Ofwat
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8th September 2025

By email - retailexitcode@ofwat.gov.uk

Dear Sir.

2025-26 Review of the Retail Exit Code (REC) Protections. Initial Ofwat Consultation August/September 2025. Response from UKWRC.

1. Introduction

This is a response by the UK Water Retailer Council (UKWRC) to Ofwat's initial consultation on the 2025-26 Review of the Retail Exit Code (REC) protections. Individual members will also make their own submissions, but this response collates areas of common interest or concern to all members.

We are pleased that Ofwat is undertaking a full review of the REC, and we welcome the opportunity to comment. We believe that there are a number of ways in which the REC could be improved to enable the development of competition, along with associated service and efficiency benefits for customers. The REC in its current form is not delivering fair prices for customers and is constraining the development of competition. In our recent dialogue with the competition team at the Independent Commission, we explored the problems with the current REC and some ideas for improving it that we've expanded on and included in our response below.

Members are agreed that in the same way as other utility markets, our aim is a market in which business customers benefit from and are protected by competition. Almost ten years after market opening, it is important that all market players and NHH customers know where we are headed. We believe that a commitment to a competitive market should be reflected in the objectives of the REC Review and that an output of this Review should be the transitional steps that will achieve it. A transition plan will reduce uncertainty and provide both current and prospective retailers and investors with a better understanding of when, and under what conditions price restraints will be relaxed and removed. It will also send an important signal to NHH customers that price regulation is not a permanent feature of the market.

We recognise that Ofwat does not yet believe that the market is ready for the removal of all price protections, and hence we have set out below in Section 3, a proposal for backstop, or safeguard, prices as an interim step.

In 2022, the UKWRC commissioned a report by eminent economist Dr Christopher Decker on how to transition from a tightly regulated sector to a competitive market. This report was shared with Ofwat at the time. The report's findings remain highly relevant to the current Review, and where appropriate, we have referred to Decker's conclusions and recommendations in the response below.

Members have raised a particular concern over bad debt: especially the way in which the market manages customers who do not pay, and the unlimited liability borne by retailers for customers who never pay but for various reasons cannot be disconnected for non-payment. A discussion of the issue and a potential solution are included at section 3.4.

In the remainder of this document, we have set out:

- In section 2, our concerns with the existing REC and the features of a new approach that would be fairer to customers, remove disincentives to engagement and be more conducive to competition;
- In section 3, alternative proposals for backstop or safeguard prices to protect those customers who are not yet engaged in the market, for removing the price protections from mid-larger Group 2 customers, and addressing the problem of customers who never pay;
- In section 4, a proposal for amending the 'no worse off' principle;
- In section 5, our response to Ofwat's suggestion of amending the REC to better align with the industry's water efficiency objectives; and
- In section 6, our summary and conclusions.

2. The Existing Retail Exit Code (REC)

We believe that this Review is an opportunity to consider how to address the problems with the current REC that have continued to hinder the development of the competitive market. As we discussed with the Independent Commission team:

- the current price controls are based on a conventional regulatory model originally designed to drive cost efficiencies within monopoly service providers, not to support the transition to competition;
- the price caps do not allow for fair, cost-reflective charges. The caps apply as a maximum permitted charge, yet the level of the caps is set by reference to average costs – averaged across retailers, across regions, across years and across customers within each Group. Hence, by definition, there is a substantial proportion of each customer Group whose total cost to serve (CTS) is higher than the average and hence higher than the cap. This means that:
    - these customers are being unfairly subsidised by more efficient customers with lower CTS/bad debt etc.;
    - they have no incentive to engage in the market (as they are paying less than they cost to service);
    - retailers have no incentive to engage with them (for the same reason);
    - but the cap doesn't provide an appropriate price signal to encourage positive behaviour changes or greater efficiency.

If retailers chose to price like this, it would be in breach of competition law.

- non-price restraints in the REC and in the Exit Regulations are backward looking, using as a service benchmark the monopoly provision of the wholesalers pre-market opening to impose billing and payment constraints which conceptually encourage sameness and discourage change;
- there is insufficient commercial headroom under the caps to encourage significant new entry, or for retailers to take risks or try new things. This stifles innovation and does not support the delivery of water efficiency services by retailers to their customers; and
- the REC was designed as a transitionary instrument to protect customers transferring from the exiting wholesalers. It was not designed as an enduring price control mechanism and hence doesn't include the appropriate checks and balances, including a route of appeal in the event of a dispute.

We believe that this is an opportunity to amend the REC, so that it provides customer protection where necessary, but is more conducive to competition. If Ofwat determines that an interim price protection is required, members agree that the key features we would like to see are as follows:

- *Allows fairer, cost reflective pricing*, i.e. moves away from the use of 'efficient' average costs as a means of setting maximum retail price caps, to an approach that allows all customers the opportunity to participate in the market, regardless of their service choices; removes cross-subsidies and so is fairer to all customers; and which provides the opportunity for retailers to incentivise customers to be more efficient – both in terms of their water use, and their billing and payment behaviours. Cost reflective pricing is also more closely aligned to the resilience objective.
- *Makes the market more attractive to new entrants and allows existing players to be more innovative, efficient and responsive to customer needs* – e.g. removes historic billing and payment method benchmarks, and facilitates tariff innovation and the provision of water efficiency support to customers; and
- *More flexible* – so it can adapt to changes in economic conditions and underlying costs, as prices do in competitive markets, and gives retailers a route of appeal to the CMA in the same way as other utility sectors, in the event of a dispute.

3. A New Approach to Price Protections

3.1 The Need for Protection

Ultimately, we want to achieve a position where everyone is confident that competition provides protection for all customers. Business customers in other utility sectors are not considered to require price protections, so it's not clear why the same customers need protections when it comes to their water services. We would like to understand Ofwat's rationale in this respect.
Ofwat's primary concern appears to be that customers who have not yet engaged in the market would be at risk of exploitation by retailers if price restrictions were relaxed or removed. This raises questions over:

- whether retailers are really in a position to exploit customers; and
- whether and why customers have not yet engaged in the market.

On this latter point, the consultation seems to suggest that the smallest customers are not and may never be engaged in the market because their bills are too low. However, we don't believe that consumption level, or even bill value per se is the problem. For example:

- as the largest new entrant (with ~7% of the market), more than 50% of Everflow's customers consume less than 0.1Ml. This demonstrates that it is possible to engage even the smallest customers, and indicates that 'small' does not necessarily equate to unengaged and in need of protection; and
- small businesses buy other services for which their annual bills are also relatively low but where there is no price regulation – banking or broadband services for example – yet businesses do engage, especially on service quality. Consequently, we don't believe that customers' failure to engage is down to bill value either.

The Decker report highlighted that customers will not invest the time to engage in the market if they are tightly protected by a price control – they don't need to. We believe that this is the case in the water market. In practice, under the existing REC, the customers least likely to engage will be those whose cost to serve is above the 'average' price cap. This applies primarily to existing Group 1 customers and those at the bottom end of Group 2. However, it must be recognised that this disinclination to engage with the market is at least partly because of the structure of the price cap. If the cap was fairer, and more cost reflective, and customers paid what they cost to serve, it would also encourage these customers to engage with the market, and retailers to engage with the customers. This in turn would remove the need to protect them.

Whilst we recognise that there is a sizable proportion of customers who have not yet engaged with the market, this is more to do with the structure of the price control than low consumption or low bills. Going forward, the most important thing will be to ensure that the design of any new price control does not in itself create a need for protection, in the same way as the current caps.

Hence at this stage we think it is more important to ensure that the design and level of the protection are right for those customers who are disengaged by the current approach, than to try and identify the need for protection by reference to a customer's consumption or bill value.

Nevertheless, we are aware that there are anomalies within the current banding approach, and customers with very large value bills may be caught within a lower Group because of their relatively low consumption or because their consumption is not measured. A good example is a car park in an area where surface water drainage charges are applied on the basis of site area, and whose bill would far exceed the level considered representative of a 'small' customer. Whilst we do not view these outliers as sufficient justification to fundamentally change the approach to assessing customer banding, we propose that a wholesale charge threshold could be used in addition to consumption, to determine which Group a premises falls into. For example, if a site was unmeasured but their wholesale bill was above a threshold of say £5,000, then the Group 2 rather than Group 1 protection could be applied.

3.2 Approach to Price Protections for Unengaged Customers

Against this backdrop, we have set out below the principles of an approach that we consider would provide protection, encourage customers to engage in the market, and help transition us towards a more competitive, flourishing market.

(i) Fairness and Cost reflectivity

It is important that retailers are able to charge cost-reflectively, to reduce cross-subsidies within customer groups, and to replicate the way pricing works in a competitive market, where suppliers' charges will tend towards the efficient cost of service provision, and will differentiate between similar customers making different service choices. As a simple example, in the air transport industry, airlines tend to charge a basic price for a seat on a plane, but if customers want to travel with a suitcase or extra baggage in the hold, they pay an extra charge to cover the costs of baggage handling. Customers also have the option to pay for enhanced services – priority boarding, more comfortable seating, refreshments etc. Customers pay for what they use.

The same principle should apply in the water market, so that retailers are able to charge their customers different prices for different service choices. If a customer chooses to pay by cash in arrears, receive a paper bill and speak to an adviser when they have a query, the costs incurred are considerably higher than a customer who pays by monthly direct debit and receives electronic bills.

To illustrate the extent of the cost differences, in the domestic energy sector Ofgem explicitly recognises that average caps are not consistent with a competitive market and that prices need to be able to reflect the different costs of customers' service choices. Hence the energy caps reflect the fact that customers who pay by cash in arrears incur additional working capital costs, have an increased propensity for bad debt, and higher administrative costs, compared with a customer who pays by direct debit. On an energy bill of ~£1,900 per annum, which is the equivalent to a water and waste consumption of 0.3-0.4Ml, this cost difference is approximately £120. There is little reason to think that the working capital, bad debt and admin costs incurred would be any different for a water retailer than an energy supplier. When the total (average) retail margin at this level is ~£190, (combined water and waste) if the cost differential is £120, it brings into focus just how far above and below the average some customers' CTS will be, and why it is important that we are able to charge them more fairly and cost-reflectively.

As an interim protection for unengaged customers, we would propose a safeguard or backstop price cap that allows retailers the scope to price cost-reflectively beneath it, which is calibrated to provide adequate headroom for competition and innovation, and to provide customers with the incentive to actively engage in the market.

This approach was suggested by the Decker report in 2022 on the basis that it has been successfully used by other UK regulators in energy, transport and telecommunications when transitioning to competition. As Decker highlighted, safeguard caps do not correspond to an estimate of efficiently incurred costs, but are set more loosely to guard against the possibility of excessive pricing or major customer detriment.

It is important to emphasise that a backstop price does not require retailers to price at this level. It is a genuine cap on the prices they can charge, but gives them scope to establish different price points for different customer groups below this level, or indeed for different service levels. Prices would continue to be published and hence transparent, so that customers could make comparisons and informed choices.

Stimulating customer engagement and additional protections.

In parallel, the market could look at other ways of stimulating customer engagement – both to address Ofwat's concerns about customer inertia, and to offer added protection for 'efficient' customers below the backstop price. Examples from other sectors that could be explored include additional information provision, trigger messaging and pricing simplicity and transparency.

What could a back stop cap look like?

We agree with Ofwat that the current structure of the Group 1 control continues to be most appropriate.

Whilst it would make sense that we only have a single approach for all price protections, it is difficult to see how a gross margin (GM) could work for small customers in practice, because it would still have to cover the fixed costs of taking meter reads, sending bills etc.. Consequently, for low consumption customers, the percentage uplift would have to be very large[1].

An entirely fixed margin would not be appropriate either as it wouldn't reflect one of a retailer's biggest risks – customer working capital and debt - which is driven by the size of the bill.

The fixed plus variable structure of the existing Group 1 price cap more closely reflects the type of costs that retailers incur and has the greatest potential to allow more cost reflective charging for different customer types. Providing each element is set at a level which allows for cost-reflective charging, this structure could be used to set a safeguard price cap for customers who are currently in Group 1.

How would it be derived?

We reiterate the point made by Decker that backstop prices should not be set by reference to an estimate of efficiently incurred retailer costs. Instead, it needs to be set to accommodate the cost to service the least efficient customers and those selecting the most expensive service options – this would include choices around payment method and frequency, billing methods and contact options. Hence we believe that the RFI needs to derive a greater understanding of the upper bounds of the costs incurred by retailers in relation to these payment, billing and contact options, rather than focus on establishing the average cost to serve an entire customer group.

(ii) Flexibility

In a competitive market, customer prices would move with changes in the suppliers' underlying costs. If significant costs change, in the way higher interest rates caused the cost of debt to increase substantially following the last REC review, the backstop price cap needs to be able to adapt. This was recognised by the Independent Commission – albeit in relation to the wholesale price controls.

There are several areas of cost that remain uncertain going forward, including the costs associated with smart meter roll out and operation. It seems inevitable that the pace and scale of smart meter

[1] To illustrate, at 0.05Ml, even the current retail margin represents more than 30% gross margin.

roll out will vary across the wholesale regions, and we will have a patchwork of dumb and smart meters for the foreseeable future. At this stage, it is difficult to know what this will mean for retailer costs, as many factors remain to be resolved. Particular concerns include:

- regional variation in smart meter penetration, meaning very different mixes of smart/dumb meters in different regions;
- uncertainties around the charging regime for smart meter reads;
- the likelihood that the cost of reading dumb meters could increase considerably as the economies of scale reduce;
- the extent of new retailer costs associated with the installation of smart meters – in terms of customer communications; dealing with issues arising etc.;
- new retailer costs associated with the issues that will arise as a result of smart metering, such as continuous flow alerts, leak alerts etc.; and
- new retailer costs arising as a result of increases in MOSL costs for setting up and running the smart metering data hub.

As we move into a new 'smart' era, there will inevitably be other, as yet unforeseen costs, that also emerge and which would require to be reflected in the safeguard price cap as they arise.

How we deal with metering costs will need proper consideration in the Review, and it will be important to recognise that historic costs will not necessarily be an indication of future costs. A mechanism for dealing with uncertainty could be built into the backstop price cap, or the subject of more regular reviews.

(iii) Appeal mechanism:

The Final Report of the Independent Water Commission identified as a gap in the market the lack of a suitable appeals mechanism for retailers if they dispute a price control decision, and in recommendation 61, called for retailers to be given the same right of appeal to the CMA as wholesalers and other utility providers.

We believe that a statutory right of appeal to the CMA for retailers is essential ahead of the conclusion of this REC Review. We recognise that this requires action by the Government, but would ask that Ofwat raise the matter with Defra.

3.3 Approach to Price Protections for Larger Customers – existing Groups 2 & 3

Group 3

We agree that customers in Group 3 are adequately protected by the current provisions. This Group is largely engaged and benefiting from the competitive market. It may be that this is partly because of the absence of tightly regulated price protections.

Group 2

There are several problems with the Group 2 control that Ofwat has not specifically identified in the consultation paper:

(i) The difference in approach to the controls for Groups 1 and 2 means that there is a step-change in cost for customers at the boundary between Groups 1 and 2. Perversely, in most regions, the retail margin for customers at the bottom end of Group 2 is lower than a customer at the top end of Group 1, despite their usage being higher; and

(ii) As we have highlighted in the past, the existing Group 2 covers a hugely diverse range of customer types and size. A customer at the bottom of the Group for example, has a combined water and waste bill of around £2,800, but a customer at the top-end has a bill of closer to £180,000. These customers have very different cost to serve profiles (meter reading and billing frequency, propensity to pay, customer service routes etc.). The 'average' margin approach means that:

- at the bottom end of the group, the margin is very tight and customers are effectively being cross subsidised by the larger customers, which (in the same way as the current Group 1 control) is constraining competition amongst the smaller (majority) of customers; and
- at the top end of the group, the cap provides more headroom and is much more like a backstop. There has been much more switching and activity amongst these customers.

These factors combined mean that in the same way as for Group 1, an average 'one-size-fits-all' approach for a large and diverse Group 2 leads to considerable cross-subsidy between customers within the Group – both on the basis of size (large to small), and of cost to serve (low to high). This is not fair to customers, it's not cost reflective for retailers, and it doesn't encourage efficient behaviours. It also means that for those customers whose cost to serve is higher than the allowance, they have no motivation to engage in the market. Conversely, at the top end of the Group, where the cap acts more as a backstop, there has been more engagement and switching.

We would like to see these issues addressed so that retailers are able to charge all customers fairly and cost-reflectively, and to reduce the disincentives to engage in the market.

How do we do this?

a) Reduce the size and diversity of the group:

We recognise that in the same way as for Group 1, the average nature of the control means that there will be customers who are currently unable or unlikely to engage. These are the ones for whom an interim protection may be required, and are likely to be at the bottom end of the Group.

On the other hand, we believe that a significant proportion of customers in this existing Group would be adequately protected by the Group 3 protections, based on evidence of the levels of engagement.

- Members have pointed out that at least 50% of customers above 5Ml have already switched retailer – a similar proportion to Group 3 – and this doesn't count those who have renegotiated with their existing retailer, or who have switched away and then back to their original retailer. This would suggest that as a minimum the upper Group 2 threshold could be reduced to 5Ml, which would remove the cap for 22k SPIDs (out of ~230k SPIDs currently in Group 2), but would still mean more than 98% of SPIDs in the market were subject to a price control;

- We believe there is a strong case for reducing the threshold to 1Ml. Switching amongst mid-level customers in the range 1-5Ml are not far behind the over 5Ml group, at 42% overall, and up to 55% in some regions. In addition, the level of the bill for mid-size Group 2 customers, especially since the wholesale price increases from April this year, will be sufficiently significant for them to be open to engagement:
    - at 2Ml, a customer's bill is over £8,000. If the Group 2/3 threshold was moved down to this level, the cap would be removed from ~67k SPIDs; and
    - at 1Ml, the customer's bill is almost £5,000 and would move 132k SPIDs into Group 3. This is still less than 10% of the SPIDs in the market. The bulk of Group 2 customers are below 1ML.

We propose that as a minimum the Group 2/3 threshold is reduced to 5Ml, and that consideration is given to reducing it to 1Ml, so that the price controls are removed from a proportion of mid-large Group 2 customers.

For the remaining customers in this group, we believe that a backstop price designed to safeguard those who are unengaged would be fair to customers and conducive to competition, removing cross-subsidies and increasing the scope for new entry and innovation.

b) Ensure the protection is a true 'backstop', recognising the cost to serve of the revised group members.

Members believe that a single price control structure (i.e. no distinction between Groups1 and 2) would be simplest. However, as indicated above there are significant drawbacks to both the gross margin and fixed allowance approaches when applied to lowest consumption consumers currently in Group 1, which would make cost-reflective charging more difficult.

If the Group 2 upper threshold was brought down to 1Ml, it may be possible to have a generic backstop price based on the current Group 1 methodology (ACTS + metering + net margin + bad debt allowance). However, above this consumption level, we don't believe it would work because the differences in the ACTS starts to vary considerably for customers with multiple meters, monthly billing and account management for example. This would make it difficult to identify a fair backstop, without having to resort to averaging costs, which in turn undermines the ability to charge customers cost-reflectively.

Consequently, if the threshold remains above 1Ml, we would be content in principle with the continued use of a gross margin (GM) backstop for a revised 'Group 2', but we need to ensure that it is set at an appropriate level to reflect the costs of the revised customer group. It still needs to be a true backstop, allowing sufficient headroom for competition and innovation beneath it, as discussed at section 3.2(i) above. As the upper threshold moves down, the percentage uplift required to cover the CTS of remaining customers is likely to increase.
One step towards simplification would be to remove the distinction between the water and waste uplifts, and move to a common backstop for all services.

c) Remove the 'step change' between different customer groups.

We also need to ensure that if we continue to have two different price control approaches for Group1 and a new 'Group 2', there are no unintended consequences (e.g. a step change in cost as now) at the boundary.

One option we considered to smooth the transition, was for the percentage gross margin for Group 2 to be set at a level equivalent to the backstop price at the top of Group 1. However, the difference in wholesale costs between regions would make it difficult to do this on a uniform basis, so we would like to revisit this issue once we have a clearer view of the likely structure of controls for each group.

3.4 Customer Bad Debt

Customers' payment behaviour is one of the most significant cost drivers for retailers and a cost that has been underestimated in the current REC allowances. We would like to ensure that during this Review, the magnitude of the costs incurred by retailers for specific customers groups, with higher propensity to pay late or to leave without paying is understood and adequately reflected in the backstop prices, so that retailers are able to charge customers appropriately.

However, there is also a group of customers who never pay and cannot be disconnected, for whom more cost reflective charging is not the answer. Where a retailer has exhausted all available avenues to recover a debt, and has resorted to disconnection, there will still be a range of circumstances in which the wholesaler is unable/unwilling to do so because of network configuration – shared supplies, drainage only customers etc. In these situations, retailers remain liable for wholesale charges under the Wholesale Retail Code, but are unable to recover the cost from the customer. Whilst this is not a new position – prior to market opening, wholesalers were able to manage the cost and risk through their revenue control, by spreading it proportionately over all other customers – as we move towards a competitive market, this is not possible for retailers and becomes an unlimited liability that we have no means of managing.

As the number of customers covered by the price protections reduces, and there are less customers from whom retailers can recover bad debt, we believe that this particular category of customer bad debt needs a solution separate from the REC. It is proposed that where a retailer has requested a disconnection for non-payment and the wholesaler is unable or unwilling to complete it, the retailer should no longer be liable for the wholesale charges associated with this site. This would effectively remove the risk imposed on retailers by restrictive metering and network infrastructure over which they have no control, and transfer it to the wholesaler responsible for the infrastructure, who does have the control. If the wholesaler is unable to physically prevent continued illegal consumption at the site, we understand that the bad debt cost could be recovered through their revenue correction factors. This ensures that the cost is recovered more evenly from all other customers than could be achieved through the REC.

We believe that this solution would require a Code Change, and a member is currently preparing the relevant case and evidence.

4. Non-Price Protections

Ofwat proposes to retain the non-price protections in their current form, including the 'no worse off' principle.

Our primary concern with this proposal is the ongoing use of a backward-looking benchmark. The 'no worse off' condition was introduced into the REC in 2020 following the 2019 review – still within 3 years of market opening and so perhaps not unreasonable to use pre-market opening as a benchmark. However, Ofwat is proposing that the new protections will come into force from April 2027, ten years after market opening. As a matter of principle, it cannot be appropriate that retailers should be bound to a set of conditions so far back in time, which pre-dates many improvements in customer service good practice. In practice, it also seems highly unlikely that anyone will have records of each customer's T&Cs 'immediately before the Exit Date' against which to benchmark.

Secondly, by definition, customers are paying more now than they did before market opening, so it is difficult to see how retailers could ever demonstrate that customers are not 'financially' worse off than before the Exit Date.

We are not opposed per se to a 'no worse off' principle, but we believe that:

(i) *the benchmark should not be pre-market opening, but current T&Cs, i.e. an involuntary change to T&Cs should not make a customer worse off than under their existing T&Cs;*

(ii) *changes approved or mandated by Ofwat should be excluded (e.g. price increases); and*

(iii) *non-price restrictions should be removed from the REC and consolidated within the Customer Protection Code of Practice.*

The Exit Regulations would also need to be amended to remove reference to the Exit Date.

5. Water Efficiency

Ofwat is seeking views on whether changes to the REC structure could improve the balance between protecting unengaged customers and the industry objective to promote WE, and considers replacing the (volume related) bad debt and net margin allowances in the Group 1 control, with entirely fixed cost bands, so as to reduce the disincentive on retailers to sell WE services (as highlighted in the Call for Evidence issued by the Independent Water Commission).

As we explained to the Independent Commission's competition team on this same point, the inclusion in the price control of a variable element linked to a customer's consumption does not work as a disincentive to water efficiency particularly. If a customer is seeking water efficiency support, and their retailer does not provide it, the customer will look elsewhere. The commercial impact of losing a customer is far more significant to a retailer than a reduction in their volume.

This is not the problem. The key reasons why there are low levels of WE activity in the NHH market are:

- there is very little awareness of the problem or incentive on customers to reduce their water consumption. Most recently, there is plenty of emerging evidence in the currently drought-constrained wholesaler regions, that even the offer of free services or tariff discounts is insufficient to motivate customers to take action.

- funding for support: the allowance in the REC contributes to retailers' promotion of water efficiency, but it is insufficient for us to provide active support to customers, even if they want it. The AMP8 obligation on wholesalers to reduce NHH consumption "in collaboration" with retailers has not yet led to any meaningful support or sharing of funding, for anything other than the services that wholesalers want to offer to a pre-defined band of customers (rather than the services that customers might want). Consequently, there is no funding available to retailers to support their customers if neither the customer nor the wholesalers are able/willing to fund it, and we cannot compete with the free services offered by the wholesalers.

Consequently, replacing the variable element of the Group 1 allowances with a series of entirely fixed bands would not solve the problem. Instead, it would create unnecessary complexity for customers as well as weaking the incentive on them to reduce their consumption. It would create greater risk for retailers (who will be unable to manage the risk of bad debt and working capital) and create more 'averaging' and cross subsidy that will make it even more difficult and less likely for higher cost customers to engage in the market (as discussed in section 3 above). Ofwat has highlighted the downsides of this proposal and we agree with their analysis.

6. Conclusions and Summary

UKWRC members are committed to working towards a competitive market, enabling greater benefits for customers, and in which price protections for NHH customers are no longer required in the same way as other in utility markets. We would like to work with Ofwat to establish a clear transition plan to this end.

We believe that there are important improvements to be made to the existing REC that would make it fairer for customers and which would remove the current disincentives to engage in the market. We would like to see changes that make it more conducive to competition, fully-cost-reflective and flexible, that will support innovation and new entry.

In summary, our key points are:

- The need for protections.
  - the current price protections disincentivise engagement in the market for customers whose cost to serve is above average. We need to ensure that new price protections do not perpetuate this situation.

- Form of price protection. We have proposed:
  - the removal of price caps from mid-large customers in the existing Group 2 – this could potentially reduce the upper Group 2 threshold to 1 Ml;
  - backstop or safeguard prices for those who are not yet engaged with the market (most likely to be customers whose CTS is above the average caps in existing Group 1 and at the bottom of existing Group 2), and which are calibrated to remove both supply-side and demand side disincentives to engage, to unwind existing cross-subsidies, be fairer to all customers, and allow competition and innovation to flourish;
  - that price protections are flexible, and respond to changes in retailers' underlying costs, including the uncertainty of costs arising from the roll out of smart meters;

- an appeals mechanism, giving retailers the right of appeal to the CMA in the same way as other utility service providers; and
- the introduction of a separate mechanism to manage customers who never pay and cannot be disconnected.

- Non-price constraints. We have suggested that:
    - existing T&Cs are used as the benchmark for the 'no worse off' principle, not pre-market opening T&Cs; and
    - all non-price protections are brought together in one place, under the Customer Protection Code of Practice, rather than the REC.

- Water efficiency:
    - moving to a fixed allowance will not improve water efficiency in the NHH market. It would only exacerbate the degree of cross-subsidy within the price protections, and weaken the signal for customers to reduce their demand.

I hope you find our response helpful. We would be grateful for the opportunity to meet with Ofwat to discuss these points in more detail. I look forward to hearing from you in due course.

Yours faithfully.

Phillip Mills
Chair
UK Water Retailer Council