

December 2022

# **Business retail market: 2021–22 review of the Retail Exit Code – Decision**

## **Annex B – Amendments to the Retail Exit Code**

## Annex B

### Amendments to the Retail Exit Code

This Annex sets out the amendments to the Retail Exit Code (REC) to give effect to our Decision to revise REC price caps.<sup>1</sup> Our amendments concern price protections for customer Groups One and Two. These amendments will take effect from 1st April 2023.

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<sup>1</sup> Current version (v.6) of the REC available here: <https://www.ofwat.gov.uk/publication/retail-exit-code-v6-0-clean-version/>

# 1. Amendments

Our main Decision document Business retail market: 2021-22 review of the Retail Exit Code – Decision (chapters 4 and 6) explains our decision to revise REC price caps in respect of Customer Groups One and Two. Our decision will take the form of amendments to the Retail Exit Code, specifically amendments to Defined terms in §1.1, Annex A1 and Annex A2. We set out here our amendments.

## 1.1 Defined terms

We will introduce a new defined term "Unique service" in Section 1.1 Defined terms of the Retail Exit Code, as follows:

"Term	"Unique service"
Definition	A service provided to a customer as follows:  1) a water service;  2) a wastewater service without a trade-effluent service;  3) a wastewater and trade-effluent service; or  4) a trade effluent service without a wastewater service. "

In particular this means that where a trade effluent service is provided to a customer alongside a wastewater service, we will regard this as a single unique service with a single retail allowance and allowed Net Margin.

## 1.2 Revisions to REC Annex A1

We will remove the current Annex A1 of the REC and replace it with the text below.

### **"A1 Allowed charges for Customer Group One**

The maximum charge in each year is set for **each** customer separately and is based on the wholesale charge which applies to that customer, an allowed cost to serve which applies to the service being taken, a common allowed net margin and common allowance for customer bad debt costs, and for measured water services, an allowed meter read cost component. For the avoidance of doubt, the limit on charges is **not** applied as an average across customers,

nor does it apply just to average revenues. It is a limit on the charge to each customer for each unique service.

To allow for a transition to a single England wide allowance for allowed cost to serve from 2024-25, the approach in the 2023-24 charging years differs to the approach from 2024-25 charging years onwards.

We first set out how to derive the maximum charge in 2023-24 prices and then explain how to apply the adjustment for inflation.

### **Maximum charge per customer per unique service – 2023-24 prices**

#### **For charging year 2023-24**

For the charging year 2023-24, in relation to Customer Group One, the Licensee's charges in respect of each unique service provided to each Customer in each Charging Year in respect of its Business Retail Activities shall not exceed  $C_{ti}$  calculated in accordance with the following formula:

$$C_{ti} = [(acts_{ti} + mc + w_{ti}) \div (1 - nm_{ti} - b)]$$

where:

$acts_{ti}$  = is the allowed cost to serve, specified in Table 1, for the Wholesaler area and customer type (i) and charging year (t) corresponding to the maximum charge as set out in Table 1.

$mc$  = £9.74 for water metered services, and zero for all other unique services;

$w_{ti}$  = the wholesale charge, for the Wholesaler area and customer type (i) and charging year t for which the maximum charge is being calculated; and

$nm$  = 2.49%, the allowed retail net margin (expressed as a percentage)<sup>2</sup>.

$b$  = 2.45%, the allowed customer bad debt cost allowance (expressed as a percentage).

In addition, Retailers must use best endeavours to set charges for customers in 2023-24 to ensure that, in respect of customers taking more than one unique service in 2023-24, the change in the sum of the relevant retail components does not increase by more than £60,

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<sup>2</sup> The 2023-24 allowed retail Net Margin includes the 0.49% uplift from Ofwat's Covid-19 bad debt provision, see: [Business retail market: Customer bad debt – Decision on adjustment to REC price caps from April 2022](#)

compared to the sum of the allowed retail elements for an equivalent customer in 2022-23; that is,  $ACRA_i$  should not exceed £60, where:

$$ACRA_i = (TRA_{2023-24} - TRA_{2022-23})$$

$TRA_{2022-23}$  = Total Retail Allowance that would be allowed for a customer taking one or more services in 2022-23, as permitted under the Retail Exit Code in force to 31st March 2023, defined as follows:

$$= \sum_{i=1}^n \frac{rc_{i,2022-23} + w_{i,2022-23}}{1 - m_{i,2022-23}} - w_{i,2022-23}$$

where:

$rc_{i, 2022-23}$  = the allowed average retail cost component for a given customer of type  $i$  (in pounds) as set out in Table 1 of the Retail Exit Code in force to 31st March 2023

$w_{i, 2022-23}$  = the wholesale charges for a given Customer of type  $i$ ,

$m_{i, 2022-23}$  = the allowed net margin for a given Customer of type  $i$  (expressed as a percentage) as set out in Table 1 of the Retail Exit Code in force to 31st March 2023

$n_{2022-23}$  = the number of services the Customer takes from the Retailer in 2022-23

$TRA_{2023-24}$  = Total Retail Allowance that that would be allowed for a customer taking one or more unique services in 2023-24, as provided for under the definition of  $C_{ti}$  above, defined as follows:

$$= \sum_{i=1}^n \frac{acts_{2023-24} + mc_{2023-24} + w_{2023-24}}{1 - nm_{2023-24} - b_{2023-24}} - w_{2023-24}$$

where:

$acts_{2023-24}$  = is the allowed cost to serve, specified in Table 1, for the Wholesaler area and customer type ( $i$ ) and charging year 2023-24 corresponding to the maximum charge as set out in Table 1 below.

$mc_{2023-24}$  = £9.74 for water metered services, and zero for all other unique services;

- $W_{i, 2023-24}$  = the wholesale charge for 2023-24, for the Wholesaler area and customer type (i) for which the maximum charge is being calculated; and
- $nm_{2023-24}$  = 2.49% the allowed retail net margin (expressed as a percentage)
- $b_{2023-24}$  = 2.45%, the allowed customer bad debt cost allowance (expressed as a percentage).
- $n_{2023-24}$  = the number of unique services the Customer takes from the Retailer in 2023-24

### **For charging years 2024-25 and subsequent charging years**

For the charging year 2024-25 and subsequent charging years, in relation to Customer Group One where a customer takes a water service on a measured basis (ie. the service includes metered reads), the Licensee's charges in respect of each unique service provided to each Customer in each Charging Year in respect of its Business Retail Activities shall not exceed  $C_{ti}$  calculated in accordance with the following formula:

$$C_{ti} = [(acts_t + mc_t + w_{ti}) \div (1 - nm - b)]$$

where:

$acts_t$  = £49.98 (in 2023-24 prices adjusted for inflation as explained below)

$mc_t$  = £9.74 (in 2023-24 prices adjusted for inflation as explained below) if the unique service for which the maximum charge is being calculated is a water metered service, zero otherwise

$w_{ti}$  = the wholesale charge, for the Wholesaler area and customer type (i), for the corresponding charging year for which the maximum charge is being calculated ; and

$nm$  = 2%, the allowed net margin (expressed as a percentage).

$b$  = 2.45%, the allowed customer bad debt cost allowance (expressed as a percentage).

### **Permitted Adjustments allowed for Customer Group One**

In Charging Years 2024-25 and subsequent charging years, the licensee's charges in respect of each unique service provided to each Customer in Customer Group One are permitted to be adjusted for inflation. The adjustment is applicable from the start of each Charging Year and

based on the CPIH inflation rate as measured in October of the Charging Year prior to the charging year to which the charges will apply. Specifically the adjustment is permitted to apply to the allowed cost to serve component acts, and the allowed meter read cost component  $mc$ , as defined by the formulae for the relevant charging years:

$$\text{acts}_t = \text{£}49.98 \times \text{inf}_t$$

$$\text{mc}_t = \text{£}9.74 \times \text{inf}_t$$

where:

$\text{inf}_t$  = inflation factor based on CPIH and is the ratio of the CPIH index from October in the charging year prior to the charge year for which the maximum charge is being calculated to the CPIH index as measured in October 2022.

This means for example that the acts to apply in the charging year 2024-25 will be the acts given for 2023-24 (ie. £49.98) multiplied by the ratio of CPIH applying in October 2023 and October 2022.

**Table 1 Customer Group One, allowed cost to serve components and allowed net margins in 2023-24 prices for charging years 2023-24 and 2024-25**

Wholesaler Area	Customer type	Allowed cost to serve (acts)	Allowed meter read cost component (mc)
		Charging year	
		2023-24	
		£	
Affinity water	Water 0-0.5Ml measured or assessed;	£49.98	£9.74
Affinity water	Water unmeasured	£49.98	-
Anglian Water	Water 0-0.5Ml measured or assessed	£49.98	£9.74
Anglian Water	Water unmeasured	£46.55	-
Anglian Water	Water unmeasured (Hartlepool)	£46.02	-
Anglian water	Wastewater 0-0.5Ml measured or assessed	£49.98	-
Anglian Water	Wastewater unmeasured	£47.16	-

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Wholesaler Area	Customer type	Allowed cost to serve (acts)	Allowed meter read cost component (mc)
		Charging year	
		2023-24	£
		£	
Anglian Water	Wastewater 0-0.5Ml measured or assessed (trade effluent)	£108.84	-
Anglian Water	Wastewater unmeasured (trade effluent)	£48.36	-
Bristol Water	Water 0-0.5Ml measured or assessed	£49.98	£9.74
Bristol Water	Water unmeasured	£39.55	-
Northumbrian Water	Water 0-0.5Ml measured or assessed	£49.98	£9.74
Northumbrian Water	Water unmeasured	£49.98	-
Northumbrian Water	Wastewater 0-0.5Ml measured or assessed	£49.98	-
Northumbrian Water	Wastewater unmeasured	£49.98	-
Portsmouth Water	Water 0-0.5Ml measured or assessed	£45.43	£9.74
Portsmouth Water	Water unmeasured	£49.98	-
Severn Trent England	Water 0-0.5Ml measured or assessed;	£49.98	£9.74
Severn Trent England	Water unmeasured	£49.98	-
Severn Trent England	Wastewater 0-0.5Ml measured or assessed; wastewater unmeasured	£49.98	-
South East Water	Water 0-0.5Ml measured or assessed	£49.98	£9.74
South East Water	Water unmeasured	£49.98	-
Southern Water	Water 0-0.5Ml measured or assessed	£49.68	£9.74

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Wholesaler Area	Customer type	Allowed cost to serve (acts)	Allowed meter read cost component (mc)
		Charging year	
		2023-24	
		£	
Southern Water	Water unmeasured	£45.53	-
Southern Water	Wastewater 0-0.5Ml measured or assessed	£49.98	-
Southern Water	Wastewater unmeasured	£49.13	-
South Staffs and Cambridge Water	Water 0-0.5Ml measured or assessed;	£49.98	£9.74
South Staffs and Cambridge Water	Water unmeasured	£49.98	-
South West and Bournemouth Water	Water 0-0.5Ml measured or assessed (South West)	£39.89	£9.74
South West and Bournemouth Water	Water 0-0.5Ml measured or assessed (Bournemouth)	£47.17	£9.74
South West and Bournemouth Water	Water unmeasured (South West)	£46.58	-
South West and Bournemouth Water	Water unmeasured (Bournemouth)	£48.52	-
South West and Bournemouth Water	Wastewater 0-0.5Ml measured or assessed	£49.03	-
South West and	Wastewater unmeasured	£48.56	-

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Wholesaler Area	Customer type	Allowed cost to serve (acts)	Allowed meter read cost component (mc)
		Charging year	
		2023-24	
		£	
Bournemouth Water			
Sutton and East Surrey	Water 0-0.5Ml measured or assessed	£49.98	£9.74
Sutton and East Surrey	Water unmeasured	£49.98	-
Thames Water	Water 0-0.5Ml measured or assessed	£49.21	£9.74
Thames Water	Water unmeasured	£49.98	-
Thames Water	Wastewater 0-0.5Ml measured or assessed	£49.98	-
Thames Water	Wastewater unmeasured	£49.98	-
Thames Water	Wastewater 0-0.5Ml measured or assessed (trade effluent)	£49.98	-
United Utilities	Water 0-0.5Ml measured or assessed;	£49.98	£9.74
United Utilities	Water unmeasured	£49.98	-
United Utilities	Wastewater 0-0.5Ml measured or assessed; water unmeasured	£49.98	-
Wessex Water	Water 0-0.5Ml measured or assessed	£48.71	£9.74
Wessex Water	Water unmeasured	£49.98	-
Wessex Water	Wastewater 0-0.5Ml measured or assessed	£49.98	-
Wessex Water	Wastewater unmeasured	£49.17	-
Wessex Water	Wastewater 0-0.5Ml measured or assessed (trade effluent)	£49.98	-
Yorkshire Water	Water 0-0.5Ml measured or assessed	£49.98	£9.74

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Wholesaler Area	Customer type	Allowed cost to serve (acts)	Allowed meter read cost component (mc)
		Charging year	
		2023-24	
		£	
Yorkshire Water	Water unmeasured	£49.98	-
Yorkshire Water	Wastewater 0-0.5Ml measured or assessed	£49.98	-
Yorkshire Water	Wastewater unmeasured	£49.98	-
Yorkshire Water	Wastewater 0-0.5Ml measured or assessed (trade effluent)	£49.98	-

## 1.3 Revisions to REC Annex A2

We will remove the current Annex A2 of the REC and replace it with the text below.

### A2 Allowed charges for Customer Group Two

#### Maximum charge per customer

In relation to Customer Group Two (customers consuming 0.5Ml to 50Ml per year), the Licensee’s charges to each Customer in each Charging Year in respect of its Business Retail Activities shall not exceed  $C_t$  calculated in accordance with the following formula:

$$C_t = (1 + gm) \times w_t$$

where:

gm = the allowed gross margin based on the service being taken and charging year (expressed as a percentage) and is the higher of:

- the gm for an equivalent usage Customer in FY2019/2020; or
- the gm for the corresponding charging year and service as set out in Table 2.

w = the wholesale charge for the specific customer for the corresponding charging year.

**Table 2 Customer Group Two allowed gross margins**

Service	Allowed gross margin (gm)	
	2023-24	2024-25 and subsequent charging years
Water supplies	8.49%	8.0%
Wastewater services	10.49%	10.0%

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