

March 2022

# **Ofwat REC22: Ofwat Cost Benchmarking Request for information (RFI)**

## **Amendments to draft RFI and draft RFI guidance**

## About this document

Ofwat in December 2021 began its review – 'REC22' – of price and non-price protections under the Retail Exit Code (REC). Ofwat requires data and information from Retailers for the purposes of reviewing price protections under the REC.

This document summarises questions and comments received from Retailers concerning Ofwat's draft Request for Information (RFI) and draft Guidance notes which Ofwat sent to Retailers on 1<sup>st</sup> February 2022. This document sets out where, how and why we have taken Retailer views – as expressed in writing and also at a Webinar held 10<sup>th</sup> February 2022 – into account in revising the RFI and Guidance notes. We have made these revisions and issued a formal RFI and Guidance note to Retailers, for completion and return to Ofwat by 11am on Monday 11<sup>th</sup> April 2022.

# 1. Introduction

Ofwat on 1<sup>st</sup> February 2022 sent Retailers a [draft version of the RFI](#) and [draft Guidance notes](#), and invited comment. We hosted a webinar for Retailers on 10<sup>th</sup> February 2022 to give Retailers an opportunity to further understand, comment on and put questions concerning our draft RFI and Guidance notes. Following receipt from Retailers of written comments on the drafts as well as discussion and questions put at the Webinar, we have summarised points raised, and if, how and why we have taken these into account and where relevant revised the RFI and/or Guidance notes. Table 1.1 sets out our considerations.

On 24<sup>th</sup> February 2022 we issued our revised RFI and Guidance notes to Retailers. This is a formal request under standard licence condition A8. Retailers are asked to complete and return the RFIs by **11am Monday 11<sup>th</sup> April 2022**.

Note we remain open to further questions and clarifications if these are necessary for Retailers to complete the RFI. We invite Retailers to put any questions in writing as soon as questions arise, rather than towards the point at which the RFI should be returned. Any questions should be sent to [retailexitcode@ofwat.gov.uk](mailto:retailexitcode@ofwat.gov.uk). Note we would look to publish (in anonymised form) any questions received as well as our answers, at [REC22 – Review of the Retail Exit Code price and non-price protections](#).

## 2. Amendments to the Request for Information (RFI) and Guidance notes

We have carefully considered all feedback received and where relevant we have amended the RFI and guidance. Table 1.1. sets out the comments and questions we received, where relevant in summarised form. Note we have excluded some clarifications concerning circumstances in Wales as we are not seeking these RFI returns from the Welsh Retailers.

**Table 2.1 List of comments / issues and action**

Issue / comment	Description of issue	Ofwat response	Description of amendment to RFI or guidance notes (where relevant)
<b>1. Timescales</b>	<ul style="list-style-type: none"> <li>Ofwat is requesting a large volume of data that will take time to compile. What scope is there for extending? Some of the key arguments for extension of the timescale included the historically looking nature of the request, the more extensive volume of requested information in comparison with annual returns, the requirement for thorough assurance of the submitted information; and data submission vs Ofwat's preparation and assessment time.</li> </ul>	<ul style="list-style-type: none"> <li>We consider that 6 weeks remains a sufficient and proportionate timescale for the compilation and return of completed RFIs.</li> <li>While we recognise that we are asking Retailers for a large volume of data, it was for this reason that we wrote to Retailers in December 2021 to give advance notice of our intentions. In addition we note that we issued a draft RFI on 1st February 2022, which we consider gives Retailers a further opportunity to anticipate and prepare material.</li> </ul>	<ul style="list-style-type: none"> <li>No further action. Deadline for submission is 11am Monday 11 April.</li> </ul>
<b>2. Verification / assurance</b>	<ul style="list-style-type: none"> <li>We were asked - what do Ofwat envisage as an appropriate level of verification in terms of the assurance statement Retailers are asked to provide?</li> </ul>	<ul style="list-style-type: none"> <li>We set out in the webinar and have made clear in the guidance notes that:                      "You should provide a description of assurance processes undertaken to verify that information and data submitted are accurate and ensure that any estimates are made within reasonable tolerances. Details of the assurance processes should be submitted in a word document or similar format at the same time as the data provision form. This document should also include a signed statement on behalf of your Company's Board."</li> </ul>	<ul style="list-style-type: none"> <li>No further action.</li> </ul>

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<p><b>3. Matching all bills to customers / single point of contact</b></p>	<p>Ofwat is requesting data at the customer level. Requests for clarification included:</p> <ul style="list-style-type: none"> <li>• How should Retailers deal with matching all bills to customers – e.g. where brokers are involved?</li> <li>• Could Retailers expect further change to the definition of customer ie. billing entity but what would happen if a customer with different premises wants to be billed separately?</li> <li>• Can Ofwat confirm the meaning of a 'single point of contact' – e.g. where a Crown Commercial Services framework agreement applies.</li> </ul>	<ul style="list-style-type: none"> <li>• We have previously asked, in our annual market monitoring requests to Retailers, for data at the customer billing level, and Retailers have provided this data set. We want to take the same approach with this RFI. That is, we are looking for data at the customer billing account level.</li> </ul>	<ul style="list-style-type: none"> <li>• We have clarified our RFI guidance (§3.2).</li> </ul>
<p><b>4. Unique customer</b></p>	<p>Our draft RFI seeks data on customer numbers. We were asked:</p> <ul style="list-style-type: none"> <li>• We are able to identify unique customers where they have engaged i.e. contracted with us, but there is no verifiable way of identifying unique default customers, who by definition have not engaged.</li> </ul>	<ul style="list-style-type: none"> <li>• We suggest that Retailers identify a customer on the basis that they have a billing account with that customer. We think the RFI guidance is already clear on this point.</li> </ul>	<ul style="list-style-type: none"> <li>• No further action.</li> </ul>
<p><b>5. Historical data reconciliation</b></p>	<p>Ofwat is requesting data segmented between customer consumption bands, including over time. Requests for clarification included:</p> <ul style="list-style-type: none"> <li>• How can / should Retailers reconcile historical data where the definition of customer groups has changed between REC periods?</li> <li>• There are account movements which can lead to a customer moving from one consumption band to another. How should Retailers deal with such changes on an ongoing consistent basis?</li> <li>• What is Ofwat's view of the suggestion that consumption should be measured by tariff band rather than consumption band, as customers will have moved significantly between the latter during the pandemic?</li> </ul>	<ul style="list-style-type: none"> <li>• We are looking for, for a year in question, the set of data relating to a customer consumption segment (eg. revenue) to be assigned to that customer segment according to a customer's consumption in that year.</li> </ul>	<ul style="list-style-type: none"> <li>• We have clarified our RFI guidance (§3.8).</li> </ul>
<p><b>6. Acquired customers</b></p>	<p>Ofwat is requesting data concerning acquired customers ie. customers that have switched to a Retailer. A question for clarification here was:</p> <ul style="list-style-type: none"> <li>• How necessary / practicable is splitting data between in-year periods before and after a customer is acquired (or where a customer has changed tariff)?</li> </ul>	<ul style="list-style-type: none"> <li>• We ask Retailers to allocate relevant data for an acquired customer (eg. revenue) from the date the customer was acquired to the end of the reporting period.</li> </ul>	<ul style="list-style-type: none"> <li>• We have clarified our RFI guidance (§4.3).</li> </ul>
<p><b>7. Vacant properties</b></p>	<ul style="list-style-type: none"> <li>• We were asked if vacant properties are to be included in the return, and if so, how, especially where moving from vacant to occupied and back?</li> </ul>	<ul style="list-style-type: none"> <li>• We will amend the RFI and guidance to request numbers of vacant properties at the end of each year. We will distinguish between BAU vacants and vacants with a 'Covid-19' flag.</li> </ul>	<ul style="list-style-type: none"> <li>• We have amended the RFI tab TD3.</li> <li>• We have amended the RFI guidance – Section added to §4.3 of guidance.</li> </ul>

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<p><b>8. Non-metered customers</b></p>	<p>Ofwat is requesting consumption for “unmetered customers” to be ascertained such that these customers can be associated with a consumption band. The data tables also include a distinct row for unmetered customer numbers. Questions here were:</p> <ul style="list-style-type: none"> <li>• Estimating unmetered customers’ consumption during the last two year Covid-19 period will not be possible. In addition, the cost to serve unmetered customers is different from metered customers (e.g. no meter read costs; but possibly more bilateral requirements to assess their charges). Would it not therefore make sense to keep unmetered in a distinct category?</li> <li>• Treat unmetered connections as a separate customer category rather than seek to assign them, inevitably arbitrarily, to consumption bands</li> <li>• Requesting an estimate of consumption for unmetered customers will also require further analysis / methodology and elongate the time it takes Retailers to respond to this RFI.</li> <li>• The proposed assignment of metered and unmetered connections to consumption bands implies a customer-by-customer analysis – is this intended?</li> </ul>	<ul style="list-style-type: none"> <li>• The current REC price caps set maximum price for Group One customers, including those who are unmeasured. We want to understand how some retail costs will accrue to this set of customers.</li> <li>• Our RFI accordingly already: <ul style="list-style-type: none"> <li>• seeks cost and other data for Group One customers, including unmetered customers who may be considered to be Group One customers; and</li> <li>• numbers of customers who are unmetered, to help understand if/where this is a cost driver.</li> </ul> </li> <li>• In addition we note Retailers have provided data in this form previously, as part of annual market monitoring returns.</li> <li>• Accordingly we do not propose to amend the RFI or guidance notes in respect of unmetered customers.</li> </ul>	<ul style="list-style-type: none"> <li>• No further action.</li> </ul>
<p><b>9. De-registrations</b></p>	<p>The draft RFI made no reference to nor requested data on de-registrations, for example relating to the number or cost of Retailers undertaking de-registrations. We were asked:</p> <ul style="list-style-type: none"> <li>• De-registrations also represent sunk costs that are not recoverable, but are nonetheless actual costs. How should we treat these?</li> </ul>	<ul style="list-style-type: none"> <li>• We recognise that it may be useful, in understanding and assessing Retailer customer cost to serve, the extent to which Retailers have incurred costs related to de-registrations in the market.</li> </ul>	<ul style="list-style-type: none"> <li>• We have amended the RFI (Tabs TD1, TD2, BU1, BU2) to request separately cost data on de-registrations (\$2.3, \$3.5, \$4.1.1, \$5.1).</li> <li>• We have amended the RFI guidance (\$4.1.1).</li> </ul>
<p><b>10. Forecast inflation assumption</b></p>	<p>Our RFI seeks forecast data on costs and other items out to 2026–27. Our draft RFI and guidance asks Retailers to state their own assumptions on general (CPIH) inflation to this time. We were asked:</p> <ul style="list-style-type: none"> <li>• To facilitate peer comparison, it may be better that Ofwat either (a) asks Retailers to quote 2026–27 at constant prices or (b) Ofwat provides an inflation rate for all Retailers to use.</li> </ul>	<ul style="list-style-type: none"> <li>• We agree that it makes sense to try to facilitate peer comparison, and so we will amend the RFI to ask for cost, revenue and other data for 2026–27 to be stated at constant 2021–22 prices.</li> <li>• Retailers are free to assume, and set out their assumptions, that some cost factors will change at rates differently to economy wide inflation, and to</li> </ul>	<ul style="list-style-type: none"> <li>• We have amended the RFI (eg. §3.4) to ask for forecast data in constant (2021–22) prices (Tabs - TD1, TD4, TD5, TD7, BU1,</li> </ul>

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	<ul style="list-style-type: none"> <li>• Can / should Retailers treat inflation differently by cost category – e.g. staff cost inflation?</li> </ul>	<p>reflect this in their forecasts for the cost categories they believe are relevant.</p>	<p>BU2, BU3, BU4, BU6 and BU7).</p>
<p><b>11. Cost categories</b></p>	<p>Our draft RFI asks for costs to be split according to a number of cost categories. We were asked:</p> <ul style="list-style-type: none"> <li>• Meter reading and bad debt costs are important retail business costs – why are they not given as separate cost categories in the breakdown of operating expenditure categories?</li> <li>• Why has Ofwat chosen to use different cost categories than was used by Economic Insight (EI) in its analysis? In particular, Meter Reading costs and Debt Recovery/Bad Debt costs. Conversely Ofwat is calling for data on MPF penalties, when this was not a cost category in the EI analysis</li> <li>• Are meter reading costs excluded as a specific category because Ofwat is asking for more granular detail in form TD6, so is the expectation that we include in Other operating as a total and then the detail in TD6?</li> <li>• Why are metering costs separated and not included in main OPEX return?</li> <li>• Some of the categories/customer segmentation we do not use when managing our business and therefore hard for us to capture information at these levels without some assumptions around drivers, e.g consumption banding, England v Scotland. Does Ofwat understand and acknowledge that will be the case?</li> </ul>	<ul style="list-style-type: none"> <li>• We agree that meter reading and bad debt costs are important components of retail business costs and should be explicitly given in the breakdown of operating expenditure categories.</li> <li>• We also consider that other costs, where they are separate and discrete, should be separately identified, including in respect of MPF penalties.</li> <li>• We understand that Retailers will or may need to make assumptions or adopt estimation approaches in providing some data; for this reason we ask Retailers to describe such assumptions or approaches in their accompanying narrative documents.</li> </ul>	<ul style="list-style-type: none"> <li>• We have amended the RFI (§3.5, §4.1.1) to give explicit and separate cost categories for meter reading and – separately – bad debt costs (Tabs TD1, TD2, BU1, BU2).</li> </ul>
<p><b>12. Customers with one or more services</b></p>	<p>Our draft RFI (eg. Tab TD3) seeks data on customers numbers categorised according to water, waste water and TE. We were asked:</p> <ul style="list-style-type: none"> <li>• Ofwat is looking for Water, Sewerage and Trade Effluent to be shown separately. How should we complete this spreadsheet where we have one customer with two bills per annum who receives all water, sewerage and TE services? A related question concerns how the number of bills should be shown, as for example there may be one customer with two bills per annum who receives all water, sewerage and TE services? In this case there would be one customer issued with a total of two bills, not two bills for each of water, sewerage and TE, which would not be easy to show under the draft RFI.</li> <li>• It is not possible to split amounts in arrears between the water, sewerage and TE components. We do not chase debt differently across each component, so why would we split it here?</li> </ul>	<ul style="list-style-type: none"> <li>• We acknowledge this point, and we would like to understand customer numbers by different combinations of water, waste water and TE. We have introduced additional columns in the RFI spreadsheet so that a customer may be captured under one of the following: <ul style="list-style-type: none"> <li>• Water only</li> <li>• Waste water only</li> <li>• TE only</li> <li>• Water + Waste Water</li> <li>• Water + TE</li> <li>• Waste water + TE</li> <li>• Water + Wastewater +TE</li> </ul> </li> </ul>	<ul style="list-style-type: none"> <li>• We have introduced additional columns to capture the combinations of water, waste water and TE (Tab TD3).</li> </ul>

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		<ul style="list-style-type: none"> <li>Concerning arrears, we ask for data on the number of customers in arrears – the additional columns noted above provide Retailers additional latitude to provide customer numbers where this best fits their practice.</li> </ul>	
<p><b>13. Merger and acquisitions</b></p>	<p>Our draft RFI guidance notes (§3.7) highlight the issue of M&amp;A activity. Our draft guidance asks for Retailers that have acquired other (water) Retailers ‘that historical data should relate to the combined activities of the entities now constituting the Retailer’. We were asked:</p> <ul style="list-style-type: none"> <li>is Ofwat asking for Retailers to fabricate pre-acquisition data as if the acquired entity had been in the Group throughout? If not, how will cost to serve data in respect of pre-acquisition periods be taken into account by Ofwat in terms of what it has actually cost Retailers in the market as a whole to serve customers over the historic period?</li> </ul>	<ul style="list-style-type: none"> <li>We acknowledge the point. We have taken into account that it is important to have accurate historical data, and also that it will not always be possible for Retailers that have acquired entities in the past to recall or have access to the cost data set we have in mind.</li> <li>For these reasons we have clarified our RFI guidance, including that for periods prior to the acquisition, Retailers are requested to include the activities of the combined entities providing the data is robust and reliable. If this is not the case the historical data for the acquired entity prior to acquisition should be excluded. Furthermore, we ask that Retailers provide a supporting narrative as to how any mergers or acquisitions have been accounted for, in each reporting period as appropriate, in the RFI.</li> </ul>	<ul style="list-style-type: none"> <li>We have clarified our RFI guidance (§3.7).</li> </ul>
<p><b>14. England and Wales (tab TD1)</b></p>	<ul style="list-style-type: none"> <li>We received a query that the line description in tab TD1 asks for information for companies in England and Wales but tab TD1 is titled ‘Historical cost data ~ England companies’</li> </ul>	<ul style="list-style-type: none"> <li>We acknowledge the point.</li> </ul>	<ul style="list-style-type: none"> <li>We have amended the RFI tab TD1.</li> </ul>
<p><b>15. Financing costs</b></p>	<p>Our draft RFI seeks data on financing costs for the retail business. We received queries as follows:</p> <ul style="list-style-type: none"> <li>Could Ofwat confirm if the finance costs should include the costs of arranging, for example, debt/equity swaps. Or should this be a special claim if properly Covid-related?</li> <li>How Ofwat will capture the costs implicit in different Retailers’ financial structures – e.g. equity injections or the use of cash reserves for example to finance customer working capital?</li> </ul>	<ul style="list-style-type: none"> <li>We seek data on costs of financing the retail business in terms of interest payments on bank loans and any relevant bond facilities. Accordingly, any payments relating to equity arrangements, eg. ordinary shares (e.g. dividends) are to be excluded.</li> <li>We acknowledge nevertheless that a Retailers, to the extent they think they have incurred financing related costs not explicitly captured under our definitions, should set these out in their narrative document.</li> </ul>	<ul style="list-style-type: none"> <li>We have amended the RFI guidance (§4.1.3) to include text to request that any financing costs outside bank loans and bond facilities that the Retailer wishes to bring to our attention should be included and described in a narrative accompaniment</li> </ul>

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<p><b>16. WOC regions</b></p>	<ul style="list-style-type: none"> <li>We received a query suggesting that the cost of separate water and waste provision is a significant regional cost in the WoC areas (separate bills, cash collection, customer service etc for each of the water and waste service), and that it is not clear how Ofwat will capture these cost differentials.</li> </ul>	<ul style="list-style-type: none"> <li>Our RFI asks for cost drivers by customer segment and also separated by water, wastewater and Trade Effluent. We will have regard to such cost driver data in seeking to understand if and where they are significant cost drivers.</li> </ul>	<ul style="list-style-type: none"> <li>No further action.</li> </ul>
<p><b>17. Data for up to / pre March 2017 (ie. TD3, TD6, TD7, BU5, BU6, BU7)</b></p>	<p>Our draft RFI (tabs TD3, TD6, TD7, BU5, BU6, BU7) seek some data for 2016-17 and/or for end 2016-17 financial year. We received queries as follows:</p> <ul style="list-style-type: none"> <li>We would comment that this period of data may represent a challenge to the industry, with varying degrees of availability due to changes within systems and transfers of customer bases leading to additional cost, complexity and a potential lack of consistency and comparability.</li> <li>There will be very few Retailers who existed in their current form prior to 1/4/17. It's not clear how much information Ofwat is hoping to acquire for this period and for what purpose?</li> </ul>	<ul style="list-style-type: none"> <li>We agree that returning data that pre-dates market opening would be challenging and, furthermore, is less likely to be of value to Ofwat in understanding customer cost to serve in the business retail market. We have accordingly removed request for such data.</li> </ul>	<ul style="list-style-type: none"> <li>We have amended the RFI tabs TD3, TD6, TD7, BU5, BU6, BU7.</li> </ul>
<p><b>18. Efficient Retailer</b></p>	<ul style="list-style-type: none"> <li>We received a question asking about the definition of an efficient Retailer and whether Ofwat has any plans to benchmark outside the business retail water market, including looking at other relevant industries.</li> </ul>	<ul style="list-style-type: none"> <li>We do intend to explore benchmarking of some form against external indicators, and using peer comparisons. We have not set out precisely our approach here. We do not intend to amend our RFI in respect of this point.</li> </ul>	<ul style="list-style-type: none"> <li>No further action.</li> </ul>
<p><b>19. Deemed vs contract customers</b></p>	<ul style="list-style-type: none"> <li>We received a query commenting that Ofwat has not differentiated between deemed and contracted customers, together with the view that one of the important considerations for the REC review is differentiating the cost to serve of customers who engage in the market and the cost of those customers who do not.</li> </ul>	<ul style="list-style-type: none"> <li>We consider that our RFI as already set out will collect data on customers segmented in a number of ways, including by 'acquired customer' and that this should assist in our understanding of customer cost to serve.</li> </ul>	<ul style="list-style-type: none"> <li>No further action.</li> </ul>
<p><b>20. Debtors / bad debt</b></p>	<p>Our draft RFI seeks views and data on bad debt costs, including if and where they might vary by wholesaler region and/or customer segment. We received comments / queries as follows:</p> <ul style="list-style-type: none"> <li>Bad debt provisioning / write-off is not determined by wholesale region, so it is not meaningful to attempt to provide data in this way.</li> <li>Likewise, it is not meaningful to separate debt management costs by customer segment.</li> <li>Where relevant, to the extent a Retailer did not take on legacy debt with their acquisitions, we have no historical data relating to debtor balances, debt provisioning or credit balances of these customers</li> </ul>	<ul style="list-style-type: none"> <li>Regarding wholesaler region - we don't disagree with the idea that bad debt provisioning or write-offs may not significantly vary according to wholesaler region or other geographical parameters. Our RFI invites views and evidence on this point.</li> <li>Regarding customer segment - Retailers have allocated bad and doubtful debts to customer segment eg. Customer Group One, in previous returns.</li> <li>Regarding legacy debt from acquisitions, we accommodate this point under our broader discussion</li> </ul>	<ul style="list-style-type: none"> <li>We have clarified our RFI guidance concerning the date for giving aged debt costs (\$4.5)</li> <li>We take account of the point on acquisitions above, under 'M&amp;A'.</li> </ul>

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	<p>for the time periods prior to acquiring the portfolios. How is Ofwat looking to capture these values to ensure a comprehensive picture of the market since market opening?</p> <ul style="list-style-type: none"> <li>On aged debt costs – is Ofwat seeking data relating to 31st March each year?</li> </ul>	<p>of data to be provided where there has been M&amp;A activity.</p> <ul style="list-style-type: none"> <li>Regarding aged debt, we can confirm that we mean 31st March each year in the case of Retailers with an accounting year ending March, or the end of the accounting year in other cases.</li> </ul>	
<b>21. Gross Margin for customer Group Two</b>	<ul style="list-style-type: none"> <li>We were asked: <ul style="list-style-type: none"> <li>If the Group Two gross margin is applied at a customer level (rather than as a cap on the average price across the group), the GM will need to be sufficient to cover the costs and risks of the highest cost/risk customers in the Group</li> </ul> </li> </ul>	<ul style="list-style-type: none"> <li>This is a point for consideration as we understand and assess Retailers' costs to serve and/or the form of the REC price caps.</li> </ul>	<ul style="list-style-type: none"> <li>No further action.</li> </ul>
<b>22. Average cost template calculations</b>	<ul style="list-style-type: none"> <li>We were asked: <ul style="list-style-type: none"> <li>Average cost template calculations will mask true costs. How will Ofwat account for e.g. real costs of meter reading that are a multiple of template costs due to asset condition, data, and access issues</li> <li>The methodology implies costs are equal across different customer groups. In reality this is not the case given separate billing and customer service / support structures to deal with small and large customers. Dividing total billing costs across these systems will not reflect this nuance. Equally, customer acquisition costs for a small SME customer versus a large tender are entirely different.</li> </ul> </li> </ul>	<ul style="list-style-type: none"> <li>These are points for consideration as we understand and assess Retailers' costs to serve and/or the form of the REC price caps.</li> </ul>	<ul style="list-style-type: none"> <li>No further action.</li> </ul>
<b>23. Special costs</b>	<p>Our RFI seeks data on special cost factors, where relevant. We received queries as follows:</p> <ul style="list-style-type: none"> <li>How should Retailers allocate costs of BAU v. non-BAU activity – e.g. costs of initiatives such as LUM –across customer groups?</li> <li>Likewise, are other market frictions such as the incidence of ‘excess’ bilateral activity intended to be included? If so, how can these be allocated directly to customer groups in a verifiable way?</li> <li>What would be considered to be “special cost claims relating to market opening” – e.g. would accounts migrated in error or with incorrect data that required fixing be defined as “special costs” or BAU? Would the complaints that arose from these data errors be special or BAU, bearing in mind that it is not always easy to split out what is BAU from special in such circumstances.</li> </ul>	<ul style="list-style-type: none"> <li>Regarding the first two points here on allocating special costs to customer segments, we advise Retailers to allocate such costs in the same way as they will allocate other costs, ie. with reference to underlying cost drivers.</li> <li>Regarding the third point on what costs may be considered or signalled as 'special', we look to Retailers to exercise their judgements here. Note we would expect, a priori, the number of special costs to be limited.</li> </ul>	<ul style="list-style-type: none"> <li>We have amended RFI guidance (§5.3) to highlight that the cost drivers for the relevant cost category should be used for allocating special cost factors to customer groups</li> </ul>

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<p><b>24. Costs relating to market frictions</b></p>	<p>Our RFI (eg. Tab TD1) asks for costs by cost category, as well as special costs (tab TD4). We have been asked about if and how costs for Retailers that relate to or stem from the effects of market frictions (ie. data quality, wholesaler-Retailer interactions, and wholesaler performance) may be identified and highlighted. Questions included for example whether such costs might be best identified as a 'special cost', and if and how a glide path illustrating how such costs are projected to change might be set out and captured.</p>	<ul style="list-style-type: none"> <li>• We think that it will be helpful to highlight where, and the extent to which, Retailers' costs, including on a historical basis, may be related to or substantially caused by the market frictions we have identified.</li> <li>• As we have noted above under item 23 on Special costs, it is open to Retailers, to exercise their judgement on what costs – including those relating to market frictions – may be considered 'special costs' and so given in tab TD4.</li> <li>• We recognise that it may not be straightforward to recognise and quantify costs related to market frictions in other cases. For example, poor market wide data quality could affect Retailers' billing costs, customer contacts, and other cost categories in ways that are not readily quantifiable.</li> <li>• Accordingly, we would request Retailers to set out in their narrative document their views on how, and to what extent, relevant cost categories have been affected by market frictions. This should include views on if and how the Retailer has addressed or plans to address such costs.</li> </ul>	<ul style="list-style-type: none"> <li>• We have amended RFI guidance (\$2.3) to make clear that we seek descriptions from Retailers concerning costs relating to market frictions.</li> </ul>
<p><b>25. Bottom up costs</b></p>	<p>Our RFI seeks data on costs disaggregated by customer segment, particularly customer Groups One, Two and Three. We were asked:</p> <ul style="list-style-type: none"> <li>• For the bottom up analysis the guidance on how to allocate costs between Groups 1, 2 and 3 suggests that Ofwat wants the cost bases simply pro-rated based on customer numbers or number of bills, etc. Averaging all costs across different customer groups assumes that all customers are served the same, which is not correct. For example, we would be much less likely to put a Group 1 customer debt into litigation than that of a larger customer on grounds of cost effectiveness.</li> <li>• We consider there must be flexibility here to allow businesses to allocate costs according to where they actually fall, in order to allow true costs to serve to be measured.</li> </ul>	<ul style="list-style-type: none"> <li>• We seek to understand and compare costs at a customer segment level, including across Retailers. For this reason we request a common approach across Retailers to the allocation / attribution of costs across such segments. We note that this approach is similar that undertaken Economic Insight (eg. p.308 <a href="#">Ready to burst? Non-household water retail market study - Economic Insight (economic-insight.com)</a>).</li> <li>• We acknowledge that our approach will be an approximation. To the extent a Retailer considers that an additional cost should be directly attributable to customer groups, in ways significantly different to that implied by Ofwat's approach, please provide your reasoning and where relevant, quantitative estimates and/or evidence, in your narrative document.</li> </ul>	<ul style="list-style-type: none"> <li>• We have amended RFI guidance (\$5.1).</li> </ul>

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<b>26. England vs Scotland cost</b>	<p>We were asked:</p> <ul style="list-style-type: none"><li>• How does Ofwat anticipate that Retailers split costs for Scotland – the Retailer finds the split between TD1 and TD7 to be a function of the allocation between two spreadsheets and this will not provide meaningful differentiation between the two reports.</li></ul>	<ul style="list-style-type: none"><li>• We request that Retailers with operations in the water retail market in Scotland as well as England and Wales to complete tab TD7 – ie. for Scotland + England and Wales – on the basis of their costs for these markets together.</li><li>• We look to such Retailers to allocate or attribute costs to the England and Wales business retail market for tab TD1 (and other tabs) and consider that such Retailers are best placed to understand how their costs might be so allocated or attributed, for example on the basis of customer numbers and/or revenue.</li><li>• We ask such Retailers to describe the approach they have taken in their narrative document.</li></ul>	<ul style="list-style-type: none"><li>• We have clarified the RFI guidance (\$4.7).</li></ul>
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**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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