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Open letter

By email

11 August 2020

Dear Pauline

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 Affinity Water has performed in our review.

From our assessment of your performance in the Business Retail and Developer Services markets and your response to our information request, Affinity Water performs poorly compared with other companies. We welcome your creation of a Transformation Plan for developer services, focused on improvements for customers. We consider there is significant room for improvement, for example in relation to your interaction and engagement with Retailers. 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. Affinity 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 Affinity Water performs poorly compared with the incumbent companies. Below is a summary of our assessment.

Areas where you have performed relatively well

Affinity Water performed well in terms of your performance against Operational Performance Standards, reporting top quartile performance for 2018/19 and 2019/20. You appear to have engaged constructively and positively with the need to improve performance, subject to an Initial Performance Rectification Plan.

In developer services, you have recently improved engagement with customers and providers of developer services and have completed certain other improvements, such as with respect to Self Lay Provider (“SLP”) design fees. From an engagement perspective, we were pleased to see that you held events for NAVs, SLPs and developers to consult on new connection charges. Thank you for hosting us at your Developer Day in November last year. We were encouraged to see that you held an open discussion on your charges from 2020 and other priority areas in your developer services work.

Areas that require attention

The evidence suggests that Affinity Water could do a lot more to improve interactions with the Retailers it serves. For example, your response notes the value of engaging with Retailers on the quality of service provided. However your engagement with Retailers appears to have been reactive rather than proactive. Your submission said that you have a plan in place to review your engagement process in the near future. We encourage you to engage with Retailers in the development of this plan and implement it as a priority.

On credit provision, your response suggests that you have not agreed any alternative eligible credit arrangements. Your rationale is that any alternative credit arrangements must carry equivalence with other forms of credit available to ensure a level playing field. The purpose of alternative credit support is to provide flexibility for Wholesalers and Retailers to negotiate agreements outside the regulated options in the Market Code, reflecting the specific risk profile of each Retailer. We have clarified our position on this in our main report, and would encourage you to consider your approach to alternative credit arrangements. We note that you referred to developing an ‘off the shelf’ alternative credit arrangement that you were due to consult on. It would be helpful to understand where you have got to with this.

We consider that as a large Water-only Company, Affinity Water could do more to support the industry-led approach to retail market governance. For example, you could make a greater contribution to the work of the Industry Panel and the Retailer Wholesaler Group going forward.

On developer services, in our assessment, you were one of the poorest performing companies. We noted above your transformation plan, and how we can see some improvements as part of our review: we are now looking to you to sustain and build on this progress.

In common with most 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.

Your service to alternative providers and developers is one of the worst, as evidenced by poor performance against Water UK Levels of Service. You are creating a barrier to NAVs by applying a slower process to NAVs on the basis of site size, but not to SLPs or developers.

We sought feedback from industry stakeholders, who believe that you are not doing enough to support the development of the NAV market. When we reviewed your NAV web pages in October 2019 they were poor and NAV tariffs were out of date. However, we are pleased to see that you have now addressed this and we can now readily find information such as the process to become a NAV with you, your bulk service tariff information and detailed guidance about how NAVs should apply. The level of NAV activity is lower than we would expect in your area; as you continue to make improvements we expect this to change.

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

