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Open letter

By email

11 August 2020

Dear Ian

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 Southern Water has performed in our review.

Overall we consider that Southern Water is performing at a level similar to many other incumbent companies, with strong responses in some areas, but weaker in others. For example, you appear to have developed and maintained good relationships with Retailers and improved the way you engage with developer services customers. But your response would have been strengthened by more evidence of your response to being placed on Initial Performance Rectification Plans (“**IPRP**”). 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. Southern 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, Southern Water performs at a similar level to other incumbent companies. Below is a summary of our assessment.

Areas you have performed relatively well

Southern Water performed well in some elements of our assessment of Wholesaler-Retailer interactions. For example, your response provided a strong explanation about how you develop and maintain your relationships with Retailers. Your response suggests you have given considerable thought to developing a tariff structure aimed at providing freedom to Retailers to make price and service offers to

end customers. You described how you had revised your tariff structures in the light of Retailer feedback. You are one of only two companies to take action in this area.

Your response also clearly evidenced your approach to offering alternative credit arrangements, explaining the Schedule 3 arrangements that you have in place and showing evidence of how you have tailored your offerings to reflect different characteristics and risk profiles of Retailers. Your response would have been stronger had you explained why you have been unable to agree alternative Payment Terms with Retailers.

Southern Water has also performed better in meeting the requirements of the Market Performance Framework with significant improvements in performance against Market Performance Standards ('MPS') in the 2019/20 financial year, although there remains room for improvement against the Operational Performance Standards.

You provided a clear and well evidenced response to questions around engagement with developer services customers, clearly describing the channels, frequency and topics covered by your engagement. You described forming a customer action groups, to better understand their issues and provide updates around the progress made to resolve issues. You are making an effort to engage with homeowners and smaller developers, who may not attend a full Developer Day. Thank you for hosting us at your workshop on new connection charges in September last year. We were encouraged to see that you held open discussions on your approach to charging. We note that you have recently improved your website and the information available to NAVs, SLPs and developers.

You have demonstrated a robust approach to reviewing the setting of charges to developers and SLPs, through undertaking practicable and effective changes to engagement with SLPs as a consequence of findings in your review.

Areas that require attention

Notwithstanding your improved performance against the MPS overall, you were subject to IPRPs concerning underperformance against some individual MPS 7 and MPS 12 metrics. We are disappointed that your description of root causes for poor performance on MPS 7 was poor and the root cause analysis for MPS12 was missing entirely. Although the response highlights that your performance was affected by your data improvement programme, we suggest that nevertheless the response gives very little detail on how you understood and tackled underperformance against MPS7 and MPS12, and did not set out how performance had changed.

It was not clear from your response what extent you had put in place effective and robust processes for ensuring or improving the quality of market data. While you indicate that you have worked with some Retailers to address some aspects of data quality, your response contains little evidence concerning the processes you have in place to improve data quality in CMOS.

In developer services, in common with a number of other companies, you did not provide sufficient evidence around assurance that the contractor rates used to set charges for developer services are cost reflective. Simply relying on the competitive tender process is insufficient to assure charges are cost reflective.

When looking at NAV performance, although performance against the NAV behavioural metrics looks good and progress has been made, NAV stakeholders remain concerned around the delivery of commitments made by Southern Water.

Although your performance against Water UK Service Level metrics for SLPs is comparatively good, you highlight that you have experienced difficulties collating data on service level performance when serving SLPs. Timely and accurate information on performance is critical to enable management to identify and respond to adverse issues in serving SLPs. Robust reporting of metrics is also crucial in developing confidence of alternative providers to participate in the market. We look forward to understanding what improvements have been made in this area to ensure that the data submitted to Water UK is an accurate reflection of the service being received by SLPs.

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

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hearing about the steps you are taking to support effective markets at our regular CEO meetings.

Yours sincerely,

Rachel Fletcher
Chief Executive