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By Email

28 May 2019

Dear Chief Executives¹

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 strategy², 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.

¹ Of incumbent water companies operating wholly or mainly in England.

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

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](#)³ and some 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

³ 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.

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 publically.

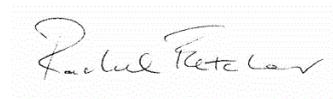
We are committed to using our powers and influence to drive better outcomes for customers through the markets we have in the sector.

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, appearing to read "Rachel Fletcher", is placed over a light grey dotted grid background.

Rachel Fletcher

Ofwat Chief Executive