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Open letter

By email

11 August 2020

Dear Heidi

## **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 Northumbrian Water has performed in our review.

Overall we consider that Northumbrian Water is performing at a comparable level to many other incumbent companies, although this masks a wide variation in individual areas. For example, you performed strongly on data quality issues but poorly in Market Performance Standards (“**MPS**”) and Operational Performance Standards (“**OPS**”). We consider you have room for improvement, particularly in MPS and OPS and in how you engage with NAVs. 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. Northumbrian 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, Northumbrian Water is performing similarly to other incumbent companies. Below is a summary of our assessment.

### Areas where you have performed relatively well

Northumbrian Water performed strongly against our assessment of its efforts to work with Retailers to address data quality issues. Examples of this included its “vacancy challenge”, additional leakage checks and “void or avoiding” initiatives, all of which have seen positive results.

You have also played a significant role in supporting the industry-led approach to market governance. For example, you have contributed effectively towards a number of Retailer Wholesaler Group (“**RWG**”) working groups and shown leadership in the drafting of the Return to Sewer Allowance Guidance Document. You have also demonstrated leadership in your efforts to try to bridge the gap in Alternative Disputes Resolution through your role with the Water Redress Scheme.

In developer services, you provided a good response to our review. You perform well against Water UK Levels of Service metrics and appear relatively well prepared to implement Codes for Adoption. We found your website is easy to navigate for developers, NAVs and SLPs.

In addition, your response to the charging review questions was clear and demonstrated that effort has been made to scrutinise the charging arrangements. You provided a very clear explanation of derivation of charges in particular and your response was well-evidenced.

We are pleased to see that you have consolidated your different agreements with NAVs into a standard Bulk Supply Agreement and a standard Bulk Discharge Agreement. Our review found that most companies had not done so.

### **Areas that require attention**

You performed poorly, in absolute and relative terms, against OPS and MPS in the 2019/20 financial year. You were also subject to two Initial Performance Rectification Plans. We note however that you undertook root cause analysis of the causes for the underperformance in your IPRPs and set out how you expected performance to change.

Northumbrian Water also has room to improve its interactions with Retailers, specifically in relation to efforts to simplify tariffs and the refinement of Wholesaler policies. Your response did not provide sufficient evidence to demonstrate that you seek and respond to Retailer feedback in the improvement or simplification of your Wholesaler policies or tariff structures.

In your submission, you did not mention how you engage with your NAV customers. Instead you focused on engagement with developers, consultants, the HBF and Planning Authorities. Additional effort is required by you to engage with NAVs around issues that matter to them, especially given NAV market share of new connections in your area is relatively low when compared with other companies. We received views from NAV stakeholders, who commented that although you have made progress, concerns remain around your current levels of performance or delivery of committed improvements.

Your response on engagement did not demonstrate clearly how you had acted on feedback received from stakeholders to improve your services. A number of companies invited us to attend their developer services events. We found these to be very informative and engaging. We would welcome Northumbrian 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.

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**