



Emma Kelso
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30th October 2019

Dear Emma

Incumbent Water Companies – support for the development of effective markets

I write in response to your letter to wholesalers of 16th September in which you set out specific questions for wholesalers' in relation to their support for the NHH Market, and invited feedback from other stakeholders.

We were very encouraged to see that the areas of concern that you highlighted cover many of the issues that we believe need to be addressed if the NHH market is to work effectively. We look forward to seeing the responses from wholesalers in due course. We're aware that there has been some progress during the summer as a result of Rachel Fletcher's letter in May, and would hope that the wholesalers' responses provide useful insight into good practices that can be rolled out across the market.

However, we believe that progress has been patchy (with varying levels of commitment) and has tended to be focused on 'easy wins' (giving retailers access to existing meter data, RWG good practice guidance on leakage, return to sewer allowances etc.). There has been little progress on the more fundamental issues that will make a material difference to the customer experience and to the efficiency of the market, such as the complexity of wholesale pricing, the improvement of legacy data, or vacant charging policies. We believe these issues need to be addressed on a consistent and coordinated basis across the whole market, otherwise, we will continue to see piecemeal development and further fragmentation of the market. It is not in the interests of customers nor is it conducive to effective competition if some regions are more/less attractive in which to operate than others.

It is not our intention to comment on each of the questions in your letter, or to pre-empt the response of wholesalers, but in the context of creating a less complex and costly market it is worth highlighting that in relation to questions 14 and 15, from a retailer and customer perspective, it is at least as important that wholesaler policies and charges are harmonised across the market, as it is that individual wholesalers make their own policies and charges as clear and simple as possible.

Next Steps

We are very keen to work with other retailers, wholesalers and Ofwat to develop an effective way forward and believe it would be useful to establish a specific objective of reducing the complexity (and hence cost) of market participation in pursuit of greater market efficiency and effectiveness.

We recognise Ofwat's ambition that retailers and wholesalers should cooperate to tackle market inefficiencies. This is a reasonable expectation for the resolution of Market Code related problems and although some of them may need to be strengthened, there are governance processes in place to facilitate changes to the market rules. However, there are no market mechanisms to tackle some



of the more fundamental issues such as wholesale pricing, legacy data improvements, policy alignment etc. These are not within the scope of the Market Code framework or the remit of MOSL. In these cases, wholesalers have no incentive to change, or to respond to retailer requests or suggestions, nor are individual wholesalers in a position to ensure a uniform approach to change across the whole industry. In these cases, it may need specific direction or intervention from Ofwat to drive the necessary change in a consistent way. In Rachel Fletcher's letter, she indicated that *"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"*. We would urge that Ofwat does use its influence to bring wholesalers to the table, so we can explore collectively how to make the more strategic and policy changes the market needs. The key areas where we believe greater pressure from Ofwat would help considerably are:

- (i) wholesale charging structures: we recognise that full harmonisation of tariff structures across the whole market is not achievable in one step, but the wholesale price reductions expected from April 2020 provide a unique opportunity to manage the potential incidence effects of moving at least some way towards more harmonised structures;
- (ii) wholesaler policies: the RWG is a useful forum for wholesaler/retailer collaboration around good practice, but has no legitimacy to enforce change across the industry. There has been some excellent work done, but we need to find a way of prioritising the consideration of areas of greatest benefit to the market and to agree and enforce industry-wide implementation;
- (iii) quality of market data: we firmly support the ongoing work led by MOSL to improve items of market data, but we believe that a more holistic strategy is required for addressing the extensive data quality issues remaining – particularly legacy data. This strategy needs to identify actions, but also funding by wholesalers for the correction of data items loaded into CMOS at market opening; and
- (iv) Vacant charging and vacant site incentives: we are very concerned about the ad-hoc and piecemeal development of bespoke vacant incentives in PR19, the uncertainty about how they will flow through to retailers and the prospect that some wholesalers may introduce or extend charges for vacant properties from April 2020. We believe that there needs to be a halt put on vacant charges/incentives to allow time for the industry to develop a common solution.

We believe that a constructive way forward would be to establish a forum of wholesalers and retailers, facilitated by Ofwat, to tackle these policy issues (as opposed to Market Code issues). The speed of change is vital. The current cost of market participation compared to the retail cost allowances is not sustainable, so it is important that we continue to build on the momentum created by your letters to wholesalers, to tackle the issues that are undermining the effectiveness of the market for customers. I would be very happy to discuss how we might help move this forward, so please don't hesitate to contact me if this would be useful.

We look forward to reading the wholesaler responses and to further dialogue on the issues discussed above.

Yours sincerely



Rosalind Carey
Director of Regulation and Strategy