

---

Centre City Tower, 7 Hill Street, Birmingham B5 4UA  
21 Bloomsbury Street, London WC1B 3HF

By email

28 May 2019

Dear Chief Executives<sup>1</sup>

### **Incumbent water companies and the development of effective markets**

Ofwat has for some time promoted the targeted use of markets where these can deliver additional benefits for customers and society. Well-functioning markets can deliver better outcomes for both current and future customers in the form of: lower prices; better quality services; and/or improved choice. They can bring new approaches, which help the industry respond to and meet its strategic challenges - such as a growing population, changing climate, affordability and changing customer expectations - in an efficient way. As set out in our draft strategy<sup>2</sup>, we propose to retain and evolve our use of markets – working closely with relevant stakeholders to make them work better for customers and society.

We see numerous, persistent examples of incumbent water companies failing to support the development of effective markets – in particular the markets for business retail and developer services. This letter sets out the areas of improvement we expect to see by the autumn, at which point we will consider what further steps we need to take.

**The overall level of incumbent water company support for markets is unacceptable. We expect to see a significant improvement over the coming months.**

In some cases incumbent water companies are giving insufficient thought to the potential impact that their actions (or inaction) can have on the effective functioning of markets for customers. In other cases we see companies' actively opposing or delaying initiatives that are aimed at improving these markets.

To be clear there are some examples of incumbent water companies taking positive and pragmatic action to support the development of markets. For example, incumbent water companies are working with retailers in the business retail market to develop guidance on important issues such as [Leak Allowance](#)<sup>3</sup> and some

---

<sup>1</sup> Of incumbent water companies operating wholly or mainly in England.

<sup>2</sup> <https://www.ofwat.gov.uk/vision-waterstories/ofwats-strategy/>

<sup>3</sup> Leak allowance is where an incumbent water company does not charge a customer for water lost due to leakage from a pipe that is the customer's responsibility.

incumbents' have supported the growth of alternative developer services in their areas.

Retailers also have a role to play in developing an effective business retail market and there are instances where retailers need to take further action. However, incumbent monopoly water companies have a special responsibility that includes supporting the development of effective markets to benefit customers.

Ofwat is taking action on a number of fronts to reiterate our expectations of the role that incumbent water companies have in supporting the development of effective markets. Further detail is provided in Annex 1.

**We will be monitoring incumbent water companies over the next few months and will review progress in the autumn, including whether particular companies are holding up progress overall.**

To aid our review we require incumbent water companies to respond to this letter by end October 2019 setting out progress. Examples of the types of areas that we will be looking at include the following, with further detail provided in Annex 2:

1. Effective engagement in and support for initiatives aimed at driving improvements to the business retail market;
2. Supporting a vibrant competitive market for developer services; and
3. Effective support for the development of new markets.

We acknowledge that real progress will require collaboration and all relevant stakeholders playing their part.

**If we do not see a significant improvement by the autumn we will increase the pace and extent of pressure we exert on incumbent water companies, considering the full range of regulatory tools we have at our disposal.** This includes our Competition Act and sectoral enforcement powers where appropriate.

For example in the business retail market we could propose changes to the governance process for code modifications if we think the current process is being hampered by companies prioritising vested interests over the effective functioning of the market. There are also formal and informal steps we could take to highlight and reward (penalise) good (poor) performance publicly.

**We are committed to using our powers and influence to drive better outcomes for customers through the markets we have in the sector.**

However, the best outcomes for customers and society will be achieved by the sector working collaboratively to develop solutions. The sector - including incumbent water companies, retailers, third parties and customers, including their representatives - has more detailed knowledge, insight and resource available to it

than we do as the regulator. However if it becomes clear the sector cannot or will not deliver improvements to these markets, then we will need to take further steps.

Where incumbent water companies are already taking positive steps, we would like to take this opportunity to thank you. Please continue your efforts, including by sharing best practice with your peers and with us.

Thank you all in advance for giving this matter your attention and support. We look forward to working with you and the rest of sector in making markets work better for customers and society.

Yours sincerely

A handwritten signature in black ink, reading "Rachel Fletcher", enclosed in a rectangular box with a dotted border.

**Rachel Fletcher**  
**Chief Executive**

## **ANNEX 1: Recent Ofwat initiatives to clarify our expectations of the role that incumbent water companies have in the development of markets**

- We recently published an [open letter to Regulatory Directors](#) about a number of areas in which we see evidence of companies not sufficiently considering the potential effects of their charging arrangements for new connections on the ability for self-lay providers to effectively compete in this market.
- Following the [market study](#) we have taken actions to reduce barriers to NAVs to compete more effectively. We have set out those actions in our consultation on [Revisions to NAV Policy Guidelines](#). We have challenged incumbent water companies to develop a Code of Practice for bulk supply/discharge agreements. We also issued new [bulk supply charging guidance](#) in May 2018, which sets out our approach in making determinations if water companies fail to agree on the terms of their bulk supply agreements.
- Our review of the draft water sector documents companies have developed with customers for our [Code for Adoption Agreement](#) found they did not sufficiently comply with some of the Code's requirements to support a level playing field, resulting in us asking companies to undertake further work and customer engagement to close this gap.
- Our letters in relation to [credit](#) and [metering](#) services in the business retail market highlighted the importance of companies making sure that they are sticking to their CA98 obligations, and highlighted the fact that where we have concerns, we raise those proactively with individual companies.
- Last summer we published [our assessment](#) of the first year of the business retail market. We noted the market was delivering some improved customer outcomes but there were a number of market frictions, some caused by poor incumbent water company performance, which the sector needs to address. Late last year we [wrote](#) to all Trading Parties in the business retail market to emphasise the importance of the Industry Panel and the need for members of this panel to act impartially in the best interests of the market as a whole. We also published a [call for inputs](#) on strengthening wholesale performance in the business retail market and will shortly publish next steps on this.
- We will continue to use the full range of our enforcement tools, both informal and formal, in instances where we have any concerns about whether companies are complying with their legal obligations. This includes their licence obligations, competition law and codes they are subject to. This can apply to company behaviours towards both upstream and downstream markets and services.

## **ANNEX 2: Further detail on the types of areas we will review in the autumn**

### **1. Effective engagement in and support for initiatives aimed at driving improvements to the business retail market**

We support MOSL's targeted approach to driving improvements in key aspects of the business retail market over the coming year and expect companies to fully support MOSL in achieving this. We expect to see incumbent water companies working constructively to:

- Improve the way wholesalers and retailers interact. This includes (but is not limited to): introducing a bilaterals solution<sup>4</sup>; and taking practical steps to resolve retailer or customer complaints where the issue or solution is at least partly the responsibility of the wholesaler;
- Make improvements to the market performance framework (MPF), including by supporting work to develop and implement a common measure of retailer satisfaction;
- Work constructively to address specific areas of underperformance where Initial Performance Rectification Plans (IPRPs) have been implemented;
- Work effectively with retailers and other stakeholders to improve the quality of data included in the central operating system, in particular meter reads; and
- As members of the Industry Panel or other relevant industry groups, demonstrate behaviours that are consistent with the development of an effective market, rather than the promotion of individual interests.

### **2. Supporting a vibrant competitive market for developer services**

We see large unexplained differences in the extent of competition for developer services in different companies' areas. As set out in our recent [letter](#), it is imperative that all companies take action to ensure that their practices are consistent with their competition law and other regulatory obligations. Companies should be taking appropriate steps to ensure that charges are cost reflective and transparent and that alternative providers can compete on a level playing field. Through the introduction of D-MeX in PR19 we are incentivising companies to provide high quality experience of developer services, and we are clear that we expect excellence in service to competing service providers as well as end customers. As part of this, we expect companies to effectively consult on their services and charging arrangements, so that potential issues are addressed before changes come into effect.

We also expect to see effective customer engagement to finalise and implement the sector documents required by our [Code for Adoption Agreements](#). We expect to see

---

<sup>4</sup> A bilateral solution involves the standardisation of transactions between wholesalers and retailers that are excluded from the central operating system, and is likely to be supported by a technology platform.

companies engaging effectively and openly with their customers to address the outstanding issues found by [our review of the draft water document](#). Likewise we will expect similar if our current review of the sewerage documents identifies any issues of compliance with the Code's requirements. We are encouraged that the sector has commenced steps to form the enduring code panel that will be responsible for considering future amendments to the sector documents. Ensuring this is done well and that the panel has a clear and appropriate future work programme will be critical for continuing to build trust and confidence in the processes and working relationships needed to support adoption agreements and to further enable consistency in companies' requirements.

### **3. Effective support for the development of new markets**

Our initial assessment of company business plans indicated that incumbent water companies have made some progress towards using and facilitating wholesale markets (for water resources and bioresources), although the rate of progress is mixed. Similarly the quality of the bid assessment frameworks for water resources developed by incumbent water companies are mixed. We want to see a step-change in progress across the sector, including by the adoption of best practice where this emerges, and we expect companies to exhibit positive market behaviours.