

Webinar

**Business retail market: 2021-22
review of the Retail Exit Code –
Consultation on proposals**

Ofwat – 20th September 2022

ofwat

Overview of session

This session is intended to clarify our proposals set out in the [consultation](#) published on 1st September 2022.

This session will cover:

- Current regulatory protections
- The continued need for price protections in the market
- Our proposals for Group One price protections
- Glide paths
- Our proposals for Group Two price protections

We welcome questions, which we will cover at the end of the presentation. Please either use the raise hand function on teams or post your question in the chat.





Current regulatory protections

Current price protections in the market

Current REC applies from April 2020 – Following our review of the REC price protections in 2018 a new REC took effect from April 2020, with different price protections for Group One, Group Two and Group Three customers.

Apply where customer remains on default terms – REC price protections apply only where there are no agreed terms, ie. where a customer has not switched to a new Retailer or negotiated a new deal with their existing Retailer, as well as where a customer's contract has expired with the Retailer and no new terms have been agreed.

REC Price protections applying from April 2020 – Allowed maximum price per customer

Customer's annual consumption		
<0.5MI (Group One)	0.5-50MI (Group Two)	>50MI (Group Three)
wholesale charge	wholesale charge	Default tariffs to be reasonable and non-discriminatory
plus Allowed Average cost to serve (differs by region and tariff/customer type) ; and	plus Gross Margin: <ul style="list-style-type: none"> • 8% water* • 10% waste* 	
Net Margin (differs by tariff type, though with overall average 2.5%)	*8.49% & 10.49% for 2022-23 and 2023-24	

Bases for allowances – The allowances for Group One customers continue to be based on the allowances and default tariffs set out in the PR14 and PR16 final determinations, although we allow an annual inflation adjustment equal to CPIH on the allowances each year.

Non-price protections

In addition to the price protections set out in the table above the REC also sets out non-price protections for customers. These protections are based on a 'no worse off' principle and prohibit Retailers changing contract terms other than price that could adversely affect customers in the market.



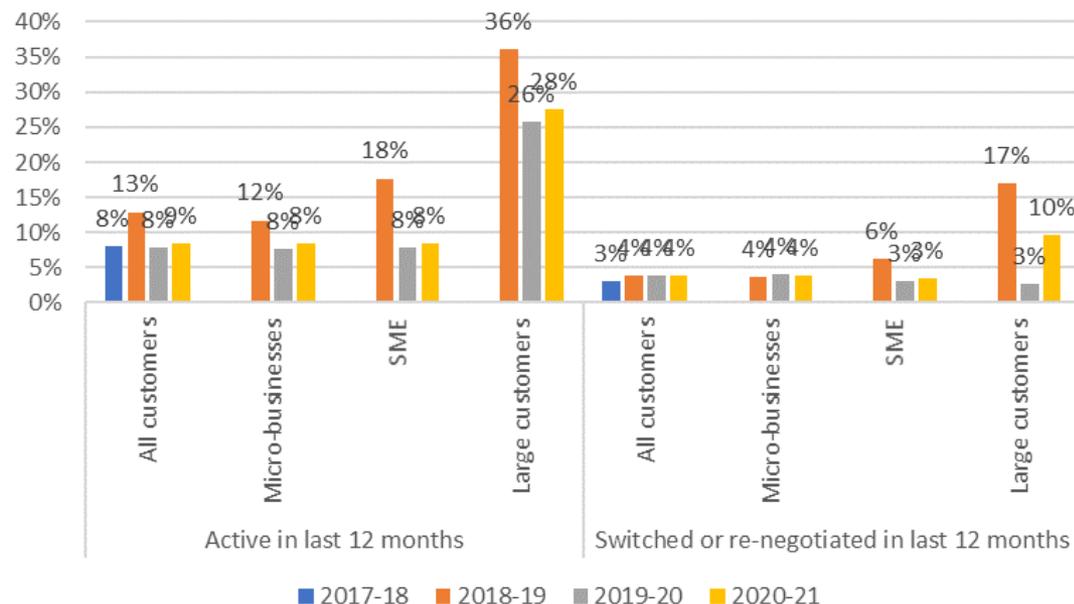


Continued need for price
protections

Is there a continued need for price protections in the market? (1)

- Our market monitoring work consistently suggests smaller customers are less active and engaged than larger customers
- We also note reduced price savings available for smaller consumption customers likely contribute to reduced motivation to engage and be active in market

Activity and Switching/Renegotiation levels



Sources: Ofwat State of the Market reports, Customer Insight Surveys

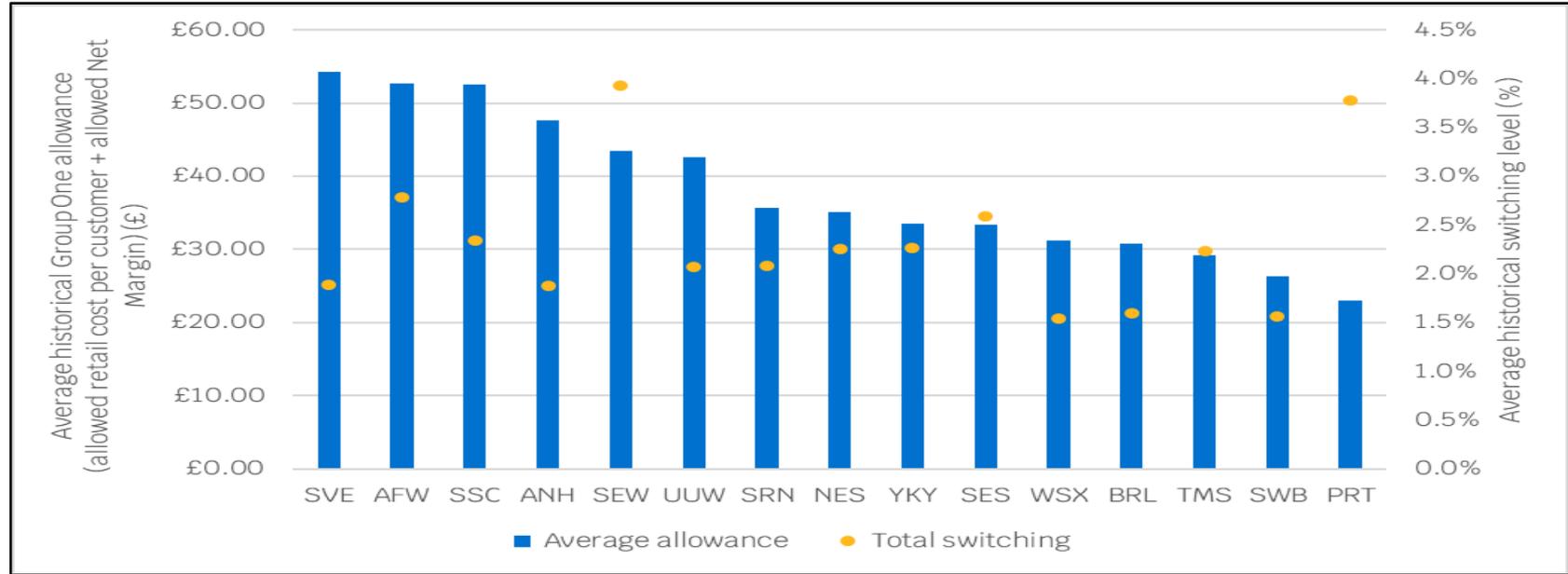
Customer segment	Average best price offered by Retailers compared to the default tariff (%)	Average best price offered by Retailers compared to the default tariff (£)	Annual savings made by customers that switched in 2020-21 (%)	Annual savings made by customers that switched in 2020-21 (£)
Group One customers	No savings	No savings	4%	£15
Group Two customers	5%	£500	3%	£250
Group Three customers	5%	£1,700	4%	£1,300

Source: Ofwat 2020-21 State of the Market, Retailer RFI returns

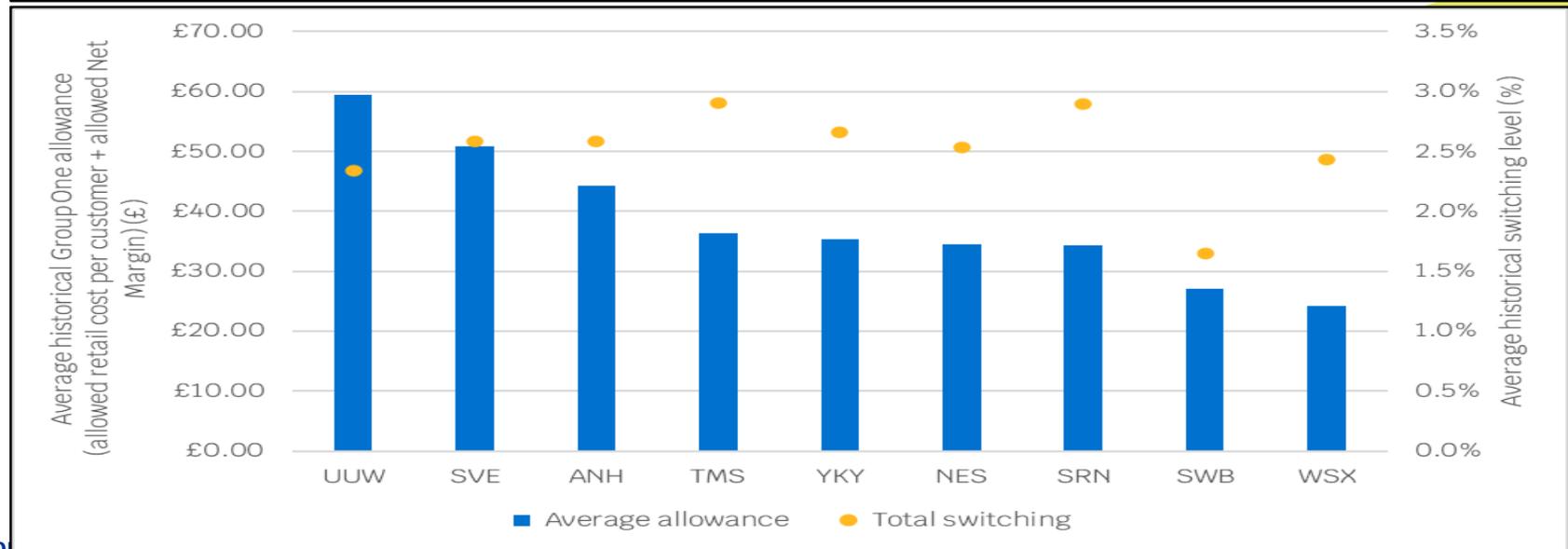


Is there a continued need for price protections in the market? (2)

Water services



Waste water services



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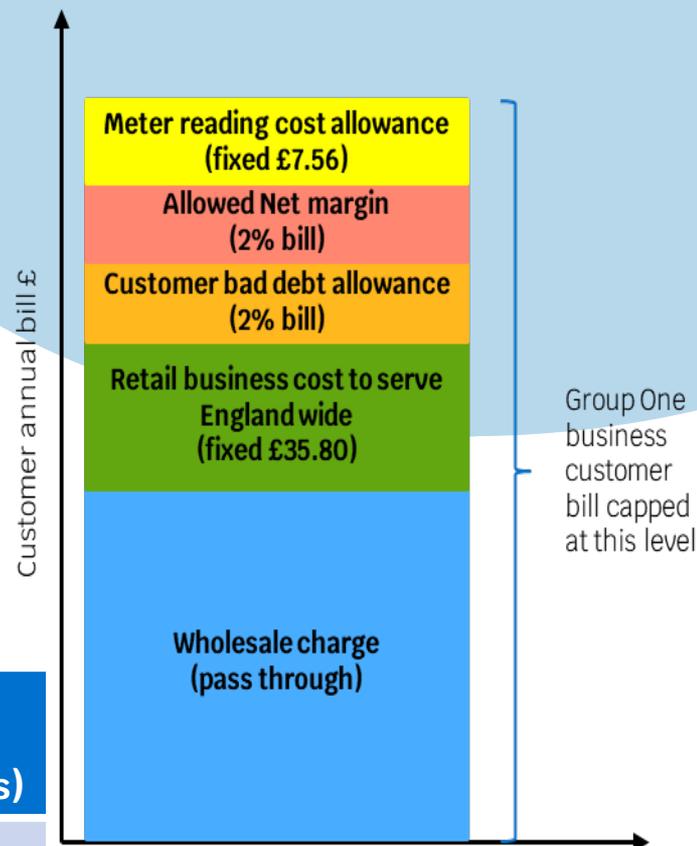


Group One customers

Proposals for future Group One price protections

We set out the following proposals in our September 2022 consultation document:

- To retain the current form of protection** as
Maximum allowed charge per unique service =
Wholesale charge (pass through) +
Allowed cost to serve (ACTS) +
Allowed net margin (2.0%) +
Customer bad debt cost (2.0%) +
(for metered water service) Meter reading cost
- To move to a single, England-wide, allowance** for
Allowed cost to serve (ACTS), meter reading cost
allowance, and allowed Net Margin.
- To base our proposals on a granular ‘bottom-up’
approach to assess efficient retail business costs**
to serve Group One customers



Allowance	Previous value at 01/09/2022 (2021-22 prices)	Updated allowance (2021-22 prices)
Running costs	£32.97	£34.63
MOSL, Ofwat, CCW fees	£0.68	£0.72
Water efficiency	£0.42	£0.45
Allowed Cost to Serve (ACTS)	£34.07	£35.80
Meter reading costs	£7.34	£7.56

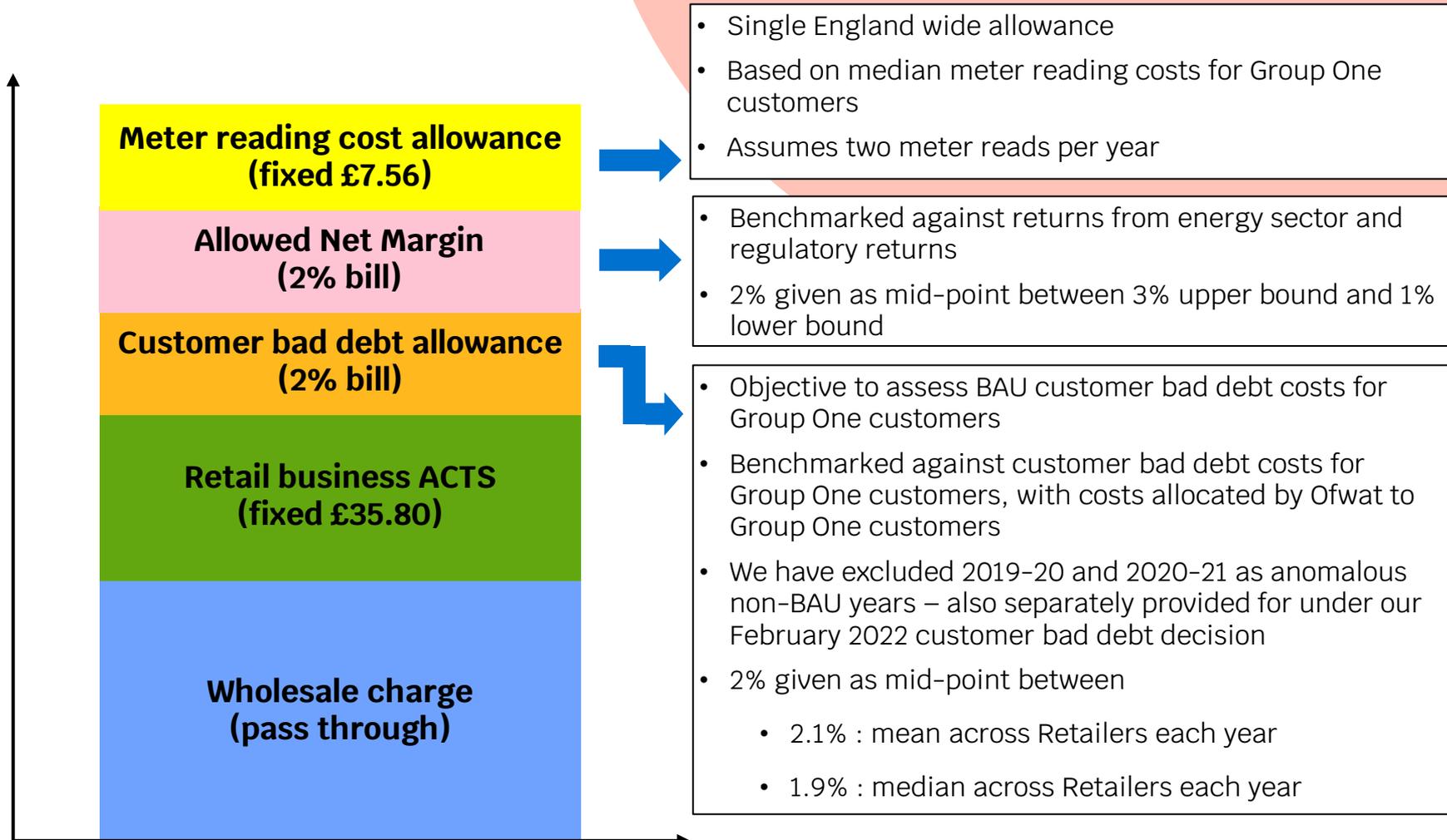
Running costs – based on ‘bottom up’ assessment & efficiency challenge

Running costs for customer Group One – per Retailer



Other elements of Customer Group One costs

Customer Group One REC price cap also comprises following elements:



Amendment of Retail Exit Code

Annex C of our consultation document set out draft amendments to the Retail Exit Code (REC) that would implement our proposals. The main features of the amendments for Group One customers are:

- Define ‘Unique service’
 - A service provided to a customer as follows:
 - 1) a water service;
 - 2) a waste water only service;
 - 3) a wastewater and trade-effluent service; or
 - 4) a trade effluent only service
- Allowed charges for Customer Group One
 - Maximum charge per unique service per customer per year:
$$C = [(acts + mc + w) / (1 - nm - b)]$$
 - For 2023-24 and 2024-25, acts is set out in table, differentiated per wholesale region, and set out according to glide path
 - For 2025-26 onwards, acts is single England wide allowance of £35.80 (2021-22 prices)
 - The acts and meter reading cost allowances will be updated by inflation (CPIH) each year
- Glide path
See following section



The background features a large, solid purple shape on the left side, which is partially obscured by a large, light blue circle on the right. The light blue circle overlaps with a smaller, semi-transparent light blue circle above it. The overall composition is minimalist and modern.

Glide path

Glide paths

We propose to phase in our proposals for Customer Group One REC price caps over a three-year time period. This aims to limit significant bill shocks for customers, and in addition should assist Retailers in adjusting to single England wide allowances.

We propose to limit year on year changes to any single tariff to 25% up until the tariff reaches our proposed national allowance. See example for Portsmouth (PRT):

Portsmouth: Water unmeasured

acts	Current REC		Proposed REC
	(2020-21 prices)	(2023-24 prices)	(2023-24 prices)
2023-24	£18.22	£20.39	+25% =£25.49
2024-25			+25% =£31.86
2025-26			+18% (ie. below 25%) =£37.81

Net Margin	Current REC allowed Net Margin	Subtract 0.49% for 2023-24	Apply 25% rule	Add back 0.49% for 2023-24	New REC allowed Net Margin
2023-24	2.68%	2.19%	2.00%	2.49%	2.49%
2024-25			2.00%		2.00%
2025-26			2.00%		2.00%





Group Two customers

Proposals for Group Two customers

We set out the following proposals in our September 2022 consultation document:

1. **To retain the current form of protection** as maximum allowed charge per customer =

Wholesale charge (pass through) +
Gross Margin (8% water, 10% waste water)*

2. **Confirm REC price cap applies as a maximum charge per customer**

To inform our assessment of whether the current level of Group Two protections remain appropriate, we compared the Group Two allowances against Retailer costs for Group Two, after Ofwat allocation of Retailer reported costs to customer Groups One, Two and Three.

Our findings indicate that most Retailers are able to more than cover their reported costs if they are able to price up to the full margin allowed under the Group Two REC price protections.

Note that Retailers' ability to price up to the Gross Margin caps is constrained given the competitive constraints for this market segment.

*8.49% and 10.49% for 2023-24, in line with our February 2022 Decision on customer bad debt costs.

