by contrast made lower provisions in 2019-20 and larger provisions in 2020-21.

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<sup>2</sup> §2.2.1 November 2020 CFI

It was, and remains, unclear to us – particularly absent a forensic assessment (via a 'true up' or otherwise) – that the totality of provisions put forward by Retailers across both 2019-20 and 2020-21 represent an accurate measure of incremental bad debt costs arising as a result of the pandemic. In particular, we noted that:

- reported provisions for 2019-20 were relatively large compared to those for 2018-19, despite pandemic lockdown measures not having been introduced until mid-March 2020;
- in response to a series of Ofwat requests for information (RFIs) between July 2020 and November 2021, some Retailers made relatively large upward adjustments to their estimated provisions for 2019-20, and in the later RFI submissions some indicated that they had potentially overestimated the level of bad debt provision required; and
- the age profile of some Retailers' bad debt is relatively old, ie. indicative that reported provisions for 2019-20 potentially include provisions for bad debt not directly related to pandemic effects, and in addition some Retailers indicated that it is not unusual for the collection of outstanding debt from customer to take in excess of 12 months.

With the above in mind, we consider that estimating relief due to Retailers on the basis of reported provisions for 2019-20 applied to 2019-20 revenue plus reported provisions for 2020-21 applied to 2020-21 revenue would risk significant over recovery of bad debt costs related to the pandemic. We consider such an approach is likely to result in customers paying for bad debt costs that should have been recovered or accounted for by Retailers before the pandemic. This would be contrary to our overriding policy aim, which is to provide additional regulatory protections in relation to excess bad debt that has arisen specifically as a result of Covid-19.

Conversely, since some Retailers had made relatively large provisions in respect of revenues due from 2019-20 and that some portion of such provisions are expected to relate to problems associated with collecting some revenue during the pandemic restrictions, including those we had imposed, relying solely on reported provisions for 2020-21 would have risked under recovery. For this reason, in our December 2021 consultation we set out that we would calculate whether relief was merited on the basis of the average reported bad debt provisions across both 2019-20 and 2020-21 (ie. 2.87%) and apply this to 2020-21 revenue.

In light of Retailer responses, and moreover noting that we have indicated that – were we to pursue a true up – we would look to measure bad debt costs accruing on usage since October 2019, we accept that our July and December 2021 approach to calculating relief could underestimate the extent to which Retailers may have incurred bad debt costs on revenue due from usage in 2019-20. For this reason, we think it is reasonable to calculate relief due on the basis of:

- market revenue from October 2019 to March 2020; plus
- 100% of market revenue for 2020-21.

Whilst we remain of the view that the sharing factor (where Retailers bear 25% of excess bad debt costs and business customers bear 75% of excess bad debt costs) is appropriate, including because this maintains strong incentives on Retailers to minimise bad debt costs, we acknowledge the importance of ensuring customers' interests remain protected. To avoid the risk that forward-looking Retailer estimates of bad debt costs turn out to have materially overestimated the level of bad debt that actually crystallises, we will continue to monitor Retailer customer bad debt positions. If it becomes clear Retailers in aggregate are significantly unwinding or reversing their provisions in respect of 2019-20 and 2020-21, we would seek to make corresponding downward revisions to REC price caps at a later date.

Concerning remaining points (2) to (8) raised, we comment as follows:

**(2) Basis of 2.87%.**

In our July 2021 decision and consultation (§6.2.3) document we included an explanation of the methodology we intended to follow for the calculation of the excess bad debt relief as follows:

"Assess £m excess bad debt costs plus efficient financing costs to be recovered from the market, as follows:

- Estimate proportion of outturn bad debt costs applying in 2020-21. On this basis we take the view that it is appropriate to measure industry wide outturn bad debt costs applying in 2020-21 as the weighted average applying across 2019-20 and 2020-21. On the basis of Retailer reported data, this at present gives an estimate of market wide outturn bad debt costs of 2.5%.
- Estimate efficient financing costs for Retailers carrying the (Retailer portion of) excess bad costs
- Noting the 2% threshold, our current estimate of bad debt costs of 2.5% and the 75% sharing factor, we would on this basis look to calculate excess bad debt costs to be recovered by Retailers as:

$$\text{£m} = (2.5\% - 2.0\%) \times 0.75] \times \text{annual market turnover for 2020-21} + \text{Estimated efficient financing costs}"$$

Our December 2021 consultation used the updated data from retailers which adjusted the estimate of the bad debt costs from 2.5% to 2.87%, but the calculation followed the same methodology. That is, the 2.87% is calculated as a weighted average of retailer reported bad debt costs across 2019-20 and 2020-21.

- (3) Disadvantages to individual retailers.** We have addressed this point in our July 2021 Decision (§3.4). We recognise that a market wide uniform adjustment to price caps will – all other things equal – create some winners and losers since some Retailers will face and manage bad debt costs better than others. However, consistent with our policy objectives, our approach should maintain incentives on Retailers to minimise bad debt costs arising now and in future, which is expected to benefit customers.

- (4) **Duration of pandemic effects.** We have committed to revising regulatory protections in the event that customer bad debt costs exceed levels that Retailers could have prudently allowed for and we have decided that Retailers should bear up to 2% of bad debt costs arising. We have set out our decision that this level has been exceeded up to March 2021, and we have accordingly revised REC price caps, as set out in this document. We further note that we are undertaking a more wide ranging review of REC price protections during 2022 and this is a further opportunity to understand if, and where appropriate, further revisions to REC price caps (either upward or downward) may be warranted.
- (5) **Recovery from contract customers.** We have addressed this point in our July 2021 Decision (§3.4). We set our view for example that to the extent that a Retailer facing higher bad debt cost levels is under priced by competitors who are better able to control such costs, this is a normal part of market functioning and by creating strong incentives for Retailers is expected to benefit customers.
- (6) **Recovery of efficient financing costs.** Our calculation of the increase to REC price caps is on the basis of a present value calculation; it is this that factors in the efficient financing costs (at 3.5%). That is, we have uplifted the relief due to Retailers – which is due to be recovered over 2022-23 and 2023-24 following revision to the REC – on the basis of 3.5% financing costs. These amounts discounted back equal the calculated value of (Retailer portion of) excess bad debt costs arising.
- (7) **Parameter assumptions.** We set out in the following sections our consideration of and decisions on the parameters that determine the REC price cap uplifts.
- (8) **Applying equal uplift to net and gross margins.** Regarding one Retailer's point on Ofwat's application of the same uplift to the net margin for Group One customers as well as the gross margin for Group Two customers, we take the view that Ofwat's approach is an acceptable approximation to the calculation of uplift. We consider that a more complex calculation would not materially affect the bad debt relief we have calculated and so our approach meets our third objective – Provide clarity and minimise implementation costs – without compromising our other objectives.

## 2.3 Single efficient financing cost

### What we said in the consultation

In our December 2021 consultation we explained that, in order to understand Retailers' financing and arrive at, for the purposes of providing additional regulatory support to Retailers in respect of the impact of Covid-19 measures, a single view for efficient financing costs, we had sought information from Retailers on their financing costs as part of both our May and October 2021 Retailer RFI's. 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 indicated that the majority of Retailers, have been able to secure funding at competitive rates. In particular, those Retailers that 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 reported finance costs above these levels.

We also set out that 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.

**December 2021 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 responses

Five out of seven Retailers agreed with or considered it reasonable to use 3.5% for efficient financing costs.

Two Retailers disagreed with our proposals, citing the following objections:

- The 3.5% is not supported by underlying external data or evidence and appears not to have had the benefits of a review by an independent specialist. Also, it is not supported by Retailer accounts.
- Ofwat should not assume that 'efficient financing' will continue to be made available at low cost during a global emergency.
- It is unclear as to how the cost of equity has been reflected.
- It does not reflect the rate at which Retailers could finance bad debt, as many retailers had to finance their bad debt by deferring wholesale charges at 5.98%, the rate charged by wholesalers under the deferral scheme.
- The reduction in the creditworthiness of retailer debt books due to the levels of bad debt during the pandemic will be reflected in average interest rates going forward as retailers seek to refinance their debt.

In response one of the objecting Retailers proposed a number of scenarios with financing costs ranging from 3.5% to 10.00%.

## Our decision

We have decided that 3.5% is an appropriate rate to use as an efficient financing cost. The majority of responses from Retailers agreed with or commented that this is a reasonable rate to use, and in some cases commented that it is in line with their current financing costs.

Data we received from Retailers in the May and October RFI's regarding Retailer financing costs indicated that Retailers use a range of equity and debt facilities (sometimes via parent company loans) to finance additional borrowing requirements. Reported financing costs varied significantly, with the majority of those responding indicating a cost of debt financing in the region of 3.5%.

In considering efficient financing costs, we have in mind possible additional borrowing to finance increased levels of bad debt costs for the relatively short duration between these occurring and the adjustment of REC price caps from April 2022. It is usual and efficient for such interim costs to be financed through short term loans or financing arrangements rather than via increased equity. We therefore do not consider that cost of equity should be taken into account in determining efficient financing costs for excess bad debts incurred as a result of the pandemic.

Two Retailers referenced the 5.98% interest rate used in the deferred wholesale charge scheme in 2020–21. This was the rate payable to wholesalers for deferring the payment of wholesale charges. We further note that not all Retailers chose to take advantage of this liquidity support, which may imply they were able to obtain financing on more competitive terms. We therefore do not consider that 5.98% is an appropriate financing rate to use here.

## 2.4 Market revenue

### What we said in the consultation

Our December consultation stated that in order to calculate the adjustment to the REC price caps, we needed to account for forecast market revenue in the years 2022–23 and 2023–24. Revenue forecasts impact the recovery of bad debt costs by Retailers as future revenue influences the REC price cap adjustment required for Retailers to recoup their portion of excess bad debt costs. As part of our October 2021 RFI, we asked Retailers 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. Revenue growth forecasts varied amongst Retailers; however, at an aggregate level, Retailers forecast a strong revenue growth through to 2023–24. Forecasts in part represented some Retailers' views of when revenue levels will return to pre-pandemic levels and/or to the extent that revenue growth will come from net

customer acquisition. Revenue forecasts also to some extent reflect Retailers' assumptions about inflation.

Where Retailers provided assumptions of inflation, after 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 noted that from April 2021, nominal increases in Wholesaler revenue charges have been slightly more modest in comparison to Retailer revenue growth. From Retailer reported and Wholesaler settlement data, Retailer revenue and Wholesale charges 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 noted that the data set is indicative and reflects among other things differences in billing and settlement cycles.

An additional source of information at the macro-economic level was the Office of Budget Responsibility's (OBR) forecasts for real GDP growth for 2021 Q3 and beyond. Projections of the OBR's medium-term outlook indicated that real GDP would return to pre-pandemic levels by early 2022.

We considered that for the purposes of calculating the adjustment to the REC price caps, it was reasonable to assume that real revenue at a market level returns to pre-pandemic (2019–20) levels by 2023–24. We considered this struck a balance between the risk of significant over-recovery of bad debt costs (which could occur if revenue forecasts are much too low) and the risk of significant under-recovery (which could occur if revenue forecasts are much too high). Table 1 summarises our assumptions of market level revenue out to 2023–24.

**Table 1 – Assumptions concerning revenue for retail business market**

	2019–20	2020–21	2021–22	2022–23	2023–24
	£'000s	£'000s	£'000s	£'000s	£'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

Source: December 2021 Consultation, §3.4.2 Table 2

**December 2021 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 responses

Three Retailers said they agreed with or considered it reasonable that our forecast of market revenue returns to pre-pandemic levels in 2023-24, with one Retailer acknowledging that forecasting revenue is problematic given the difficulty forecasting consumption.

While finding it difficult to agree with our assumptions or not, CCW acknowledged that it may be prudent assume that market revenue returns to pre-pandemic levels by 2023-24, rather than 2022-23, given the pandemic's ongoing impact on businesses and the market.

One Retailer sought clarification as to whether it is only the size of the market protected under REC price caps that is relevant to estimating the recoverability of Retailers.

Four Retailers did not agree with our views of forecast market revenue. These Retailers viewed our forecast market revenue as too high for the following reasons:

- 1. Revenue growth forecasts are overly optimistic.** Revenue projections from RFI submissions are overstated due to ambitious assumptions regarding customer acquisition and increases in Retailer revenue. The OBR's real GDP forecast returns to pre-pandemic levels around the turn of 2022 but revenue lags behind this.
- 2. Ofwat's forecast of market revenue does not account for the ongoing impact of Covid-19.** The ongoing uncertainty and impact of Covid-19 means market revenue will be less than forecast. The increased prevalence of working from home has decreased consumption levels in the market. Revenue forecasts should be adjusted downwards to reflect this; one Retailer suggested adjusting revenue growth forecasts to 95% of pre-pandemic market revenue to account for the shift to household consumption.
- 3. Forecast of market revenue does not take into consideration the impact of water efficiency measures on consumption.** Exclusion of the impact of water efficiency initiatives would mean market revenue recovery is overestimated.
- 4. Customer switching reduces total market revenue.** Customers switching reduces the total revenue (even if they preserve market share) due to customers savings taking place once contracted.

## Our decision

We have decided that our assumptions of market revenue out to 2023-24 as set out in table 1 above remain appropriate. This means we will maintain our view that business retail market revenue will return to pre-pandemic levels in 2023-24.

We recognise there are a number of sources of uncertainty concerning revenue growth, including potential legacy effects of the pandemic (such as increased home working), possible effects of water efficiency initiatives, and customer switching. The size of such effects is not certain, and we cannot rule out that other effects, such as stronger economic growth, has the effect – all other things equal – of increasing revenue growth.

We have formed a balanced view on forecast market revenue by using a wide variety of available evidence, including from Retailers' RFI returns<sup>3</sup>, analysis of Retailer revenue and Wholesaler settlement data, and the OBR's real GDP forecast. We have not observed a change in the evidence that was used to form this balanced view. We therefore consider our assumptions about future revenue strikes a balance between risks of significant over-recovery or significant under-recovery of excess bad debt costs.

In response to the queries raised by a Retailer regarding if it was only REC protected customers considered estimating the recoverability of Retailers, we confirm that we have taken account of both REC protected and non-REC business customers in our calculations.

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<sup>3</sup> Amongst Retailers, there was significant variation in assumptions of, revenue growth, inflation, customer consumption, and customer acquisitions. As such, we took a cautious view of revenue recovery to account for Retailers' varying assumptions used in forecasting revenue.

## 3. REC price cap adjustment to apply from April 2022

### 3.1 Summary

We have decided to temporarily increase net and gross margins in the business retail (REC) price caps by 0.49%, with effect from April 2022. Our decision will be given effect via amendment to the Retail Exit Code, as set out in Appendix A2.

### 3.2 Amended calculation of REC price cap adjustment

#### 3.2.1 Introduction

Our December 2021 consultation set out the approach to the calculation of the REC price cap adjustment. The calculation requires the specification of three parameters;

- (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.

In the light of responses to our consultation, and as set out in §2.2 above, we have altered our approach to the calculation in respect of parameter (i), that is, we have amended our calculation of customer bad debt costs arising and the relief that will be oriented to Retailers. We have not otherwise altered our approach or parameters.

#### 3.2.2 Amended outturn customer bad debt costs

We have decided to calculate the excess bad debt costs (EBPC) which Retailers in aggregate may pass through to customers on the basis of market revenue from 1<sup>st</sup> October 2019 to 31<sup>st</sup> March 2020 and 100% of market revenue for 2020–21. Retailer reported revenue for 1 October 2019 to 31 March 2021 aggregated to £1,257 million, meaning that we calculate EBPC at £22.586 million as follows:

$$EBPC = (R_{\text{Oct19-Mar20}} + R_{\text{2020-21}}) \times (OB_{\text{2020-21}} - 2\%) \times SF$$

where:

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

$R_{\text{Oct19-Mar20}}$  = business retail market turnover for period October 2019–March 2020 (£ million)

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

$OB_{2020-21}$  = estimated outturn turn bad debt as proportion of market turnover (%) (calculated as a weighted average over 2019–20 and 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

We recall our values for  $R_{2020-21}$  and  $OB_{2020-21}$  from our December 2021 consultation document, which have not changed. We note from Retailer returns that business retail market turnover for period October 2019 – March 2020 was £1,257 million; uprated for inflation to give this parameter in 2020–21 prices gives a value for  $R_{\text{Oct19-Mar20}}$  of £1,267.446 million.<sup>4</sup>

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

$$\text{EBPC} = \text{£}22.586 \text{ million} = (\text{£}1,267.446 \text{ million} + \text{£}2,194 \text{ million}) \times (2.87\% - 2.0\%) \times 0.75$$

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

### 3.2.3 Amended REC price cap uplift

With the amended calculation of EBPC, and our approach and parameters otherwise unchanged from our December 2021 consultation, we have re-calculated the uplift to be applied to REC price caps as +0.49%. This represents a change from the 0.31% uplift we consulted on in December 2021.

Appendix A1 summarises the calculation. Further details are also provided in an updated spreadsheet model, published to accompany this decision document.

## 3.3 Amendments to the Retail Exit Code

Our December 2021 consultation explained that we would look to implement revised REC price caps through amendments to the Retail Exit Code, and sought views on this approach.

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<sup>4</sup>  $\text{£}1,267.446 = \text{£}1,257 \times 109.2 \text{ (Price index for 2020-21)} \div 108.3 \text{ (Price index for 2019-20)}$

We set out below our decision to amend the REC to give effect to the 0.49% uplift in REC price caps we have explained in §3.2 above.

## What we said in the consultation

Our December 2021 consultation noted that any adjustments to REC price caps, as set out in our proposals, would be expressed and take effect through amendments to the REC. We said that any amendments would comprise changes to the way maximum price caps are specified for Group One and Group Two customers. We set out in Annex A4 of our December document the detailed amendments we would propose to make, were we to implement our December proposals.

**December 2021 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.**

## Consultation responses

Most Retailers who commented, as well as CCW, agreed that the form of amendment as set out by Ofwat would be correct in terms of implementing the proposed adjustment to REC price caps we had set out in our proposals. Some Retailers reiterated their view that they nevertheless disagreed with the *level* of the proposed adjustment (ie. +0.31% as set out in our December 2021 consultation), as opposed to Ofwat's proposed method of implementing the adjustment via amendments to the REC.

Two Retailers in addition raised more general queries about how the REC price caps should be applied by Retailers. Both suggested that the some of the wording contained within Appendix 4 appears to suggest that REC price caps should be applied as a strict pricing cap at the customer level. Both commented that the REC price controls were established at PR16 to operate as an average revenue control per customer group, with retailers retaining the “freedom to set tariffs for its customers provided that it meets the overarching requirements of the price control”, ie. that the controls do not or should not establish a strict price cap at the customer level. Both Retailers requested that Ofwat further clarify this position.

## Our decision

We consider that the form of amendment to the Retail Exit Code as set out in Annex A4 of the December 2021 consultation remains an appropriate way to bring the REC price cap uplift into force. Note that our decision is for an uplift of 0.49% as opposed to the 0.31% set out in our December 2021 document.

Accordingly we have decided to amend the REC. Appendix A2 of this document sets out the amendments we are making to the REC, to enable REC price caps to be uplifted from April 2022. We will also separately publish an updated version of the REC, to take effect from April 2022.

We confirm that the REC price caps have and continue to set maximum allowed prices for different groups and categories of business customer and are working with Retailers to resolve this difference.

## 4. Next steps

Our decision to amend the REC and so allow a temporary uplift to REC price caps takes effect from April 2022. We expect Retailers to communicate any revised terms to their customers.

We are currently undertaking a more wide ranging review of the REC price and non-price protections, with a view to any revisions taking effect from April 2023. We [consulted](#) on our approach in December 2021. As part of that review, and consistent with the data we are requiring from Retailers, we plan to consider relevant evidence regarding both backward-looking and forward-looking bad debt costs. We plan to publish proposals in September 2022, followed by publication of a Decision by end 2022.

To protect customers' interests and to avoid the risk that forward-looking Retailer estimates of bad debt costs turn out to have materially overestimated the level of bad debt that actually crystallises, we will continue to monitor Retailer customer bad debt positions. If it becomes clear Retailers in aggregate are significantly unwinding or reversing their provisions in respect of 2019-20 and 2020-21, we would seek to make corresponding downward revisions to REC price caps at a later date.

## A1 REC price cap adjustment

Appendix A1 of our December 2021 consultation set out the method of calculation of the adjustment to apply to REC price caps. This appendix re-states this calculation using the revised value for EBPC as set out in our decisions in chapter 2, and so explains the calculation of the +0.49% uplift to REC price caps we have decided to apply with effect from April 2022.

Note we have separately published alongside this decision document an updated Excel spreadsheet model which sets out the updated calculation of the REC price cap adjustment. Table A1.1 below summarises the main elements of the calculations and the published Excel model.

**Table A1.1 – 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)
<b>EBPC: Excess bad debt costs which Retailers in aggregate may pass through to customers</b>	22,586			
<b>Counterfactual: - i.e. assume no REC price cap adjustment</b>				
<b>Market revenue</b>	2,194,000	2,311,111	2,445,926	2,586,316
<b>Factual: i.e. after adjusting REC price cap and prices by +0.4893%</b>				
<b>Market revenue</b>			2,457,894	2,598,971
<b>Difference delivers:</b>				
<b>Unadjusted for finance costs</b>			11,968	12,655
<b>Present value of differences:</b>				
<b>Two years out: i.e. reflects efficient financing costs two years out</b>			11,172	
<b>Three years out: i.e. reflects efficient financing costs three years out</b>				11,414
<b>Sum of discounted values equals excess bad debt costs to be recouped</b>	22,586			

## Use of the Excel spreadsheet model

We have set out our determination of the 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 – 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 F52). 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 (cell F51). 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 F85) equals the portion of excess bad debt costs to recouped by Retailers from customers (cell F84).

- 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.

## A2 Amendments to Retail Exit Code

This Appendix sets out the amendments we are making 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 have decided to apply an uplift to net margins of 0.49%. Accordingly, we are making the following amendments to *Table 1 Customer Group One, allowed average retail cost components and allowed net margins (2020/21)* of the REC. Our amendments 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 MI measured or assessed; water unmeasured	£49.18	<del>2.94%</del>	<u>3.43%</u>
ANH	Water unmeasured	£14.42	<del>4.54%</del>	<u>2.03%</u>
ANH	Water unmeasured (Hartlepool)	£13.96	<del>2.06%</del>	<u>2.55%</u>
ANH	Water 0-0.5MI measured or assessed	£45.69	<del>3.76%</del>	<u>4.25%</u>
ANH	Wastewater unmeasured	£14.95	<del>4.12%</del>	<u>1.61%</u>
ANH	Wastewater 0-0.5MI measured or assessed	£41.97	<del>3.26%</del>	<u>3.75%</u>
ANH	Wastewater unmeasured (trade effluent)	£16.00	<del>4.17%</del>	<u>1.66%</u>
ANH	Wastewater 0-0.5MI measured or assessed (trade effluent)	£120.97	<del>3.55%</del>	<u>4.04%</u>
BRL	Water 0-0.5MI measured or assessed	£26.60	<del>3.66%</del>	<u>4.15%</u>
BRL	Water unmeasured	£8.32	<del>4.07%</del>	<u>4.56%</u>
NES	Water unmeasured	£18.60	<del>6.68%</del>	<u>7.17%</u>
NES	Water 0-0.5MI measured or assessed	£30.59	<del>4.00%</del>	<u>4.49%</u>
NES	Wastewater unmeasured	£19.59	<del>4.36%</del>	<u>4.85%</u>
NES	Wastewater 0-0.5MI measured or assessed	£32.81	<del>2.56%</del>	<u>3.05%</u>
PRT	Water unmeasured	£18.22	<del>2.19%</del>	<u>2.68%</u>
PRT	Water 0-0.5MI measured or assessed	£21.93	<del>2.40%</del>	<u>2.89%</u>
SVT	Water 0-0.5MI measured or assessed; water unmeasured	£49.31	<del>3.73%</del>	<u>4.22%</u>
SVT	Wastewater 0-0.5MI measured or assessed; wastewater unmeasured	£49.47	<del>2.85%</del>	<u>3.34%</u>
SEW	Water unmeasured	£39.69	<del>4.14%</del>	<u>1.63%</u>
SEW	Water 0-0.5MI measured or assessed	£39.69	<del>2.73%</del>	<u>3.22%</u>

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SRN	Water unmeasured	£13.53	<del>2.17%</del>	<u>2.66%</u>
SRN	Water 0-0.5MI measured or assessed	£25.64	<del>6.32%</del>	<u>6.81%</u>
SRN	Wastewater unmeasured	£16.67	<del>1.95%</del>	<u>2.44%</u>
SRN	Wastewater 0-0.5MI measured or assessed	£28.03	<del>3.62%</del>	<u>4.11%</u>
SSC	Water 0-0.5MI measured or assessed; water unmeasured	£48.65	<del>2.96%</del>	<u>3.45%</u>
SWT	Water unmeasured (South West)	£14.45	<del>1.87%</del>	<u>2.36%</u>
SWT	Wastewater unmeasured	£16.17	<del>1.87%</del>	<u>2.36%</u>
SWT	Water 0-0.5MI measured or assessed (South West)	£17.11	<del>3.13%</del>	<u>3.62%</u>
SWT	Wastewater 0-0.5MI measured or assessed	£16.58	<del>2.74%</del>	<u>3.23%</u>
SWT	Water unmeasured (Bournemouth)	£16.14	<del>1.82%</del>	<u>2.31%</u>
SWT	Water 0-0.5MI measured or assessed (Bournemouth)	£23.45	<del>3.01%</del>	<u>3.50%</u>
SES	Water unmeasured	£20.92	<del>2.61%</del>	<u>3.10%</u>
SES	Water 0-0.5MI measured or assessed	£32.44	<del>2.61%</del>	<u>3.10%</u>
TMS	Water 0-0.5MI measured or assessed	£25.23	<del>2.88%</del>	<u>3.37%</u>
TMS	Wastewater 0-0.5MI measured or assessed	£34.11	<del>3.15%</del>	<u>3.64%</u>
TMS	Wastewater 0-0.5MI measured or assessed (trade effluent)	£34.84	<del>3.39%</del>	<u>3.88%</u>
TMS	Water unmeasured	£24.71	<del>2.50%</del>	<u>2.99%</u>
TMS	Wastewater unmeasured	£33.16	<del>2.50%</del>	<u>2.99%</u>
UWU	Water 0-0.5MI measured or assessed; water unmeasured	£38.10	<del>2.84%</del>	<u>3.33%</u>
UWU	Wastewater 0-0.5MI measured or assessed; water unmeasured	£57.30	<del>2.84%</del>	<u>3.33%</u>
WSX	Water unmeasured	£20.84	<del>1.45%</del>	<u>1.94%</u>
WSX	Wastewater unmeasured	£16.70	<del>1.57%</del>	<u>2.06%</u>
WSX	Water 0-0.5MI measured or assessed	£24.79	<del>3.30%</del>	<u>3.79%</u>
WSX	Wastewater 0-0.5MI measured or assessed	£18.53	<del>3.41%</del>	<u>3.90%</u>
WSX	Wastewater 0-0.5MI measured or assessed (trade effluent)	£24.77	<del>3.31%</del>	<u>3.80%</u>
YKY	Water unmeasured	£18.90	<del>11.71%</del>	<u>12.20%</u>
YKY	Wastewater unmeasured	£19.04	<del>7.03%</del>	<u>7.52%</u>
YKY	Water 0-0.5MI measured or assessed	£28.75	<del>3.55%</del>	<u>4.04%</u>
YKY	Wastewater 0-0.5MI measured or assessed	£31.04	<del>2.93%</del>	<u>3.42%</u>
YKY	Wastewater 0-0.5MI measured or assessed (trade effluent)	£24.79	<del>2.35%</del>	<u>2.84%</u>

## Group Two customers

For Group Two customers, we have decided to apply an uplift to gross margins of 0.49%. Accordingly, we are making the following amendments to *Table 2 Customer Group Two and allowed gross margins* of the REC. Our amendments 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 MI to 50 MI	<del>8%</del> <u>8.49%</u>
Wastewater services 0.5 MI to 50 MI	<del>40%</del> <u>10.49%</u>

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