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

Open letter

By email

11 August 2020

Dear Andy

## **Review of incumbent company support for effective markets**

In September 2019, we [wrote to you](#) to ask for your views and evidence as part of our review of incumbent company support for effective markets. We also sought input from Retailers in the business retail market, self-supply licensees and new appointees. Today we have published the results of our [review](#). I am writing to you to explain how South Staffs Water has performed in our review.

Overall we consider that South Staffs Water is performing at a level similar to many other incumbent companies and has played a leading role in the development of the R-MeX incentive. We consider there is room for improvement – for example by engaging more proactively with NAVs, in demonstrating charges reflect costs and by improving performance against market performance standards in business retail. This letter contains detail from our assessment and highlights some areas deserving particular attention.

### **1. Why incumbent company support for markets matters**

Competition and markets can deliver benefits for customers and the wider sector by incentivising cost efficiencies, improved service and innovation. By supporting and providing high quality services to markets, incumbent companies can help the sector meet its strategic challenges associated with more volatile weather, population growth, affordability and changing customer demands.

Incumbent company effectiveness in supporting markets is as much about company culture and behaviour as it is about measurable service standards, which is why we cannot solely rely on market rules and quantifiable standards to achieve the goals we set. Please continue using your leadership position to support the behaviours needed to make markets work and to ensure your company delivers high quality

services to these markets, including by ensuring adequate resources are provided to these parts of your business.

I am grateful to you and your company for providing a period of liquidity support to Retailers facing a loss of turnover during lock down. I look forward to seeing you work constructively with Retailers as we unwind the temporary interventions through to full payback of support by March next year.

## 2. What we found

Thank you for the information and evidence you submitted in response to the letter I [wrote](#) to CEOs last year. We have now assessed the evidence provided and our headline findings are as follows:

- Overall, there is room for incumbent companies to play a more active role in supporting the business retail and developer services markets;
- But this headline conclusion masks the real differences we found *between* companies and *within* companies. Some companies performed much better than others in many areas; others performed well in some areas and poorly in others;
- Collaboration can support markets and thereby benefit customers. A common theme was incumbent companies, in our view wrongly, using competition law as reason not to collaborate or as reason not to be more responsive of the needs and specific circumstances of individual market participants;
- Too few companies embrace markets and the role they can play in helping them address the strategic issues they are facing. Incumbent companies need greater commitment at senior or board level to effect change, so that supporting markets goes beyond compliance to behaviour and culture.

## 3. South Staffs Water's support for effective markets

All companies must raise their game to improve their support for markets, however some have further to improve than others. Overall we consider South Staffs Water has room for improvement, although we also acknowledge the leadership demonstrated by the company in the development of the R-MeX incentive. Below is a summary of our assessment.

### Areas where you have performed relatively well

We understand South Staffs Water has contributed greatly to the design and introduction of the R-MeX metric, which is intended to be a key measure and driver of wholesaler performance in providing Retailers with the services they need to enter

and operate effectively in the business market. We understand this incentive was developed through Board level debate and consider this an excellent example of the type of strategic support that company Boards could and should be providing to the development of effective markets. We also understand that South Staffs Water worked collaboratively with the Retailer Wholesaler Group (“**RWG**”) to implement this as a common, industry wide, incentive.

You responded well to our questions relating to alternative credit arrangements. You provided a clear explanation of your approach to providing Schedule 3 agreements, and our assessment would have been more positive had you been able to provide evidence that you had proactively consulted with Retailers in developing your offerings. However, you have not tailored your offerings to reflect the characteristics of individual Retailers, citing compliance with competition law as rationale behind its approach. We have clarified in our main report our view that all Retailers need not be treated the same. While Wholesalers should not discriminate between Retailers, there is nothing preventing Wholesalers agreeing alternative credit arrangements that are specific to the Retailer in question, providing that any difference can be objectively justified. We would encourage you to continue to develop your positive approach in this area.

From a developer services perspective, you perform well against the Water UK Levels of Service metrics. We reviewed your website and found it was user-friendly with a dedicated webpage providing information around how to use an SLP to make the new connection.

On reviewing your Wholesaler charging document, we recognise that your charging arrangements have significantly improved relative to those submitted as part of the Company Monitoring Framework in 2018/19.

### **Areas that require attention**

You were not subject to an Initial Performance Rectification Plan but have not performed as well as other incumbents in meeting the requirements of the Market Performance Framework (**MPF**) in the 2019/20 financial year.

You could be more proactive in facilitating better Wholesaler-Retailer interactions. Your response suggests that you have not fully engaged with Retailers to understand if and how your Wholesaler policies or tariff structures might be refined or simplified to better meet Retailer needs. You indicated in your response that you hadn't made any significant updates to the scope of your wholesale services since market opening. There was no explanation or evidence to support this decision or to show that your services and policies were suitable for Retailers.

It was also not clear from your response that you have effective and robust processes in place for ensuring or improving the quality of market data. This appears to be particularly an issue in terms of the processes in place to take account information received from Retailers or end customers regarding inaccurate or incomplete data, where your description of the processes for this was limited.

Overall, the brevity of the responses we received to our questions around the calculation of charges gave us cause for concern. There was insufficient evidence demonstrating that charges are set to reflect underlying costs. You also did not provide sufficient evidence around assurance that the contractor rates used to set charges for developer services are cost reflective.

We note that you have only recently received a request from a NAV for a Bulk Supply Agreement. In October 2019 we reviewed your website and found that you have no NAV specific webpage. We were unable to readily find information we expected, such as details around how to become a NAV with you and a published bulk service agreement.

Engagement with developers is centred on site specific issues and it is not clear how you communicate with developers to gather feedback on areas for improvement. You did not provide information around how you engage directly with development customers, as opposed to carrying out engagement via another water company. A number of companies invited us to attend their developer services events. We found these to be very informative and engaging. We would welcome South Staffs Water inviting us as an observer to future engagement events.

#### **4. Next steps**

The report published today provides more detail on our findings and also sets out a number of next steps. We want to see all companies improve - particularly those companies where we have identified weaknesses - and that support for markets is given proper senior management priority.

Transforming water companies' performance is a key strategic aim for Ofwat, and we see support for markets as an important component of overall water company performance. As a result we are exploring ways of making company support for markets increasingly visible. This could include, for example, adding company performance against some market performance measures (e.g. R-MeX), to our reports on company performance, further building on industry work to establish reputational incentives in this area, or requiring companies to publish information on their websites.

Andy Willicott  
11 August 2020

Both the report and the letters I am writing to CEOs highlight examples of good practice and I encourage companies to learn from these. I also look forward to hearing about the steps you are taking to support effective markets at our regular CEO meetings.

Yours sincerely,

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