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Open letter

By email

11 August 2020

Dear David

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 East Water has performed in our review.

From our assessment of your performance and your response to our information request, South East Water performs poorly compared with other companies, particularly in the business retail market. Your response lacked evidence and where you suggest you have made improvements, the examples you gave were unconvincing. We do, however, thank you for your contribution to improving the NAV market through leadership of the NAV improvement project. 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 lockdown. 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 East 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 that South East Water performs very poorly relative to other incumbent companies. Below is a summary of our assessment.

Areas where you have performed relatively well

South East Water provided a good response against our "Credit and Payment terms" assessment. You provided a clear description of your approach to providing Schedule 3 arrangements and explained that these are available to all relevant Retailers. You also provided details of engagement and consultation you carried out

with Retailers on your offering and have explained that after review you amended your scheme to broaden availability to more Retailers. Our assessment would have been more positive had you provided evidence of tailoring your offerings to reflect specific characteristics of different Retailers. 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 provided a clear and well evidenced response to questions around engagement with developers, demonstrating that your communications are tailored to each customer group. Your roadshow ensures all customers access the relevant information. Examples were provided to show how customer feedback led to process improvements, such as monthly asset payment forecasts for SLPs. 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 East Water inviting us as an observer to future engagement events.

We recognise your considerable contribution to supporting the NAV market through chairing the NAV Improvement Project. This promises to deliver benefits, notably through greater transparency of NAV service levels and through industry adoption of the new NAV bulk supply agreement template. We have been pleased with some of the progress made, and we found the work to be progressive and inclusive of NAVs.

Areas that require attention

South East Water performed relatively poorly against the Market Performance Framework (“**MPF**”). We note that you were also subject to Initial Performance Rectification Plans (“**IPRP**”). Your response states that you undertook work to identify causes of your underperformance against the MPF. However, your response only provided limited detail on this analysis. Where a company is subject to an IPRP we would expect it to have carried out a detailed analysis of the root causes of underperformance and be able to set out a plan to rectify performance.

Your submission suggests you are aware that you have a role to play in assisting Retailers with data quality improvements. You said you have implemented data improvement projects since market opening and have recently instigated work to identify gap sites in market data. However, the examples you provided were very limited in detail and not convincing. Whilst the response suggests a process does exist, you did not provide any evidence about how you deal with information submitted by a Retailer or customer, including timescales for responding to concerns raised. Similarly you did not outline how you update Retailers or customers on your

progress with data queries and any actions that have been taken to address issues raised.

Going forward we encourage you to consider how you can provide greater support to the industry-led approach to market governance, in particular the work of the Industry Panel and Retailer Wholesaler Group (“**RWG**”). We asked Wholesalers to confirm if they had fully implemented published RWG guidance. We were disappointed that we needed to write back to you to clarify this point, particularly with regard to its adoption of RWG unplanned events guidance.

In developer services, you did not provide enough evidence that your charges were cost reflective. In common with a number of other companies, you relied on contractor rates. Simply relying on the competitive tender process is insufficient to assure charges are cost reflective.

In October 2019, we compared companies’ 2019/20 contestable new connection charges and found that your charges were in the lower range compared with other incumbents. Company specific costs should be reflected in charges. However, the incorrect allocation of costs between contestable and non-contestable services could pose a risk to effective competition.

When we undertook a review of companies’ websites in October 2019 we found the information you published with respect to developer services markets (as well as other markets such as water resources) was poor relative to other companies. For example, the information published with respect to SLPs was contained within a single file and so was less suited to online viewing.

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.

David Hinton
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